

MINUTES OF THE HOUSE FINANCIAL INSTITUTIONS.

The meeting was called to order by Chairperson Ray Cox at 3:30 p.m. on February 9, 2000 in Room 527-S of the Capitol.

All members were present except: Representative Vaughn Flora - Excused
Representative Henry Helgerson - Excused

Committee staff present: Dr. Bill Wolff, Legislative Research
Bruce Kinzie, Office of Revisor
Maggie Breen, Committee Secretary

Conferees appearing before the committee: David Brant, Securities Commissioner
Professor Robert Gustavson, Washburn University
Matthew D. All, Kansas Insurance Department
Carl Wilkerson, American Council of Life Insurers
Rick Friedstrom, Ks. Assn of Financial Advisors (KAIFA)
Pat Morris, Kansas Association of Insurance Agents
Amy Lee, Security Benefit Group
Steve Handke, Community Bankers Association
Chuck Stones, Kansas Bankers Association

Others attending: See Attached

Chairman Cox asked for introduction of bills. There were none.

Chairman Cox opened the hearing on **HB 2690 - Securities, regulating variable annuities**

Proponents:

David Brant, Securities Commissioner, said that the most significant provision of the bill, in Sections 1, 2, and 5, proposes to amend the definition of "securities" to include variable annuities. It is a hybrid product involving both investments and insurance components. The merits of **HB 2690** can best be analyzed by considering the following questions: 1) Is it unreasonable to treat this hybrid insurance/investment product the same under both state and federal law? 2) Does our current law promote a "level playing field" for the regulation of variable products in the new era of financial modernization and functional regulation? 3) Does this proposed legislation add a burden or place additional cost on insurance companies or their agents? And, 4) Does **HB 2690** enhance investor protection for Kansas consumers? Commissioner Brant addressed these questions and concluded by stating that the bill does not promote bigger government or unnecessary regulation. The bill will not add any significant regulatory paperwork, fees, or licenses. Most annuity firms and the agents selling variable products will only be affected by the bill - **if there is a problem**. And if there is a problem in the year 2000, Kansas investors deserve a regulatory structure that is reasonable and that makes good common sense - not a structure that was devised in 1968, some 32 years ago. (**Attachment 1**) He stated that the bill also includes three additional technical amendments. (**Attachment 2**)

Professor Robert Gustavson, Washburn University, addressed the committee with a personal story involving his 86 year old father-in-law who lives in Dallas, Texas. In essence, he went to his bank with the intent of renewing a \$50,000 CD. He ended up buying a variable annuity which he felt he had been deceived into purchasing. He was almost 85 at the time and the annuity was to kick in at age 90. He wanted out of the annuity but the surrender charge ranged from \$4,000 during the first 2 years to \$2,000 during the fifth year of ownership. Although there was a beneficiary, Professor Gustavson's mother-in-law, she is also 86. After conferring with a couple of people, Professor Gustavson did contacted the bank in Texas and asked for his father-in-law's money back without any surrender cost. He advised them that if this were not done, the case would be taken to the Insurance Commissioner, Securities Commissioner and consumer advocate groups. They can readily be taken advantage of. They find themselves having purchased products they do not need

CONTINUATION SHEET

FINANCIAL INSTITUTION, Room 527-S Statehouse at 3:30 p.m. on February 9, 2000.

and do not want. Regulation needs to be looked at. He supports **HB 2690**. (No handout)

Neutral:

Matthew D. All, Kansas Insurance Department, said the Insurance Commissioner supports the intent of **HB 2690**, which she understands to be to allow the Securities Commissioner to enforce his statutory and regulatory standards on sales practices in the area of variable annuities. This would be a reasonable and preferable approach to the current practice of granting exclusive and sole jurisdiction over the entire area of variable annuities to the Insurance Commissioner. It would be preferable because: 1) Those who sell variable annuities tend to also sell products that are currently defined as securities. 2) The Securities Commissioner has greater power to address wrongdoing than the Insurance Commissioner. (Of course the Insurance Commissioner would prefer to have heavier sanctions at her disposal too.) And 3) **HB 2690**, if crafted to meet its intent, will not create any significant additional burden for those who sell variable annuities. The Insurance Commissioner would not support any additional administrative burdens on insurance companies, agents, or brokers. Also, she does not support any change in the jurisdiction over product approval, or any other area of regulation of variable annuities, other than a grant of joint jurisdiction with the Securities Commissioner over sales practices. The Insurance Department supports any effort to clarify the language to more closely fit its intent. (**Attachment 3**)

Opponents:

Carl Wilkerson, American Council of Life Insurers, representing 435 members, spoke in opposition to **HB 2690**. They are oppose to the printed bill as well as the proposed technical amendments presented today. Two aspects of the bill are particularly troubling to life insurance companies. It would remove the Kansas Insurance Commissioner's sole and exclusive authority to regulate the issuance and sale of variable life insurance and variable annuities. Also, it would subject variable life insurance and variable annuities to the Kansas Securities Code for the first time. Variable life insurance and variable annuities are one of the most heavily regulated financial products in today's broad marketplace. The bill would disrupt a coordinated system of state and federal regulation established by the U.S. Supreme Court. It would cause duplicate regulation of the same product under the Kansas Insurance and Securities Code. It would create expensive, unnecessary compliance burdens for life insurers and salespeople, and would discourage life insurers from distributing variable life insurance and variable annuities in Kansas. It would impose a forth layer of regulation on variable life insurance and variable annuities on top of comprehensive SEC, NASD, and state insurance regulation. The need for the amendment has not been justified. A pattern of abuse has not been identified. It creates an aberrant regulatory structure in Kansas that differs from almost every other state. There are laws on the books that address misconduct and misrepresentation. These are being taken care of through the SCC, NASD and State Insurance Department. Mr. Wilkerson had a slide presentation and presented charts showing that there has been a downward trend in disciplinary action needed in the industry since 1996 when the SCC said disciplinary action needed to be stronger. It did become stronger and people have received the message. He asked the committee to vote no on **HB 2690**. (**Attachment 4 & 5**)

Rick Friedstrom, Kansas Association of Financial Advisors (KAIFA), testified in opposition to **HB 2690**. His organization has worked with the Kansas Insurance Department since 1935 to craft legislation and regulation to protect the Kansas insurance consumer and Kansas insurance agent. KAIFA does not feel it is appropriate to single out variable annuities for inclusion in regulation by the Securities Commissioner. His associate is now spending 2 1/2 hours a day doing compliance and regulation work. Mr. Friedstrom does not think a fourth layer of regulation is needed on top of everything they have right now. He is in agreement with Mr. Wilkerson's testimony. (**Attachment 6**)

Pat Morris, Kansas Association of Insurance Agents, asked why the state legislature would be interested in adding another level of regulation oversight for agents when the current structure seems to be working? Why does the Department of Insurance feel compelled to give up the law's specific mandate that they are the sole and exclusive jurisdiction and authority to regulate the issuance and sale of such contracts? What sort of provisions or plans have been established, to ensure that this new system will be able to deal with conflicts and overlaps between the agencies? Are we are going to have multiple regulators each time we have hybrid products? His organization stands in opposition to **HB 2690**. (**Attachment 7**)

CONTINUATION SHEET

FINANCIAL INSTITUTION, Room 527-S Statehouse at 3:30 p.m. on February 9, 2000.

Amy Lee, Security Benefit Group, stated that the insurance industry is a highly regulated industry and SBG's main product is variable annuities. They spend a lot of time dealing with various states with regards to the insurance laws and also with the Securities and Exchange Commission, so they are pretty sensitive to the idea of additional regulation. The bill does pose an additional burden on the industry. If you are selling only variable annuity products, you are dealing with NSDA regulation and the state insurance department licensing in the 50 states. If you have to deal with registration with another regulator, you're dealing with a lot of paper work. SBG thinks the current system works well. There can be difficulties if you have shared regulation. You can have a vacuum when each regulatory body thinks the other is handling a matter. She urged a no vote for **HB 2690**. (**Attachment 8**)

A question and answer period followed.

Chairman Cox closed the hearing on **HB 2690** and opened the hearing on:

HB 2754 - Banks and trust companies, holding of real estate

Proponents:

Steve Handke, Community Bankers Association, explained that **HB 2754** makes a technical change in K.S.A. 9-1102(a)(2), which regulates the real estate Kansas banks are allowed to hold. The present language has been in effect since 1975. The inflexibility of the law, with its rigidly defined holding period, has caused problems over the years. These problems have been accentuated in recent years with the industry's movement in Kansas toward branch banking with multiple locations. The problem is with the defined beginning point, of the seven-year holding period, that a bank has to dispose of unneeded real estate. The beginning point in the current statute is set as the date of acquisition. It makes it virtually impossible to dispose of property that has been used for banking purposes for a number of years. The proposed bill would give banks seven years, after a change in intended use of property, to dispose of it. He asked the committee to report **HB 2754** favorably. (**Attachment 9**)

Chuck Stones, Kansas Bankers Association, said his organization supports **HB 2754**. It allows the banks to be flexible with their "other real estate owned" category of assets. It doesn't change the seven year time frame, it changes the time the clock starts. (**Attachment 10**)

Chairman Cox closed the hearing on **HB 2754**.

Chairman Cox asked for a motion regarding the committee minutes for January 26, 2000 and February 2, 2000. Representative Dreher made a motion to approve the minutes as written. Representative Sharp seconded the motion. The motion carried.

The meeting adjourned at 5:06 p.m.

The next meeting is scheduled for February 14.

HOUSE FINANCIAL INSTITUTIONS COMMITTEE GUEST LIST

DATE: February 9, 2000

NAME	REPRESENTING
Anne Spiess	Peterson Public Affairs Group
Rick Friedstrom	KAFPA
Jim Hacc	ACHI American Council of Life Insurers
Carol Wilkerson	ACLI " "
ROBERT L. GUSTAVSON	Washington University
Stan Parsons	KGC
Steve Handke	Community Bankers Assoc.
George Barbee	KAFS
Sue Anderson	Community Bankers Assoc.
Bill Sneed	CONSECO
Marilyn Bowman	Ks. Securities Comm.
David Brant	" " "
Walter Smith	KMHA
Roger Viola	SBG
Amy Lee	SBG
Trish Hein	SBG
Pat Morris	KATA
Carrie Donovan	KATA
Kevin Glendenig	OSBC

Jodi Stonk " Federico Consulting.
 Maria Espinoza
 David Hanson Ks Life Ins. Assn



KANSAS

Bill Graves
Governor

OFFICE OF THE SECURITIES COMMISSIONER

David Brant
Commissioner

TESTIMONY IN SUPPORT OF HOUSE BILL No. 2690
Amendments to the Kansas Securities Act
Financial Institutions Committee Kansas House

DAVID BRANT
Kansas Securities Commissioner
February 9, 2000

Mr. Chairman and members of the committee, thank you for this opportunity to testify in support of House Bill No. 2690 which proposes a number of amendments to the Kansas Securities Act.

I would like to initially address the most significant provisions of the bill in Sections 1, 2, and 5 which propose to amend the definition of "securities" to include variable annuities.

A variable annuity is a hybrid product involving both investment and insurance components which is typically marketed as a tax-deferred way to invest in mutual funds for retirement. A variable annuity is an insurance contract which provides for future payments, the amount of those payments depends on the performance of the underlying investments.

I am not here to criticize the variable annuity product or the insurance industry or its agents. You should know that (thanks to the Governor and the Legislature) a sizeable portion of my retirement savings is invested in a number of mutual funds through an Aetna variable annuity contract which is offered through the state's deferred compensation benefit plan.

I believe that the merits of House Bill 2690 can best be analyzed by considering the following questions:

- 1. Is it unreasonable to treat this hybrid insurance/investment product the same under both state and federal law?**

The U.S. Supreme Court has opined and confirmed that variable insurance products are securities and are subject to regulation by the U.S. Securities and Exchange Commission (SEC). At the state level, the original version of the Uniform Securities Act adopted by Kansas in 1956 did not exclude variable annuities as securities. However, the Kansas law

was amended in 1968, as it was in many states, to exclude variable annuities from the definition of securities and to grant exclusive jurisdiction to the Insurance Commissioner.

It appears that the trend is for states to treat variable annuities as securities with Kentucky being the most recent to change its laws in 1998. Regardless of state law treatment, a New York insurance company has provided their internal checklist which shows that they require their agents to obtain state securities licenses (in addition to the insurance license) in at least 13 states in order to sell variable annuities.

2. Does our current law promote a “level playing field” for the regulation of variable products in the new era of financial modernization and functional regulation?

“Financial modernization” will become a reality due to the federal law changes contained in the Gramm-Leach-Bliley Act of 1999. Congress passed the Act to modernize the delivery of financial services by removing depression-era barriers that separate banking, securities, and insurance functions. The new federal act provides for “functional regulation” of financial entities and their products – banks by banking regulators, securities affiliates by the SEC and state securities regulators; and insurance companies by state insurance regulators. For a hybrid product such as variable annuities, functional regulation requires shared jurisdiction between securities and insurance at the state level – just as it exists at the federal level.

3. Does this proposed legislation add a burden or place an additional cost on insurance companies or their agents?

In proposing this bill, my purpose is not to impose any additional regulatory burden or cost on the insurance companies that package the products or on the agents who sell variable annuities. Attached is a chart which outlines the various requirements for variable annuities and the licensing requirements for agents.

Many agents currently hold both securities and insurance licenses so that they can offer a variety of investment and insurance products, including variable annuities, to their customers. These agents are proof that financial modernization and “one-stop shopping” have already arrived. I assert that the majority of Kansas insurance agents (and the numbers increase every month) already have both licenses so that they can also sell mutual funds. Thus, the change in the definition of “securities” proposed by the bill will not require any additional paperwork, nor cost these agents any additional fees. For the few agents that would need to obtain the securities license, the annual fee is \$50.

The agents are required to be affiliated with a Broker-Dealer firm which is usually a subsidiary or an affiliate of an insurance company which is required to be registered with the National Association of Securities Dealers (NASD). It is only these Broker-Dealer firms, and not the insurance companies, that need to be registered and many of these firms are already registered with the Kansas Securities Commissioner in order to sell mutual funds in addition to variable annuities. Thus, the bill will not require any additional paperwork or fees for the firms that are already registered. There may be some out-of-state Broker-Dealers that will need to register and pay an annual fee of \$200.

The variable annuity product will continue to be exempt from registration with the Securities Commissioner as provided in K.S.A. 17-1261 which is amended in Section 2 of the bill. The product is registered with the SEC (since the product is a federal covered security) and it is qualified by the Insurance Commissioner. None of this will change.

Neither do we anticipate any fiscal impact on our agency at this time. There should be no minimal effect on the revenues to the Securities Act Fee Fund since most of the broker dealers and agents that sell variable annuities are already licensed to sell securities as previously noted. If the bill is enacted, there would be additional responsibility and some work for the agency. However, we do not anticipate a need and we will not be asking for any additional budget authority for staff or other expenses at this time.

4. Does House Bill 2690 enhance investor protection for Kansas consumers?

The benefit for Kansans who invest in variable products is better investor protection. Not only does this bill “level the playing field” regarding the regulation of variable products, but the most important purpose of this proposal is to provide for effective enforcement remedies in the rare occasion when there is a problem. Why should we encourage our citizens to contact the Securities Commissioner if they have a problem with an agent who sold them mutual funds... but send them to another agency when the problem involves an agent who sold them mutual funds wrapped inside a variable annuity?

We have had several cases which cause me concern about the current disjointed regulation of variable products. These cases involve serious violations which have resulted, or could result, in a felony conviction or the revocation of a securities license. In fact, in one case, we revoked the securities license of a salesperson, only to receive calls from his customers who were solicited by the salesman to “roll over” their mutual funds into a variable annuity (to be invested in mutual funds) since the agent could still purportedly sell annuities with his insurance license. Attached for your reference is a list of newspaper articles from recent years describing regulatory concerns, including sales practice problems, in regard to variable products.

As the Securities Commissioner, I am not motivated by regulatory turf or by revenues. Let me clarify that we are not proposing “an additional layer” or “duplicative” regulation. It may be suggested that Kansas would be the first state to “share” jurisdiction between insurance and securities. I believe that the bill proposes a reasonable “hybrid” approach of functional regulation in regard to these “hybrid” variable products. It may be suggested that the Kansas Securities Commissioner is not needed since the industry’s regulator, the National Association of Securities Dealers (NASD), has taken a number of actions regarding variable products in recent years. Kansas Securities shares jurisdiction with the NASD over the agents who sell mutual funds – why shouldn’t we share jurisdiction over the agents who sell mutual funds wrapped in a variable annuity contract?

In conclusion, please review the four questions outlined above. This bill does not promote bigger government or unnecessary regulation. This bill will not add significant regulatory paperwork, fees, or licenses. Most annuity firms and the agents selling variable products will only be affected by this bill – if there is a problem. And if there is a problem in the

year 2000, Kansas investors deserve a regulatory structure that is reasonable and that makes good common sense – not a structure that was devised in 1968, some 32 years ago. Times have changed – financial modernization is here.

Lastly, House Bill 2690 includes three other technical amendments. In Section 2, K.S.A. 17-1261 (h) which deals with securities offered by non-profit entities including church bonds – the proposed amendment authorizes the Commissioner to issue rules and regulations to set forth the filing requirements. Section 3 amends K.S.A. 17-1262 to delete specific references to Moody's and other manuals and to authorize the Commissioner to recognize certain manuals by rule and regulations. (The Moody's manual may experience a name change due to a change in ownership.) And finally, Section 4 amends K.S.A. 17-1270a to delete paragraph (f) which is now obsolete since the provisions expired last year.

Thank you for your consideration.

Recent Articles pertaining to Variable Annuities

1/25/00	“ ‘Bonus’ Annuities Attract SEC Scrutiny”	<i>The Wall Street Journal</i> by Bridget O’Brian
11/9/99	“Lawyers Seek Class Action Against Insurers Over Annuities”	<i>The Wall Street Journal</i> by Deborah Lohse and Bridget O’Brian
7/13/99	“Variable Annuities are more hassle than they are worth”	<i>The Topeka Capital Journal</i> by Jane Bryant Quinn
9/98	“Variable Confusion”	Registered Representative by Russ Wiles
2/9/98	“The great annuity rip-off”	<i>Forbes</i> by Carolyn T. Geer
2/2/98	“Annuity Industry Attempts to Shake Its Bad-Dog Image”	<i>The Wall Street Journal</i> by Bridget O’Brian
6/30/97	“For Older Investors, Allure of Variable Annuities Belies Pitfalls”	<i>The Wall Street Journal</i> by Bridget O’Brian and Ellen E. Schultz

Regulatory Guidelines pertaining to Variable Annuities

May 1999	Reminder of responsibilities regarding the sales of Variable Annuities -- Notice to Members 99-35	<i>National Association of Securities Dealers (NASD)</i>
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House Bill 2690

Product	Purpose	Considered a Security			Offered through Broker-Dealer	Registration/Qualification		
		Federal	Other States	Kansas		SEC	KS Securities	KS Insurance
Mutual Funds	Investment	Yes	All	Yes	Yes	Yes	Notice Filing (covered security)	NA
Variable Annuities (with mutual fund options)	Investment and Insurance	Yes	Some	<i>No</i> *	Yes	Yes	Exempt (covered security)	Yes

Agent	Affiliated with a Broker-Dealer	Licenses Required				Exams Required by Kansas	
		National Assoc. Securities Dealers	Other State Securities	KS Securities	KS Insurance	NASD	Blue Sky and Ethics
Mutual Funds	Yes	Yes	All	Yes	NA	Series 6	Series 63
Variable Annuities (with mutual fund options)	Yes	Yes	13+ [⊙]	<i>No</i> *	Yes	Series 6	<i>None</i> *

* Will change if House Bill 2690 is enacted.

⊙ Arizona, Idaho, Kentucky, Minnesota, Montana, Nevada, North Dakota, Rhode Island, South Dakota, Utah, Vermont, Washington, Wyoming and Puerto Rico.

Amendments proposed by the
Kansas Securities Commissioner
2-9-00

1 interest or shares in an unincorporated investment trust not having a
2 board of directors (or persons performing similar functions) or of the
3 fixed, restricted management or unit type; the term "issuer" also means
4 the person or persons performing the acts and assuming the duties of
5 depositor or manager pursuant to the provisions of the trust or other
6 agreement or instrument under which the security is issued. The issuer
7 of a certificate of interest in an oil and gas royalty, lease or mineral deed
8 is the owner of the interest in the oil and gas royalty, lease or mineral
9 deed who creates the certificate of interest for purpose of sale.

10 (f) "Nonissuer" means not directly or indirectly for the benefit of the
11 issuer.

12 (g) "Person" means an individual, a corporation, a partnership, a *lim-*
13 *ited liability company*, an association, a joint-stock company, a trust where
14 the interests of the beneficiaries are evidenced by a security, an unincor-
15 porated organization, a government or a political subdivision of a
16 government.

17 (h) (1) "Sale" or "sell" includes every contract of sale of, contract to
18 sell, or disposition of, a security or interest in a security for value.

19 (2) "Offer" or "offer to sell" includes every attempt or offer to dispose
20 of, or solicitation of an offer to buy, a security or interest in a security for
21 value.

22 (3) Any security given or delivered with, or as a bonus on account of,
23 any purchase of securities or any other thing is considered to constitute
24 part of the subject of the purchase and to have been offered and sold for
25 value.

26 (4) Every sale or offer of a warrant or right to purchase or subscribe
27 to another security of the same or another issuer, and every sale or offer
28 of a security which gives the holder a present or future right or privilege
29 to convert into another security of the same or another issuer, is consid-
30 ered to include an offer of the other security.

31 (5) A purported gift of assessable stock is considered to involve an
32 offer and sale of such stock.

33 (i) "Securities act of 1933," "securities exchange act of 1934," "public
34 utility holding company act of 1935," and "investment company act of
35 1940" mean the federal statutes of those names.

36 (j) "Security" means any note; stock; treasury stock; bond; debenture;
37 evidence of indebtedness; certificate of interest or participation in any
38 profit-sharing agreement; collateral-trust certificate; preorganization cer-
39 tificate or subscription; transferable share; investment contract; voting-
40 trust certificates; thrift certificates or investment certificates, or thrift
41 notes issued by investment companies; certificate of deposit for a security;
42 certificate of interest in oil and gas royalties, leases or mineral deeds, or,
in general, any interest or instrument commonly known as a "security,"

variable insurance contract or policy that is
required to be registered with the Securities
and Exchange Commission;

non-variable ←
fixed ←
(delete)

1 or any certificate of interest or participation in, temporary or interim
2 certificate for, guarantee of, or warrant or right to subscribe to or pur-
3 chase, any of the foregoing. "Security" does not include any insurance or
4 endowment policy or annuity contract under which an insurance company
5 promises to pay ~~fixed sum of~~ money either in a lump sum or periodically
6 for life or some other specified period.

7 (k) "State" means any state, territory, or possession of the United
8 States, as well as the District of Columbia and Puerto Rico.

9 (l) "Investment adviser" means any person who, for compensation,
10 engages in the business of advising others, either directly or through
11 publications or writings, as to the value of securities or as to the advisa-
12 bility of investing in, purchasing, or selling securities, or who, for com-
13 pensation and as a part of a regular business, issues or promulgates anal-
14 yses or reports concerning securities. The term does not include:

- 15 (1) An investment adviser representative;
- 16 (2) a bank, savings institution, or trust company;
- 17 (3) a lawyer, accountant, engineer or teacher whose performance of
18 these services is solely incidental to the practice of the individual's
19 profession;
- 20 (4) a broker-dealer or its agent whose performance of these services
21 is solely incidental to the conduct of its business as a broker-dealer and
22 who receives no special compensation for them;
- 23 (5) a publisher of any bona fide newspaper, news column, news mag-
24 azine, newsletter, or business or financial publication or service, whether
25 communicated in hard copy form or by electronic means, or otherwise
26 that does not consist of the rendering of advice on the basis of the specific
27 investment situation of each client;
- 28 (6) any person that is a federal covered adviser; or
- 29 (7) such other persons not within the intent of this definition as the
30 commissioner designates by order or by rules and regulations.

31 (m) (1) "Investment adviser representative" means any partner, of-
32 ficer, director of or a person occupying a similar status or performing
33 similar functions or other individual except clerical or ministerial person-
34 nel, who is employed by or associated with:

- 35 (A) An investment adviser that is registered or required to be regis-
36 tered under this act and who does any of the following:
 - 37 (i) Makes any recommendations or otherwise renders advice regard-
38 ing securities;
 - 39 (ii) manages accounts or portfolios of clients;
 - 40 (iii) determines which recommendation or advice regarding securities
41 should be given;
 - 42 (iv) solicits, offers or negotiates for the sale of or sells investment
43 advisory services; or

House Financial Institutions
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Attachment 2

1 of any state and authorized to do business in this state ~~when such secur-~~
2 ~~rities are sold by the issuer.~~
3 (f) Any security issued or guaranteed by any railroad, or public utility
4 which is:
5 (1) a registered holding company under the public utility holding
6 company act of 1935 or a subsidiary of such a company within the mean-
7 ing of that act; or
8 (2) regulated by a governmental authority of the United States or any
9 state in respect to the issuance or guarantee of the security.
10 (g) Any security as to which the commissioner by rule and regulation
11 finds that registration is not necessary or appropriate for the protection
12 of investors.
13 (h) Any security issued by any person organized and operated not for
14 private profit but exclusively for religious, educational, benevolent, char-
15 itable, fraternal, social, athletic, fire protection, fire fighting or reforma-
16 tory purposes, or as a chamber of commerce or trade or professional
17 association if no part of the net earnings of such person inures to the
18 benefit of any private stockholder ~~and provided that the issuer has filed~~
19 ~~with the commissioner at least 10 days prior to any sale a notice setting~~
20 ~~forth the material terms of the proposed sale, copies of any sales and~~
21 ~~advertising literature to be used, and such other information required by~~
22 ~~the commissioner, and the commissioner does not by order disallow the~~
23 ~~exemption within 10 days after filing. The commissioner may require the~~
24 ~~filing of a notice and other information pursuant to rules and regulations~~
25 ~~adopted by the commissioner.~~
26 (i) Any commercial paper which arises out of a current transaction or
27 the proceeds of which have been or are to be used for current transac-
28 tions, and which evidences an obligation to pay cash within nine months
29 of the date of issuance, exclusive of days of grace, or any renewal of such
30 paper which is likewise limited, or any guarantee of such paper or of any
31 such renewal.
32 (j) Any securities issued in connection with an employee's stock pur-
33 chase, savings, pension, profit-sharing or similar benefit plan, or a self-
34 employed person's retirement plan.
35 (k) Any security evidencing membership in, or issued as a patronage
36 dividend by, a cooperative association organized under the laws of this
37 state exclusively for the purpose of conducting an agricultural, dairy, live-
38 stock or produce business, or selling, processing, storing, marketing or
39 otherwise handling any agricultural, dairy, livestock or produce, and any
40 activities incidental to these purposes.
41 (l) Any security issued by and representing an interest in or debt of,
42 or evidencing membership in, or issued as a patronage dividend to resi-
43 dents or landowners of not to exceed five contiguous counties in Kansas

specify conditions for this exemption ←

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1 authorized to issue or deliver such contracts in this state, until such com-
2 pany has satisfied the commissioner that its condition and methods of
3 operation in connection with the issuance of such contracts will not be
4 such as to render its operation hazardous to the public or to its policy-
5 holders in this state. In determining the qualification of a company to
6 issue or deliver such contracts in this state, the commissioner shall con-
7 sider, among other things, the history and financial condition of the com-
8 pany; the character, responsibility, and general fitness of the officers and
9 directors of the company; and in the case of a foreign or alien company,
10 whether the regulation provided by the laws of its domicile provides a
11 degree of protection to policyholders and the public substantially equal
12 to that provided by this section and the rules and regulations issued by
13 the commissioner pursuant thereto. The state of entry of an alien com-
14 pany shall be deemed its place of domicile for this purpose.

15 (j) Every life insurance company which issues or delivers such con-
16 tracts in this state shall file with the commissioner, in addition to the
17 annual statement required by K.S.A. 40-225, and amendments thereto,
18 such other periodic or special reports as the commissioner may prescribe.

19 (k) Any domestic life insurance company which establishes one or
20 more separate accounts pursuant to this section, may amend its charter
21 or bylaws to provide for special voting rights and procedures for the own-
22 ers of contracts under such separate account relating to investment policy,
23 investment advisory services and selection of independent public account-
24 ants, in relation to the administration of the assets in any such separate
25 account and such other matters as the company deems necessary in the
26 management of the assets in any such separate account. This provision
27 shall not in any way affect existing laws pertaining to the voting rights of
28 the company's policyholders.

29 (l) The commissioner shall have the sole and exclusive jurisdiction
30 and authority to regulate the issuance and sale of such contracts, and to
31 promulgate such reasonable rules and regulations as may be necessary to
32 carry out the purposes and provisions of this act, and such contracts, the
33 companies which issue them, and the agents or other persons who sell
34 them, shall not also be subject to the provisions of article 12 of chapter
35 17 of the Kansas Statutes Annotated nor and to the jurisdiction of the
36 securities commissioner of this state.

(undo)
(delete) → (insert)
(delete) →

The amended paragraph would read:

- (l) The commissioner shall have the sole and exclusive jurisdiction and authority to regulate the terms and provisions in such contracts and the obligations of insurance companies under such contracts and to promulgate such reasonable rules and regulations as may be necessary to carry out the purposes and provisions of this act.

the terms and provisions in
and the obligations of insurance
companies under such contracts

37 Sec. 6. K.S.A. 40-436 and K.S.A. 1999 Supp. 17-1252, 17-1261, 17-
38 1262 and 17-1270a are hereby repealed.

39 Sec. 7. This act shall take effect and be in force from and after its
40 publication in the statute book.



Kathleen Sebelius
Commissioner of Insurance
Kansas Insurance Department

Testimony Regarding House Bill 2690
Kansas House of Representatives
Committee on Financial Institutions

MATTHEW D. ALL
Counselor to the Commissioner
Kansas Insurance Department
Wednesday, February 09, 2000

Mr. Chairman and Members of the Committee:

Thank you for allowing me to be here today to discuss H.B. 2690.

The Commissioner of Insurance supports the intent of H.B. 2690, which we understand to be to allow the securities commissioner to enforce his statutory and regulatory standards on sales practices in the area of variable annuities. This would be a reasonable and preferable approach to the current practice of granting exclusive and sole jurisdiction over the entire area of variable annuities to the insurance commissioner.

It would be preferable for a variety of reasons, including the following:

1. Those who sell variable annuities tend to also sell products that are currently defined as securities. This makes sense because variable annuities have many of the essential characteristics of securities. Indeed, the

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Securities Exchange Commission defines variable annuities as securities for purposes of federal enforcement. Allowing the securities commissioner to engage in a more seamless investigation in which he could investigate and appropriately sanction all of the products sold by a particular individual would create a more efficient and effective enforcement system. Although this bill will not completely eliminate the need for split or joint investigations by both departments, it will take a reasonable step in that direction.

2. The securities commissioner has greater power to address wrongdoing than the insurance commissioner. If the insurance commissioner discovers that an agent or company is guilty of wrongdoing in its sale of variable annuities, she can under certain circumstances pull the individual's license and issue the fairly weak sanctions available under the Unfair Trade Practices Act. The securities commissioner, however, can issue heavier fines and even institute criminal proceedings as an assistant attorney general. These heavier sanctions will provide greater deterrent to wrongdoing in the area of variable annuities, which will provide greater protection to Kansas consumers. Of course, the insurance commissioner would prefer to have these heavier sanctions at her disposal, too.

3. H.B. 2690, if crafted to meet its intent, will not create any significant additional burden for those who sell variable annuities. It is our understanding that this bill will not create any new licensing requirements, additional fees, forms, or other red tape. Its intent is merely to allow the

securities commissioner to enforce his statutory and regulatory standards regarding sales practices on those who sell variable annuities. The insurance commissioner would not support any additional administrative burdens on insurance companies, agents, or brokers.

Although we support the intent of H.B. 2690, we would like to make clear that we do not support any change in the jurisdiction over product approval or any other area of regulation of variable annuities other than a grant of joint jurisdiction with the securities commissioner over sales practices. And that is exactly what Commissioner Brant has stated is his intent. An expansive reading of the H.B. 2690 in its current form, however, may support the interpretation that it grants the securities commissioner more jurisdiction over variable annuities than is necessary or sought. We support any effort to clarify the language to more closely fit its intent.

In addition to this bill, the office of the securities commissioner and the insurance department have entered into discussions regarding how the two agencies can work more closely in these investigations. Our goal in this area is to provide the most protection to Kansas consumers while placing the lightest burden possible on insurance companies, agents, and brokers. The intent of H.R. 2690 is consistent with this goal.

Testimony of

Carl B. Wilkerson, Chief Counsel, Securities
of the American Council of Life Insurers

Before the Committee on Financial Institutions
on House Bill No. 2690

February 8, 2000

The American Council of Life Insurers (the "Council") greatly appreciates the opportunity to share its views on House Bill No. 2690. Our 435 members represent 79.4 percent of all United States life and health insurance companies, 82.2 percent of the pension business, and 86.9 percent of the long term care insurance with such companies. 361 of our members are licensed to conduct life insurance in Kansas. Many of our members manufacture and distribute variable life insurance and variable annuities.

We oppose House Bill No. 2690. Two aspects of the bill are particularly troubling to life insurance companies:

House Bill No. 2690 would remove the Kansas Insurance Commissioner's sole and exclusive authority to regulate the issuance and sale of variable life insurance and variable annuities.¹

¹House Bill No. 2690 would amend the variable contract law in the Kansas insurance code at 5. K.S.A. 40-436(1) as follows:

"The commissioner shall have ~~the sole and exclusive~~ jurisdiction and authority to regulate the issuance and sale of such contracts and to promulgate such reasonable rules and regulations as may be necessary to carry out the purposes and provisions of this act, and such contracts, the companies which issue them, and the agents or other persons who sell them, shall ~~not~~ also be subject to the provisions of article 12 of chapter 17 of the Kansas Statutes Annotated ~~not~~ and to the jurisdiction of the securities commissioner of this state."

House Bill No. 2690 would also subject variable life insurance and variable annuities to the Kansas Securities Code for the first time.²

Summary of Position

- Variable life insurance and variable annuities are one of the most heavily regulated financial products in today's broad marketplace.
- HB 2690 would disrupt a coordinated system of state and federal regulation established by the U.S. Supreme Court.
- The bill would cause duplicate regulation of the same product under the Kansas Insurance and Securities Codes.
- HB 2690 would create expensive, unnecessary compliance burdens for life insurers and salespersons, and would discourage life insurers from distributing variable life insurance and variable annuities in Kansas.

²The bill would amend the definition of "security" under the Kansas securities statute at K.S.A. 17-125(j) to provide that:

"Security" does not include any insurance or endowment policy or annuity contract under which an insurance company promises to pay *a fixed sum of* money either in a lump sum or periodically for life or some other specified period.

- The bill would impose a fourth layer of regulation on variable life insurance and variable annuities on top of comprehensive SEC, NASD, and state insurance regulation.
- The need for the amendment has not been justified. A pattern of abuse has not been identified.
- HB 2690 creates an aberrant regulatory structure in Kansas that differs from almost every other state

Background

Variable contracts are perhaps the most heavily regulated financial products in today's broad marketplace. The U.S. Supreme Court observed that variable contracts possess important characteristics of both insurance and securities, and ruled that their securities characteristics are subject to federal securities regulation, while their insurance characteristics are subject to state insurance regulation.³ In the manufacture and distribution of variable contracts, therefore, life insurers satisfy multiple state and federal layers of regulation.

Variable contract separate accounts must be registered under the Investment Company Act of 1940, which is administered by the U.S. Securities and Exchange Commission. The disclosure appearing in variable contract prospectuses is reviewed and approved by the SEC.

³*SEC v. Variable Annuity Life Insurance Company*, 359 U.S. 65 (1959); *SEC v. United Benefit Life Insurance Company*, 387 U.S. 202 (1967).

Advertisements must satisfy several detailed regulations under the federal securities laws, and must be filed with the SEC.

Variable contracts subject to the federal securities laws can only be sold by registered representatives of a broker-dealer that is a member of the National Association of Securities Dealers. The NASD's rules of conduct strictly govern the activity of securities salespersons, and impose detailed standards concerning advertising, supervision and the suitability of individual securities transactions. All advertisements used by NASD licensed salespersons must be filed with, and approved by, the NASD Advertising Department.

Activities of securities salespersons are also subject to SEC jurisdiction under the Securities Exchange Act of 1934. In addition to these specific standards, the federal securities laws impose broad antifraud proscriptions and give the SEC significant enforcement authority. Unlike other regulatory structures, the federal securities laws uniquely provide for private rights of actions by individual investors on certain core protections.

State insurance departments have comprehensive authority over life insurers and the products they issue. In addition to the variable contract statutes and regulations in most jurisdictions, variable life and variable annuities must also satisfy a broad array of requirements protecting the interests of consumers, such as unfair trade practices acts, illustration regulations, and advertising regulations. State insurance departments wield substantial authority over variable contracts in the issuance of variable contract certificates of authority, and in policy form

filing and approval. State insurance departments also continually evaluate insurers and their product distribution through very detailed market conduct examinations.

The Burdens of Conflicting State and Federal Standards

Life insurers must satisfy multiple, comprehensive state and federal regulatory structures in developing and selling variable life and variable annuities. The financial services market in which variable contracts are distributed is extremely competitive and fast-moving. The delay and added expense caused by regulatory conflicts can significantly burden the marketability and competitiveness of variable contracts. Further, life insurers are untenably caught in an irreconcilable position when faced with inconsistent interpretations from a single insurance regulator that contradict the standards and interpretations of federal regulators and other state insurance departments.

Chronology From Design to Regulatory Approval

The regulatory chronology insurers confront in bringing a variable contract to market may help illustrate the burdens of inconsistent regulation. After substantial investment in the design and mechanics of a variable life and variable annuity, actuaries price and identify the product to uniquely position it in the marketplace. Following this process, a life insurer must register a separate account funding the variable contract with the SEC under the federal securities laws. At this stage, SEC staff meticulously review the registration and its prospectus for completeness and

clarity, screening against material omissions or materially misleading statements. By this juncture, life insurers have invested substantial time and funds for accounting, legal and registration fees. With the product's approval under the federal securities laws, life insurers commit substantial resources to the systems supporting the product and its marketing. By the end of the SEC registration process, the identity and name of the variable annuity contract has been crystallized.

Following SEC approval, life insurers must have certificates of authority and policy form approval for the new variable contract from their domestic state and each state in which the variable contract will be marketed. Additionally, life insurers must fulfill comprehensive regulatory requirements in each state where they conduct business, based on standards patterned after NAIC model laws and regulations.

Kansas has enacted comprehensive laws and adopted regulations governing the manufacture and distribution of variable life insurance and variable annuities based on the NAIC model laws and regulations. These laws and regulations grant the insurance commissioner sole and exclusive jurisdiction to regulate these products, and follows the practice in almost every jurisdiction. This approach to regulation dovetails with the joint state and federal regulation of this product according to the standards established by the U.S. Supreme Court.

Salespersons distributing variable contracts must obtain an NASD license in order to sell these products, and must maintain rigorous continuing education standards. Supervising broker-

dealers enforce the NASD's rigorous rules of conduct, and fulfill significant supervision and suitability standards. Individuals committing felonies and dishonesty crimes are statutorily disqualified from being NASD licensed. Broker-dealers immediately must report salespersons terminated for cause on Form U-5, which is available on the NASD's publicly available computerized database, the CRD.

In sum, variable life and annuities pass meticulous scrutiny from design through approval.

Costs and Benefits of the Bill

The need for the amendments has not been substantiated. No pattern of abuse has been cited. In our view, the desire for the amended statutes stems from a conceptual theory of expanded securities jurisdiction that is unfounded and incorrect. Adequate means already exist under the Kansas laws and regulations to police and prosecute market conduct matters. Subjecting variable life and annuities to the Kansas securities laws provides little regulatory value beyond that of the Kansas Insurance Commission, the SEC and the NASD. Duplicate, shared jurisdiction in Kansas over the same product will inevitably lead to expensive, untenable regulatory conflicts. The added cost of redundant regulation could deter the continued sale of variable contracts in Kansas. This consequence unnecessarily harms Kansas consumers by choking competition, and erects disincentives to conduct insurance and annuity business in Kansas. On balance, the economic burdens of the bill's amendments greatly overshadow its nebulous, unsubstantiated regulatory benefits.

Conclusion

For the reasons stated above, the bill should be eliminated. We would be happy to address any questions, and greatly appreciate your time and attention to our views.

SPOTTING TRENDS:
STATISTICAL ANALYSIS OF REPORTED NASD DISCIPLINARY ACTIONS
INVOLVING THE DISTRIBUTION OF ANNUITIES, INSURANCE PRODUCTS, OR
BROKER-DEALERS AFFILIATED WITH LIFE INSURERS BETWEEN 1996 AND 1999.

Carl B. Wilkerson, Chief Counsel

American Council of Life Insurance
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I. Trend Analysis as a Barometer of Broker-Dealer Behavior

- A. The NASD publishes reports of disciplinary actions monthly in its Notices to Members which highlight breaches in broker-dealer market conduct.
1. A cyclical review of the reported disciplinary actions exposes common areas of deficient conduct, while also giving early warning to evolving patterns of disciplinary misconduct that can be useful in preventive compliance programs.
 2. Since 1996, I have annually compiled reviews of reported disciplinary actions involving annuities, insurance products, or broker-dealers affiliated with life insurance companies .
 - a. *See, ALI-ABA Conference on Life Insurance Company Products: Current Securities, Tax, ERISA, and State Regulatory Issues (1999) at 183; ALI-ABA Conference on Life Insurance Company Products: Current Securities, Tax, ERISA, and State Regulatory Issues (1998) at 409; ALI-ABA Conference on Life Insurance Company Products: Current Securities, Tax, ERISA, and State Regulatory Issues (1997) at 597; and, ALI-ABA Conference on Life Insurance Company Products: Current Securities, Tax, ERISA, and State Regulatory Issues (1996) at 176.*
 3. These compilations provide a base of data shedding additional light on trends between 1996 and 1999, and highlight common problems and evolving patterns of behavior over a multi-year sequence.
 4. The attached spreadsheet and graphics were developed by Joshua M. Greenberg, Research Associate, ACLI Policy Research Department, using data compiled in the reviews of reported disciplinary actions annually

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between 1996-1999.

II. What are the trends?

- A. Over the period of 1996-1999, the *total number of disciplinary actions* involving annuities, insurance products, or broker-dealers affiliated with life insurance companies has progressively decreased.
- B. Over the period of 1996-1999, the *number of disciplinary action by type* (conversion, forgery, misrepresentation, etc.) involving annuities, insurance products, or broker-dealers affiliated with life insurance companies has experienced a downward trend in almost every category.
- C. Over the period of 1996-1999, the *total fines in disciplinary actions* involving annuities, insurance products, or broker-dealers affiliated with life insurance companies peaked in the middle of the period, and dropped off toward the end of the period. [*Note*: two cases in 1999 were not included in the fines total because the fines in the cases exceeded two standard deviations from the data set, and a fine was levied in one year for conduct spanning up to 13 years.]
- D. Over the period of 1996-1999, the *average fine per disciplinary action* involving annuities, insurance products, or broker-dealers affiliated with life insurance companies peaked in 1998, and fell off in 1999. [*Note*: two cases in 1999 were not included in the calculation of average fine per disciplinary action because the fines in the cases exceeded two standard deviations from the data set, and a fine was levied in one year for conduct spanning up to 13 years.]
- E. Over the period of 1996-1999, the *most frequent categories of disciplinary action* were conversion of funds (ranging from 51% to 69% of annual disciplinary actions), forgery (ranging from 7% to 20% of annual disciplinary actions), unauthorized policy loans (ranging between 3% and 25% of annual disciplinary actions), and fraud (ranging from 1% to 8% of annual disciplinary actions).
- F. Over the period of 1996-1999, the *number of disciplinary actions with restitution ordered* trended downward.
- G. Over the period of 1996-1999, the *average amount of restitution* peaked in 1998 and declined in 1999.
- H. Overall, disciplinary statistics show improved market conduct during the period.

III. What contributed to the trends?

- A. It is not possible to determine with certainty the causes of the trends in disciplinary actions over this time period. There are, however, several causal factors that individually and collectively could have affected the trends depicted, including:
1. Improved market conduct by registered representatives and broker-dealers affiliated with life insurance companies;
 2. More effective broker-dealer compliance programs, and allocation of increased compliance resources and staff at broker-dealers;
 3. Improved understanding of regulatory and compliance responsibilities through continuing education programs that were developed and implemented in response to the Securities Industry Continuing Education Initiative over this period;
 4. Increased use of deficiency reporting as a compliance monitoring tool to identify broker-dealer offices or salespersons with statistically measurable behavior outside the firm-wide norm for the broker-dealer (replacements, account turnover, etc.);
 5. Prevention and avoidance of private litigation and securities arbitration;
 6. Desire to retain or obtain membership in Insurance Marketplace Standards Association (IMSA);
 7. Better ability to identify and weed out problem salespersons through improvements to the NASD's CRD, and more detailed factual reports about individual terminations in Form U-5.
 8. SEC and NASD inspection sweeps between 1996 and 1999;
 9. Responsive reaction to increased SEC and NASD enforcement actions; and,
 10. Responsive reaction to increased SEC fines in prosecutions, and increased NASD fines in disciplinary actions following mandate in SEC's §21(a) Report on NASD self regulation and enforcement.

Insurance Related Disciplinary Actions, Yearly Breakdowns

	1996	1997	1998	1999 ⁽¹⁾	4 Year Totals
# of Cases ⁽²⁾	89	77	71	54	291
# of Violations	113	115	97	75	400

# of Violations by Type					
Conversion of Funds	55	45	44	39	183
False Identity of Salesperson	0	0	0	1	1
Product Sold w/o Firm's Consent	2	3	2	4	11
Misrepresentation	0	6	7	2	15
Finders Fee to Unlicensed Indiv	0	0	0	1	1
Unauthorized Policy Loan	3	10	6	5	24
Unauthorized Dividend Disbursement	0	0	0	1	1
Forgery	34	35	23	12	104
False Insurance App/Policies	4	6	2	5	17
Unsuitable/Excessive Trading	0	0	0	1	1
Supervisory Breaches	0	0	0	1	1
Fraud	9	5	3	2	19
False Documents	0	1	2	1	4
Misappropriated Funds	1	0	6	0	7
Unlicensed Sales	0	0	1	0	1
Unauthorized Surrender of Policy	0	0	1	0	1
Misuse of Funds	4	5	0	0	9
Conflict of Interest	1	0	0	0	1

Total Fine by Case \$3,171,453.25 \$12,785,951.32 \$16,822,819.50 \$4,845,922.90 \$37,626,146.97

Avg Fine per Case \$35,634.31 \$166,051.32 \$236,941.12 \$89,739.31 \$129,299.47

Avg Fine per Violation by Type ⁽³⁾					
Conversion of Funds	\$43,649.94	\$272,215.65	\$351,128.49	\$109,761.54	\$187,873.25
False Identity of Salesperson	0.00	0.00	0.00	416,500.00	7,620,444.67
Product Sold w/o Firm's Consent	161,250.00	67,233.33	150,000.00	26,250.00	84,472.73
Misrepresentation	0.00	55,424.53	11,428.57	122,611.45	63,484.67
Finders Fee to Unlicensed Indiv	0.00	0.00	0.00	390,000.00	11,901,942.67
Unauthorized Policy Loan	33,333.33	0.00	0.00	0.00	4,166.67
Unauthorized Dividend Disbursement	0.00	0.00	0.00	0.00	167,206.60
Forgery	1,470.59	0.00	11,195.65	0.00	2,956.73
False Insurance App/Policies	4,375.00	5,833.33	262,500.00	11,000.00	37,205.88
Unsuitable/Excessive Trading	0.00	0.00	0.00	545,000.00	816,000.00
Supervisory Breaches	0.00	0.00	0.00	165,000.00	340,000.00
Fraud	0.00	0.00	11,666.67	0.00	1,842.11
False Documents	0.00	0.00	12,500.00	0.00	6,250.00
Misappropriated Funds	0.00	0.00	0.00	0.00	714.29
Unlicensed Sales	0.00	0.00	0.00	0.00	25,000.00
Unauthorized Surrender of Policy	0.00	0.00	0.00	0.00	35,000.00
Misuse of Funds	0.00	0.00	0.00	0.00	3,888.89
Conflict of Interest	0.00	0.00	0.00	0.00	75,000.00

Total Fine by Type⁽³⁾					
Conversion of Funds	\$2,400,746.65	\$12,249,704.15	\$15,449,653.70	\$4,280,700.00	\$34,380,804.50
Forgery	701,005.00	4,831,028.87	1,671,910.80	416,500.00	7,620,444.67
Fraud	322,500.00	201,700.00	300,000.00	105,000.00	929,200.00
False Insurance App/Policies	294,500.00	332,547.17	80,000.00	245,222.90	952,270.07
Unauthorized Policy Loan	142,500.00	6,151,942.67	5,217,500.00	390,000.00	11,901,942.67
Conflict of Interest	100,000.00	0.00	0.00	0.00	100,000.00
Misuse of Funds	83,706.60	83,500.00	0.00	0.00	167,206.60
Misappropriated Funds	50,000.00	0.00	257,500.00	0.00	307,500.00
Product Sold w/o Firm's Consent	17,500.00	35,000.00	525,000.00	55,000.00	632,500.00
Misrepresentation	0.00	128,500.00	142,500.00	545,000.00	816,000.00
False Documents	0.00	110,000.00	65,000.00	165,000.00	340,000.00
Unauthorized Surrender of Policy	0.00	0.00	35,000.00	0.00	35,000.00
Unlicensed Sales	0.00	0.00	25,000.00	0.00	25,000.00
False Identity of Salesperson	0.00	0.00	0.00	5,000.00	5,000.00
Finders Fee to Unlicensed Indiv	0.00	0.00	0.00	25,000.00	25,000.00
Unauthorized Dividend Disbursement	0.00	0.00	0.00	35,000.00	35,000.00
Unsuitable/Excessive Trading	0.00	0.00	0.00	35,000.00	35,000.00
Supervisory Breaches	0.00	0.00	0.00	75,000.00	75,000.00

Restitution Awarded by Case	21	21	12	7	61
Total Restitution by Case	\$448,421.29	\$1,961,961.37	\$1,959,690.35	\$756,051.97	\$5,126,124.98
Avg Amount of Restitution by Case	\$21,353.39	\$93,426.73	\$163,307.53	\$108,007.42	\$84,034.84

Restitution Awarded by Violation					
Conversion of Funds	16	17	9	6	48
Forgery	4	5	2	0	11
Misrepresentation	0	4	1	1	6
False Insurance App/Policies	2	2	0	1	5
Unauthorized Policy Loan	1	1	1	1	4
Fraud	2	0	1	0	3
Misuse of Funds	2	1	0	0	3
Product Sold w/o Firm's Consent	0	1	1	0	2
Supervisory Breaches	0	0	1	0	1
False Documents	0	1	0	0	1
Misappropriated Funds	0	0	1	0	1
False Identity of Salesperson	0	0	0	0	0
Finders Fee to Unlicensed Indiv	0	0	0	0	0
Unauthorized Dividend Disbursement	0	0	0	0	0
Unsuitable/Excessive Trading	0	0	0	0	0
Unlicensed Sales	0	0	0	0	0
Unauthorized Surrender of Policy	0	0	0	0	0
Conflict of Interest	0	0	0	0	0

Avg Restitution Awarded by Violation					
Conversion of Funds	\$17,392.25	\$113,587.24	\$212,766.67	\$122,001.23	\$101,170.13
False Identity of Salesperson	0.00	0.00	0.00	0.00	0.00
Product Sold w/o Firm's Consent	0.00	8,200.00	75,000.00	0.00	41,600.00
Misrepresentation	0.00	8,763.23	6,544.12	99,794.42	23,565.24
Finders Fee to Unlicensed Indiv	0.00	0.00	0.00	0.00	0.00
Unauthorized Policy Loan	7,500.00	1,145,079.10	763.00	49,935.37	300,819.37
Unauthorized Dividend Disbursement	0.00	0.00	0.00	0.00	0.00
Forgery	8,677.88	124,303.85	56,420.73	0.00	69,915.65
False Insurance App/Policies	18,597.83	0.00	0.00	24,044.58	12,248.05
Unsuitable/Excessive Trading	0.00	0.00	0.00	0.00	0.00
Supervisory Breaches	0.00	0.00	6,544.12	0.00	6,544.12
Fraud	72,750.00	0.00	60,000.00	0.00	68,500.00
False Documents	0.00	10,000.00	0.00	0.00	10,000.00
Misappropriated Funds	0.00	0.00	404.60	0.00	404.60
Unlicensed Sales	0.00	0.00	0.00	0.00	0.00
Unauthorized Surrender of Policy	0.00	0.00	0.00	0.00	0.00
Misuse of Funds	5,370.66	9,096.79	0.00	0.00	6,612.70
Conflict of Interest	0.00	0.00	0.00	0.00	0.00

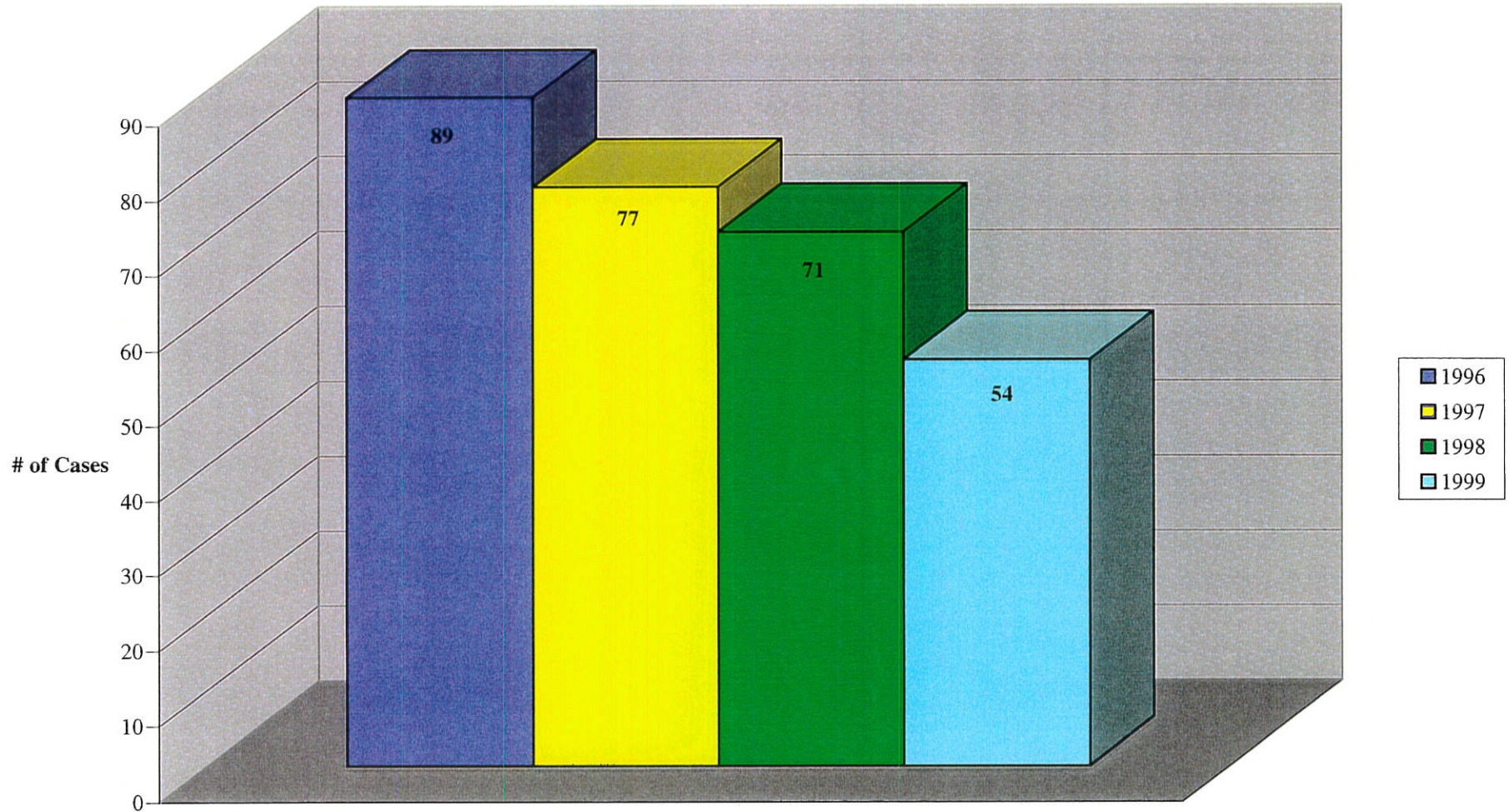
Total Restitution Awarded by Violation					
Conversion of Funds	\$278,276.00	\$1,930,983.00	\$1,914,900.00	\$732,007.40	\$4,856,166.40
False Identity of Salesperson	0.00	0.00	0.00	0.00	0.00
Product Sold w/o Firm's Consent	0.00	8,200.00	75,000.00	0.00	83,200.00
Misrepresentation	0.00	35,052.90	6,544.12	99,794.42	141,391.44
Finders Fee to Unlicensed Indiv	0.00	0.00	0.00	0.00	0.00
Unauthorized Policy Loan	7,500.00	1,145,079.10	763.00	49,935.37	1,203,277.47
Unauthorized Dividend Disbursement	0.00	0.00	0.00	0.00	0.00
Forgery	34,711.50	621,519.23	112,841.45	0.00	769,072.18
False Insurance App/Policies	37,195.65	0.00	0.00	24,044.58	61,240.23
Unsuitable/Excessive Trading	0.00	0.00	0.00	0.00	0.00
Supervisory Breaches	0.00	0.00	6,544.12	0.00	6,544.12
Fraud	145,500.00	0.00	60,000.00	0.00	205,500.00
False Documents	0.00	10,000.00	0.00	0.00	10,000.00
Misappropriated Funds	0.00	0.00	404.60	0.00	404.60
Unlicensed Sales	0.00	0.00	0.00	0.00	0.00
Unauthorized Surrender of Policy	0.00	0.00	0.00	0.00	0.00
Misuse of Funds	10,741.32	9,096.79	0.00	0.00	19,838.11
Conflict of Interest	0.00	0.00	0.00	0.00	0.00

Note: Two fines in excess of \$20,000,000 each have been removed for the following reasons:

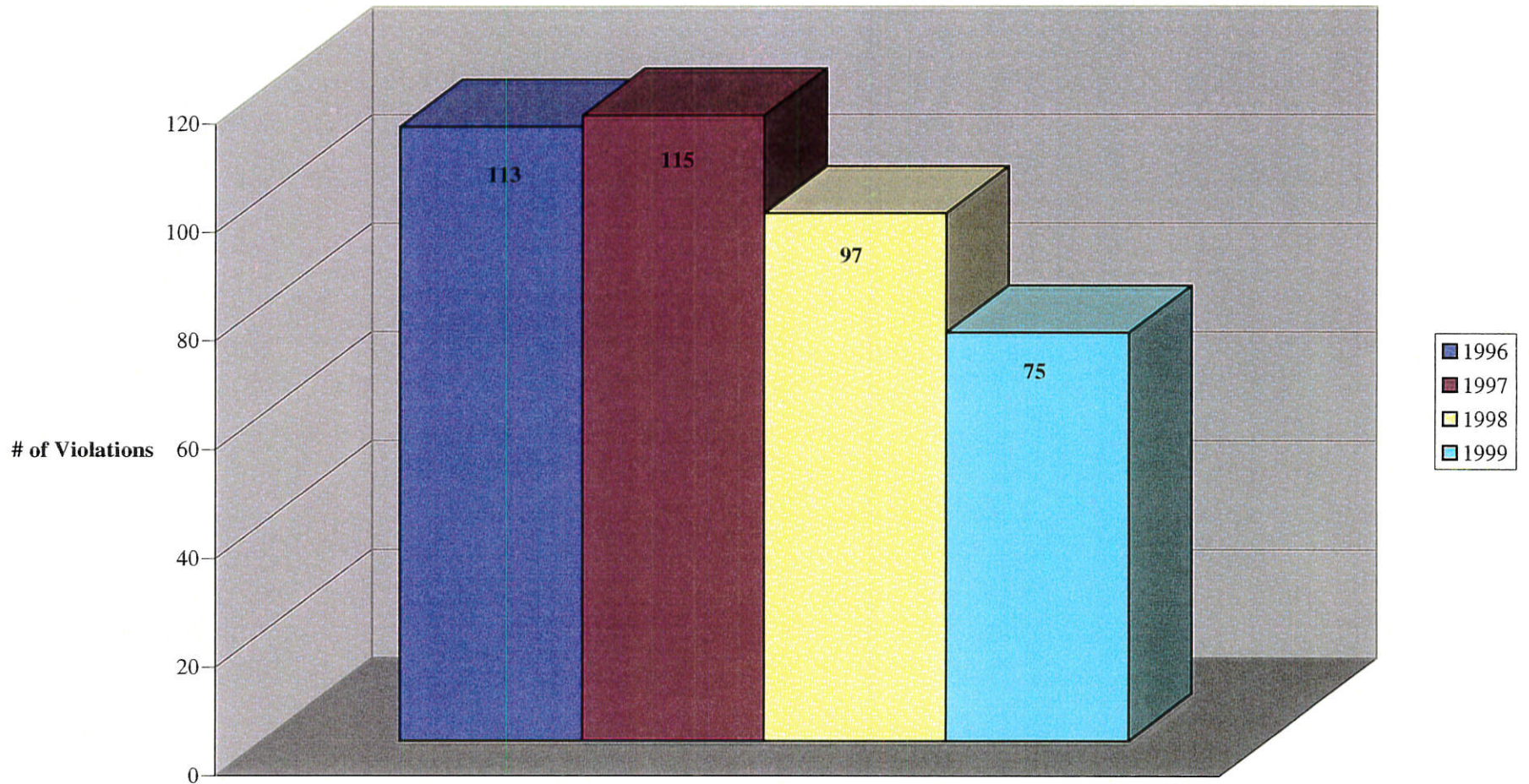
a) fine was levied in one year for violations spanning 13 years; b) fine was outside standard deviation for this data set

- (1) Through September 18th
- (2) Cases can include multiple violations
- (3) Multiple violation cases have fine attributed to each violation (double counting)

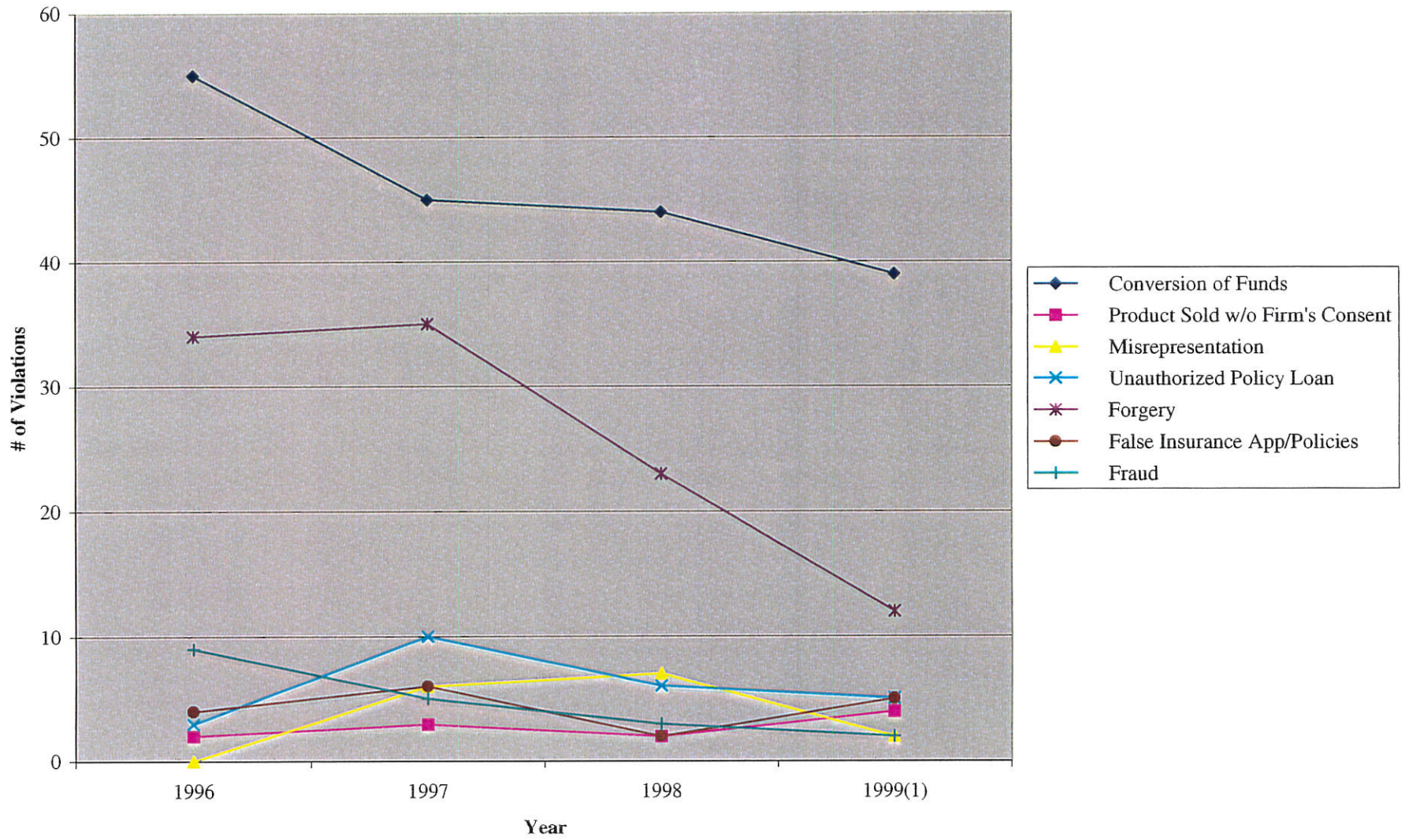
of Disciplinary Actions by Case, Four-Year Trend



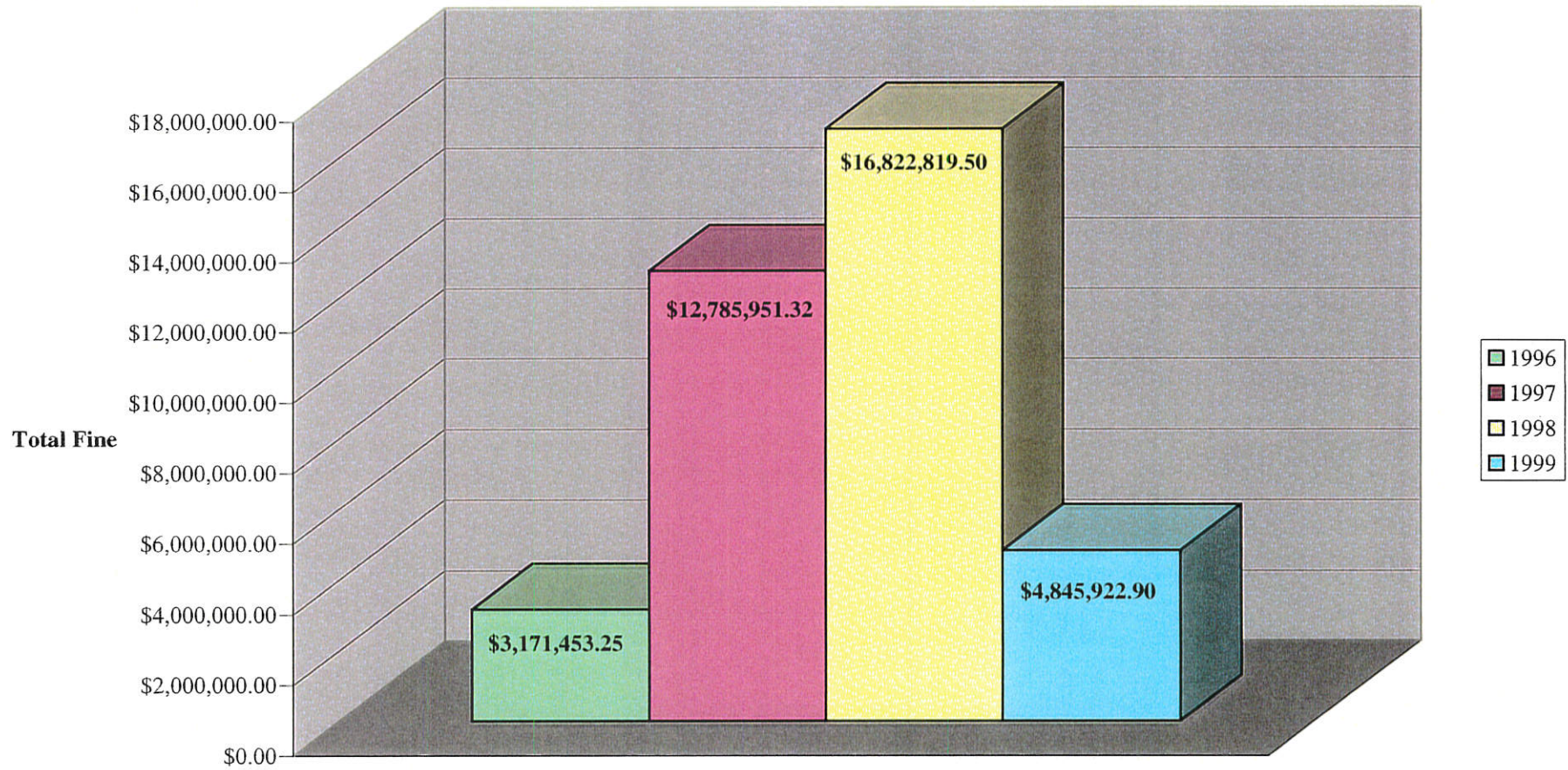
of Violations, Four-Year Trend



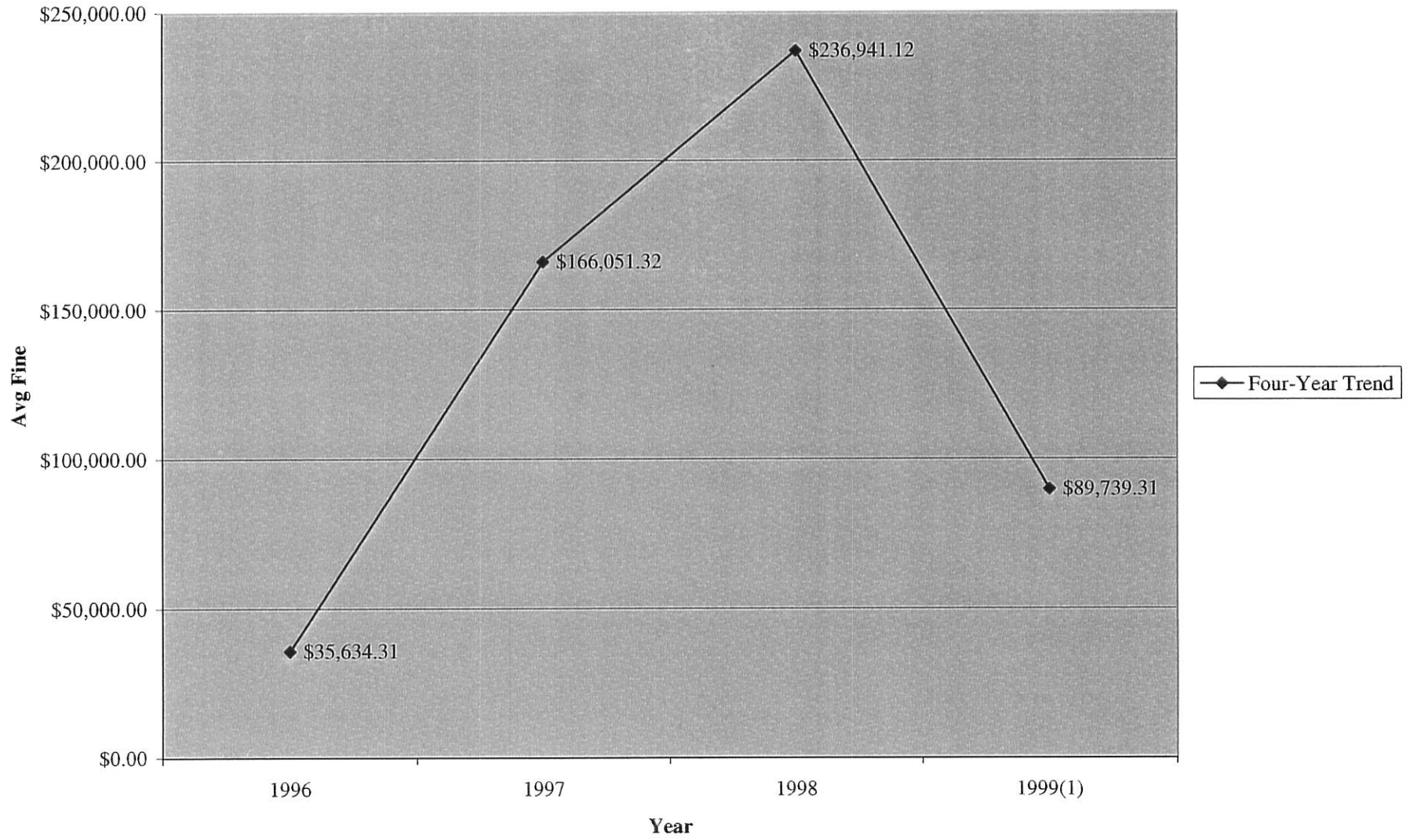
of Violations, by Type, Four-Year Trend



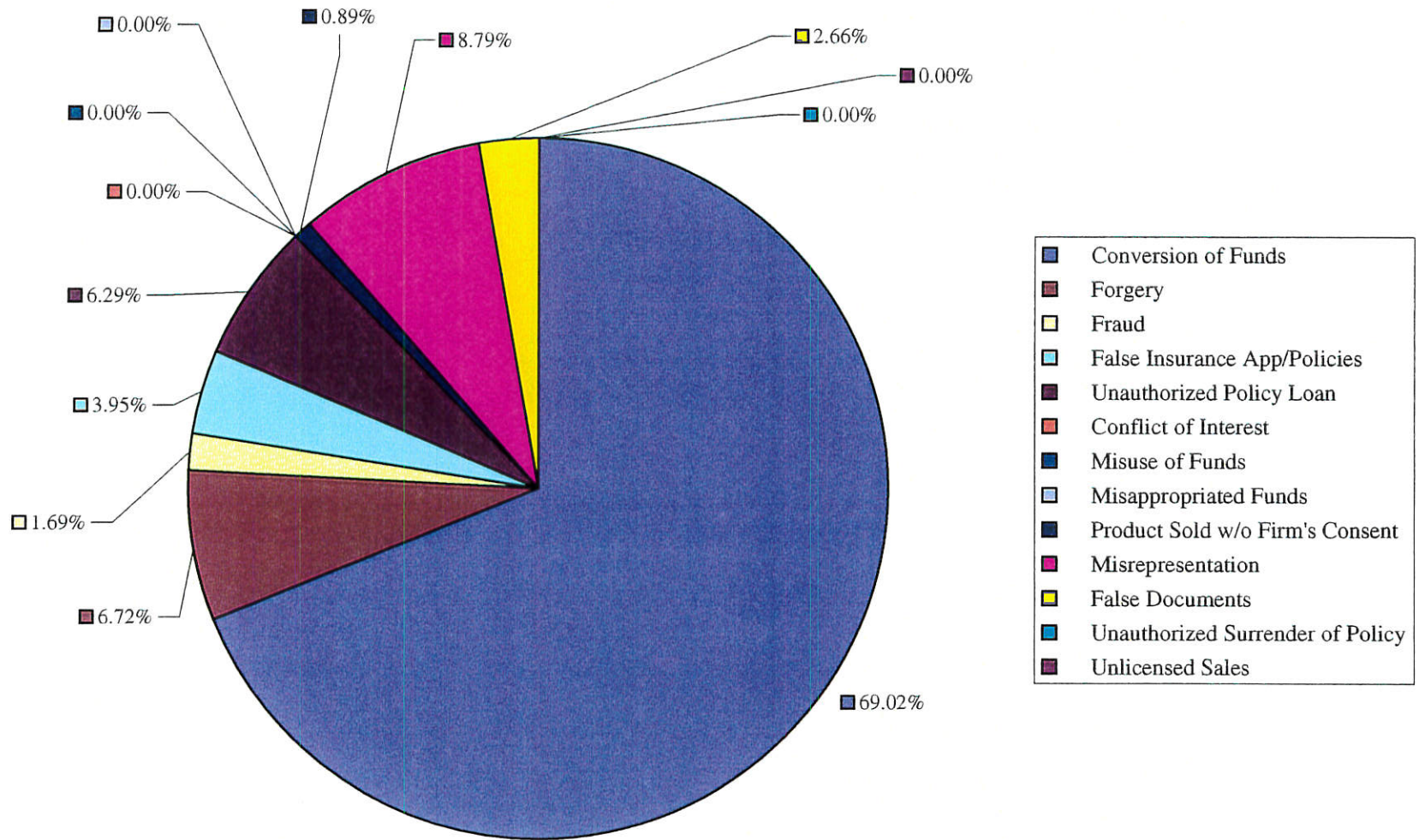
Total Fines by Case, Four-Year Trend



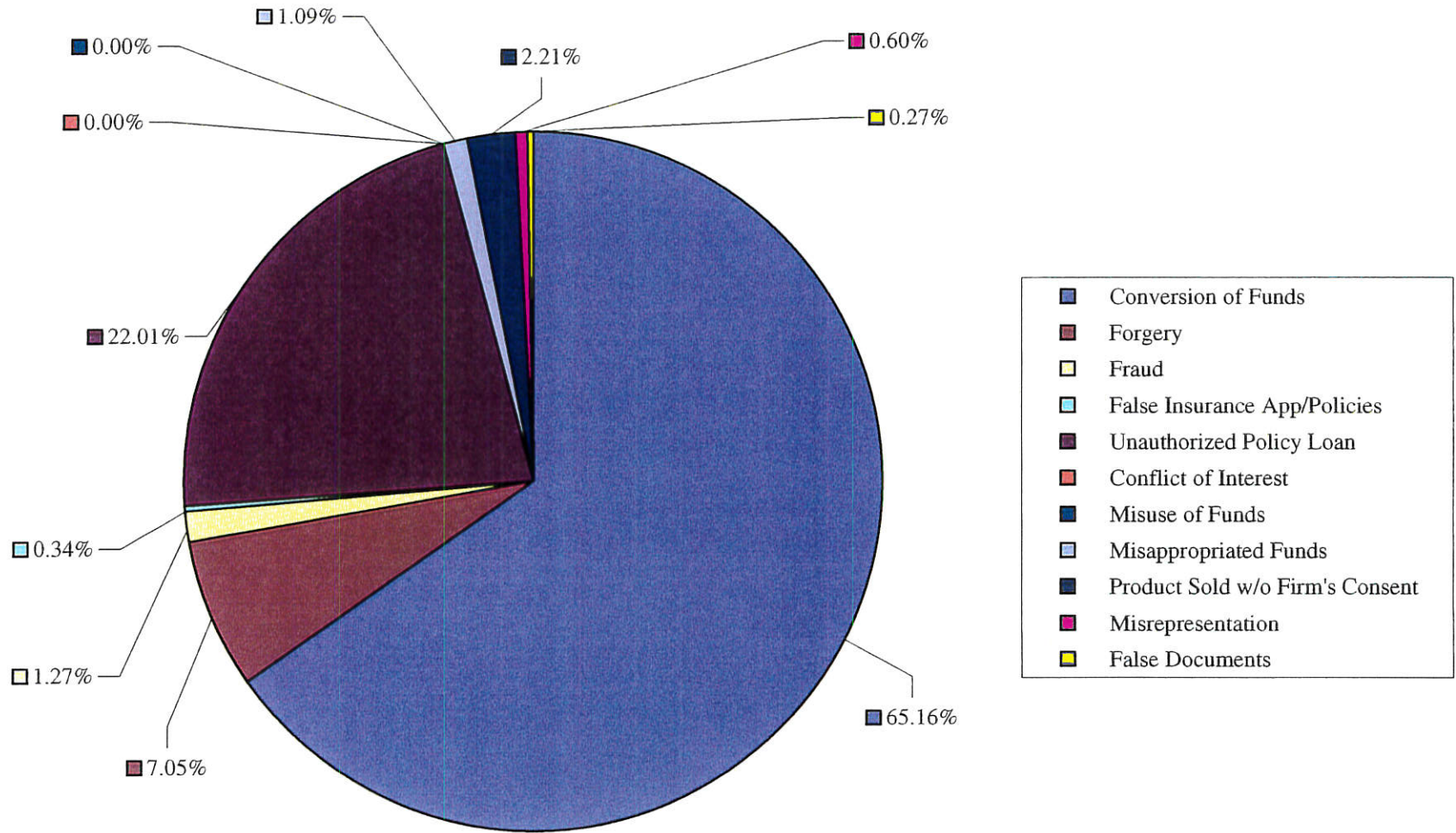
Average Fine per Case, Four-Year Trend



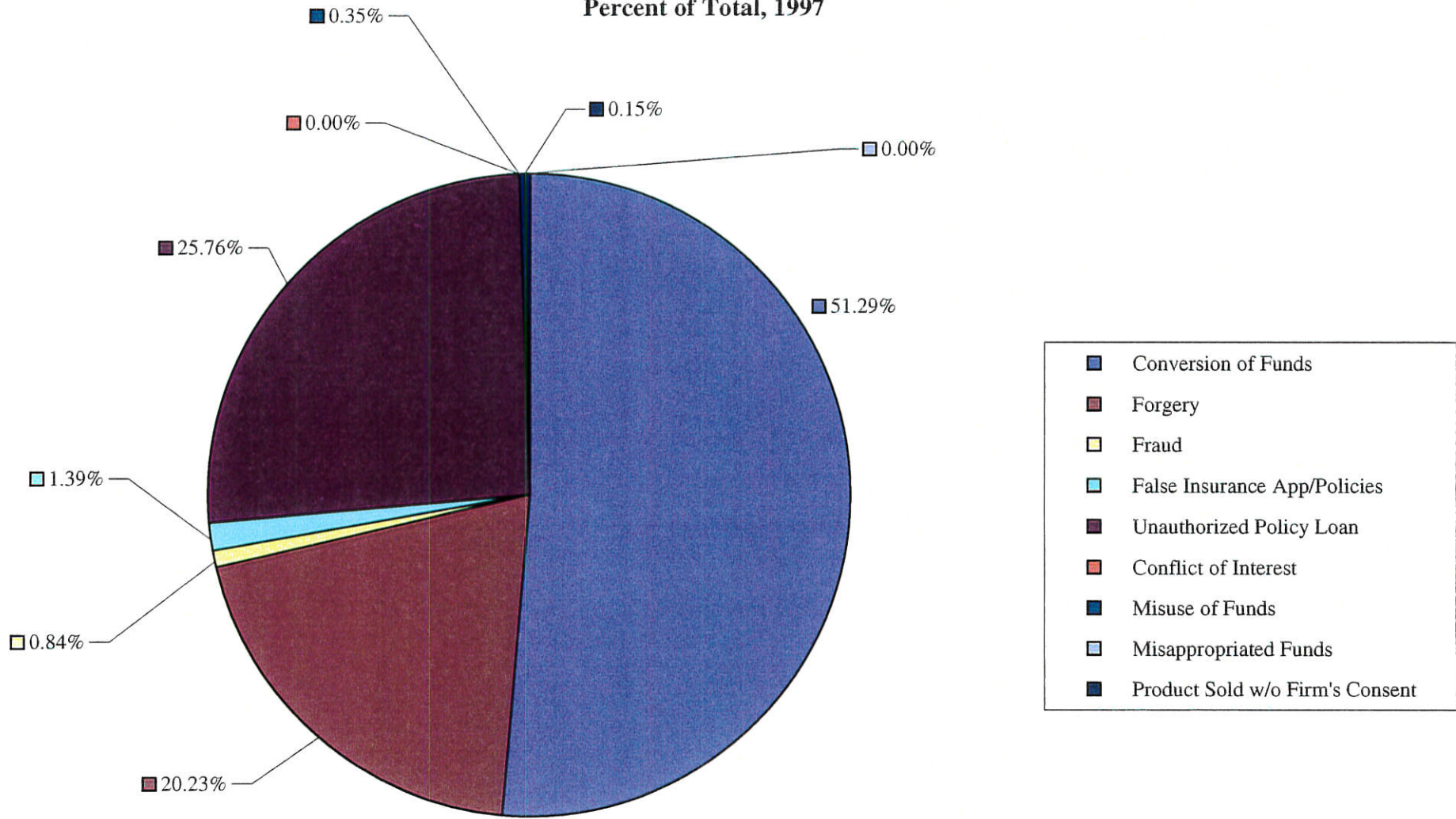
Percent of Total Fines, 1999



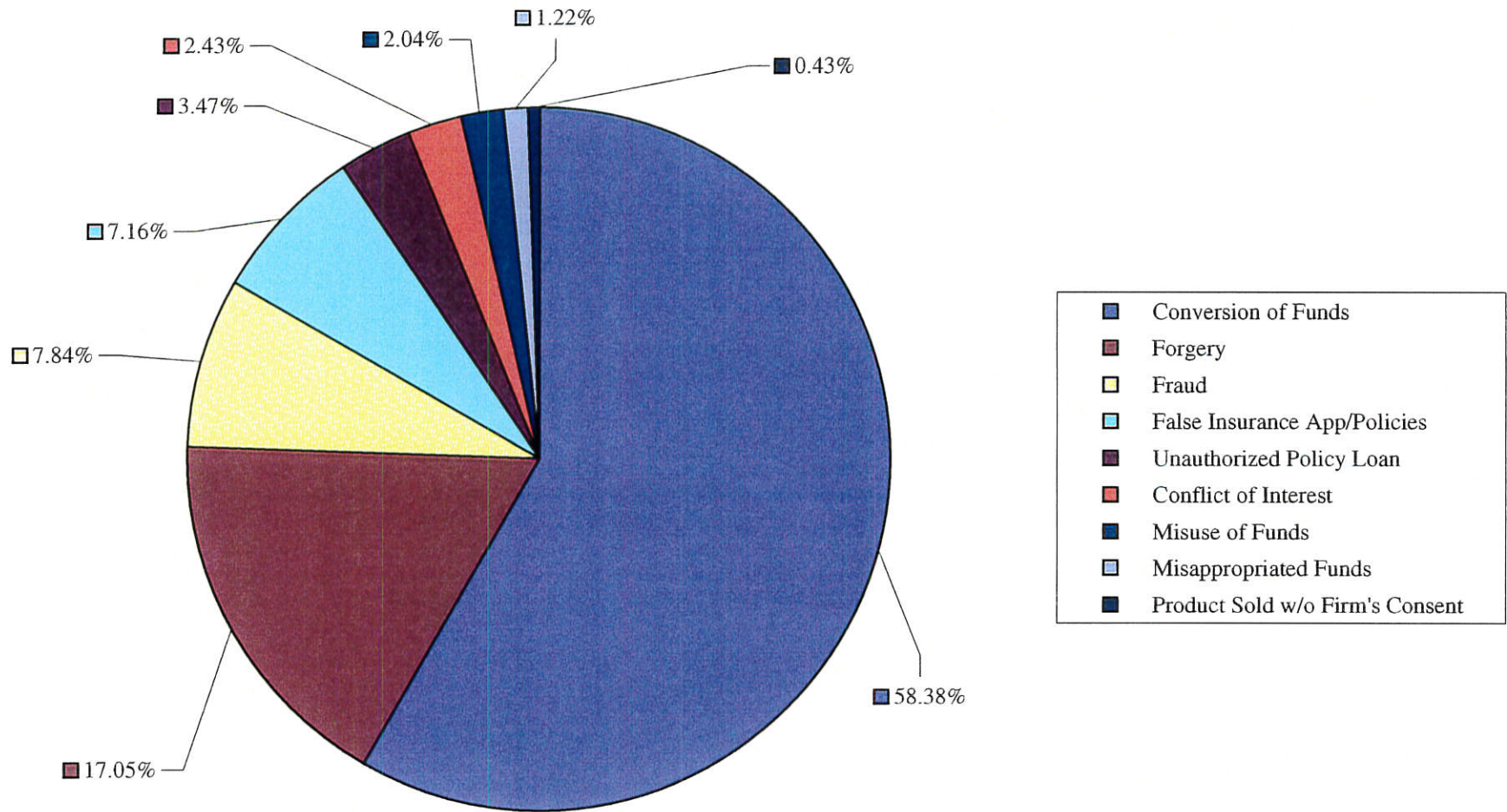
Percent of Total Fines, 1998



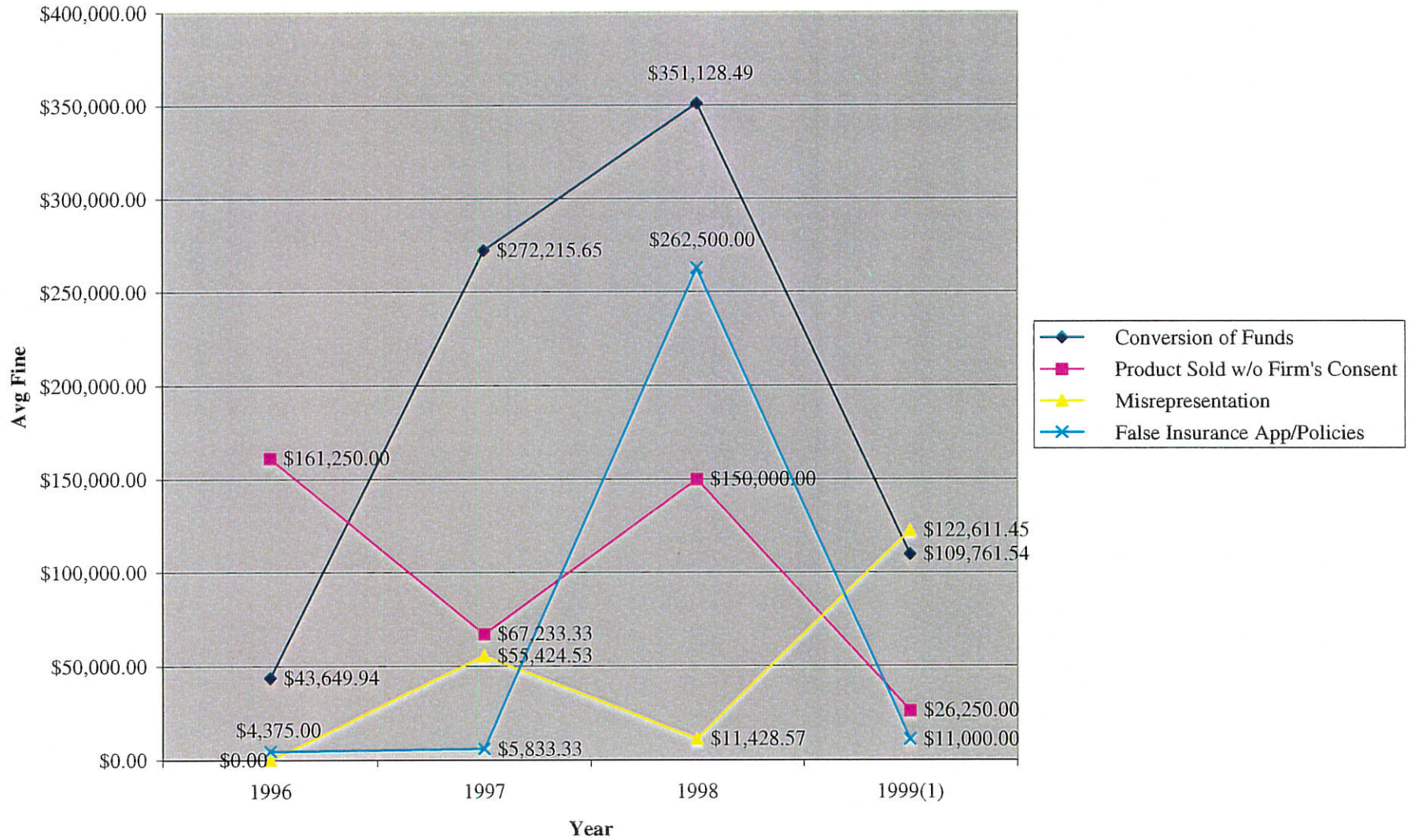
Percent of Total, 1997



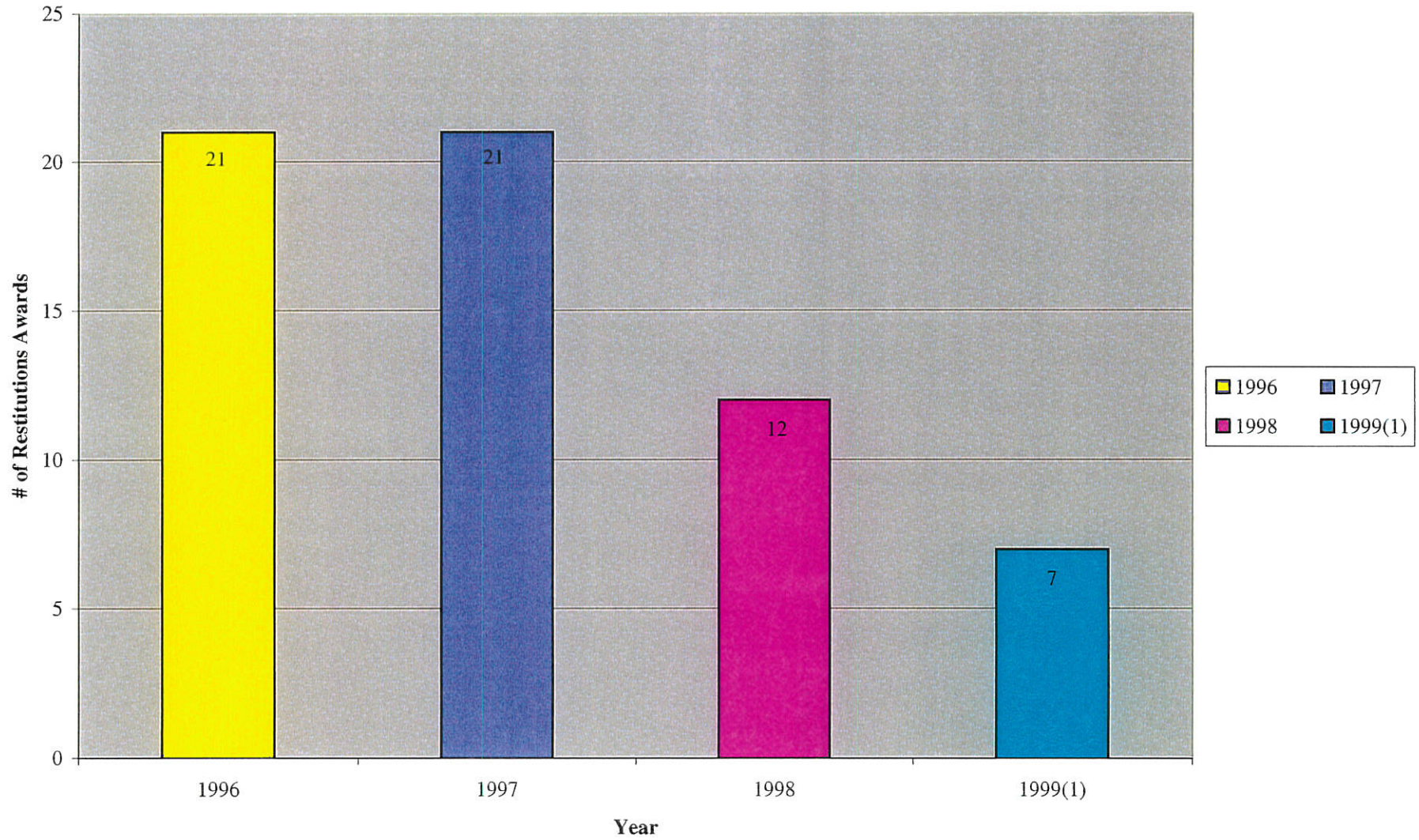
Percent of Total Fine, 1996



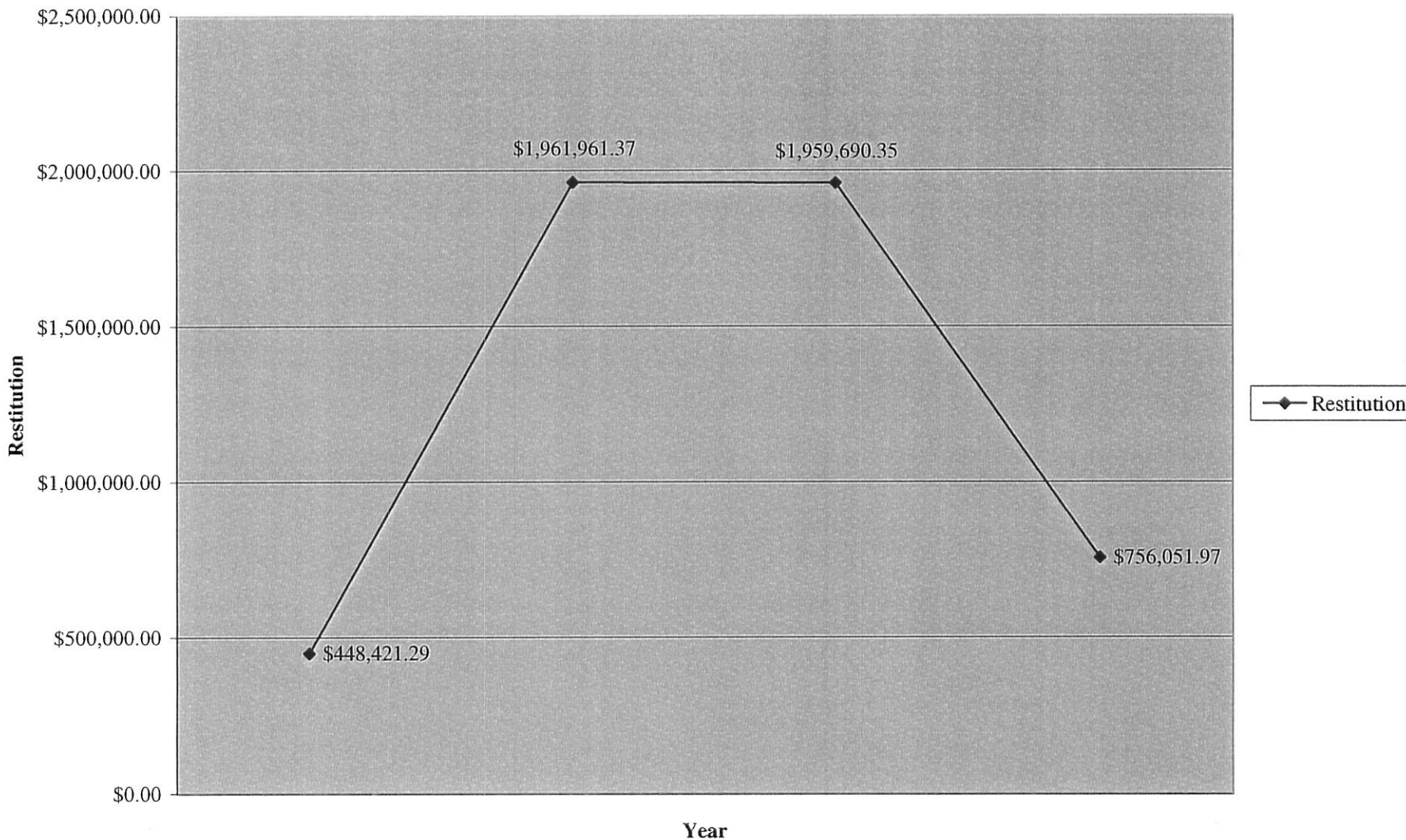
Average Fine by Violation, Four-Year Trend



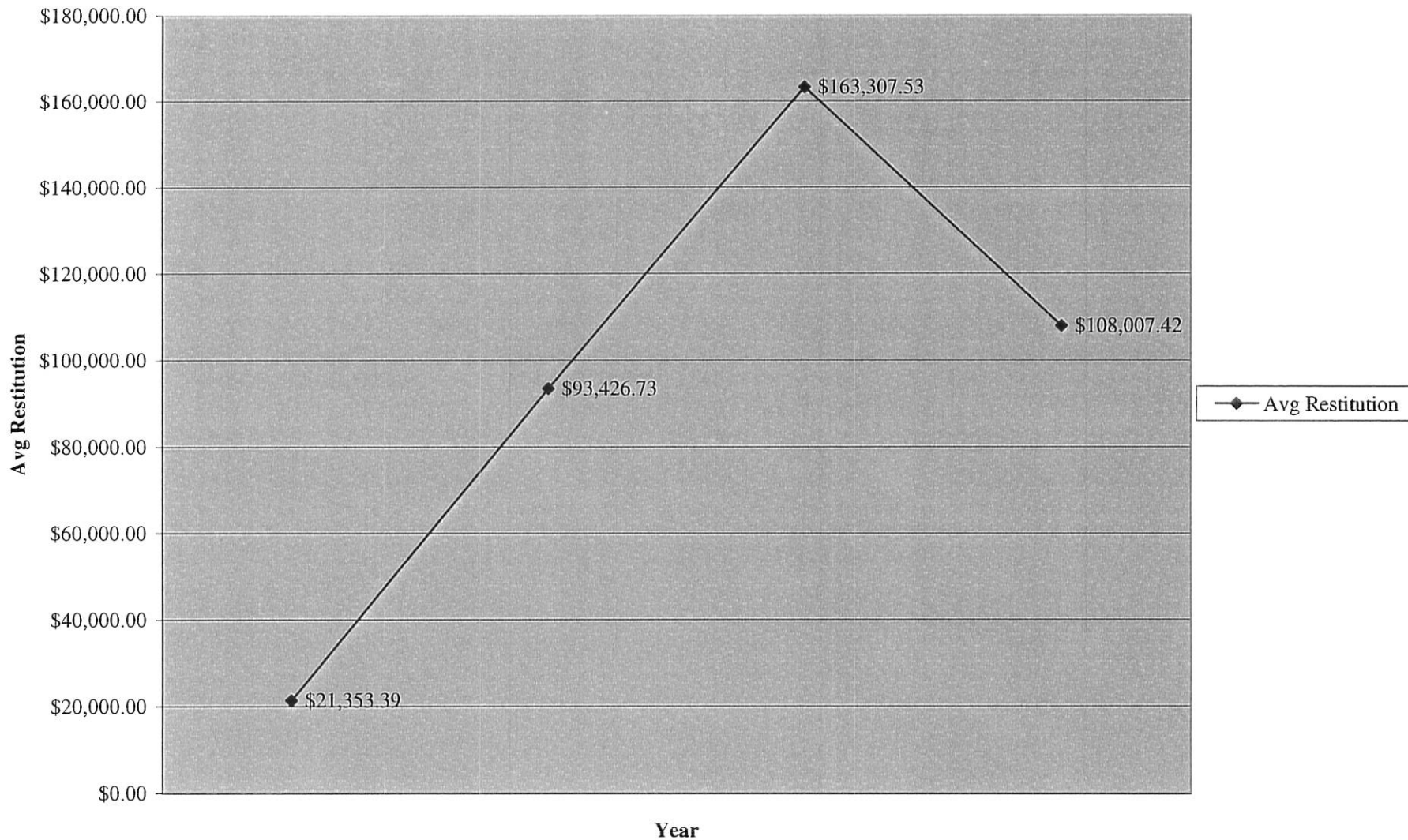
of Restitution Awards by Case, Four-Year Trend



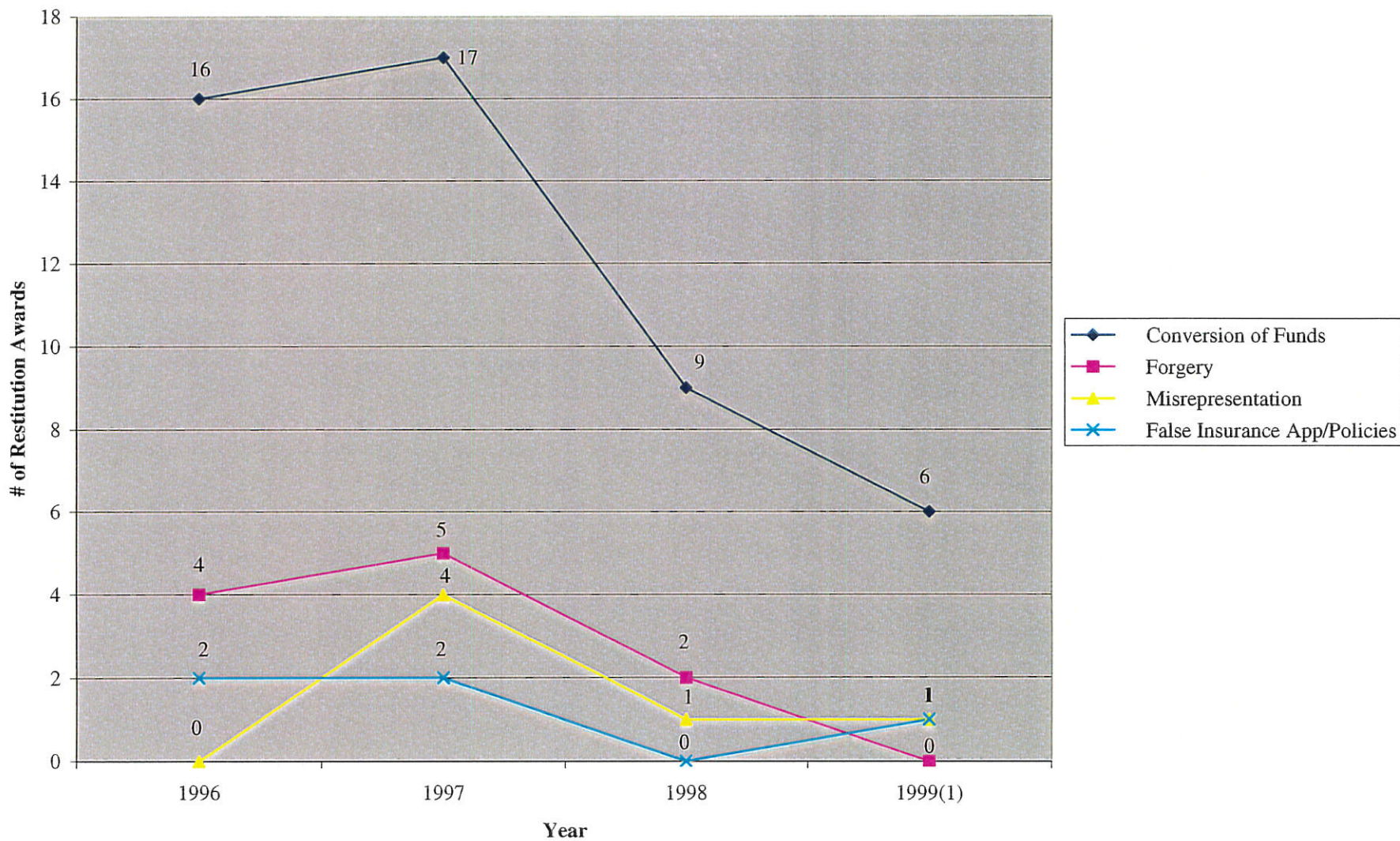
Total Restitution by Case, Four-Year Trend



Average Amount of Restitution by Case, Four-Year Trend



of Restitution Awards by Violation, Four-Year Trend



TESTIMONY
Before
House Committee on Financial Institutions
By
Richard K. Friedstrom, CLU
February 9, 2000
Regarding
House Bill 2690

Mr. Chairman, Members of the Committee, Thank you for opportunity to speak with you today regarding House Bill 2690.

I am Rick Friedstrom. I am licensed to sell life insurance, health insurance, and annuities in the state of Kansas. In addition, I am registered to sell mutual funds. I speak with you today as Legislative Chairman of the Kansas Association of Insurance and Financial Advisors (KAIFA). Our 1,500 insurance professionals sell a full range of insurance products throughout Kansas. In addition, many of our members sell equity-based life insurance and annuities. Our Association has worked with the Kansas Insurance Department since 1935 to craft legislation and regulation to protect the Kansas insurance consumer and the Kansas insurance agent.

Mr. Chairman, on behalf of KAIFA, we stand in opposition to this Bill.

We concur with opponent statements presented by previous conferees.

Members of the Committee, we do not feel it is appropriate to single out Variable Annuities for inclusion in regulation by the Securities Commissioner. We feel the regulation of Variable Annuities by the Kansas Department of Insurance is fair, adequate, and reasonable for the consumer and agent. In addition, the recent passage of the Gramm-Leach-Bliley Act provides for functional regulation of the various financial institutions. We feel the potential over-lapping regulation between the Kansas Department of Insurance and the Office of Securities Commissioner will not benefit the insurance consumer of Kansas.

Thank you!

Richard K. Friedstrom
2916 West 20th
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Testimony on House Bill 2690

Presented by Patrick J. Morris

Kansas Association of Insurance Agents

February 9, 2000 - House Financial Institutions Committee

Thank you Mister Chairman and members of the committee for the opportunity to appear in opposition to House Bill 2690 at today's hearing. I am Pat Morris, the Executive Vice President of the Kansas Association of Insurance Agents. Our association represents over 500 independent agency members across Kansas whose agencies employ nearly 3,000 people, most of whom are licensed agents.

While our members predominantly sell and service insurance products in the property and casualty arena of insurance, most also hold life licenses and all of our agents are very interested in proposals such as this bill that may confuse or complicate who or what agency in the government is responsible for regulating their activities. Of particular concern to our association, in an era of focused and specialized "de-regulation" and "consolidated regulation," is the push that seems to be implicit in this bill to establish a new system of "dual regulation" and "shared jurisdiction."

Our association was very involved at the national level in helping pass the Congressional Gramm-Leach-Bliley Act (P.L. 106-102), better known as S. 900 (The Financial Services Modernization Act) which had, as one of its base components, the streamlining of regulation in the financial services industry and a continuation of the McCarren-Ferguson Act which makes the business of insurance subject to state regulation via the state insurance commissioner. The push in that national legislation was to streamline future regulations, and this proposal seems to head in the opposite direction toward duplicative regulation. We would ask why the state legislature would be interested in adding an additional level of regulatory oversight for insurance agents, when the current regulatory structure appears to be working?

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Also, what is wrong with the system as it exists, that the Kansas Insurance Department feels compelled to give up the current law's specific mandate, that "(t)he commissioner shall have the sole and exclusive jurisdiction and authority to regulate the issuance and sale of such contracts..." Finally, what sort of plans or roadmap has been established to ensure that this new proposed system will have provisions built in to deal with potential conflicts and overlaps between regulating agencies?

In conclusion, I would point out to the committee that our association has been diligent in watching for ways to simplify the regulatory structures that hover above the insurance industry, and would ask that you examine the costs and complications of dual regulation versus the proposed benefits. For this reason, we would ask that you not support House Bill 2690.

Thank you again for the opportunity to appear at today's hearing.

**Testimony of Amy Lee, Vice President and Associate General Counsel of
Security Benefit Life Insurance Company**

**Before the Committee on Financial Institutions on
House Bill No. 2690**

February 9, 2000

Security Benefit Life Insurance Company ("Security Benefit") is a Kansas life insurance company located in Topeka, Kansas with approximately \$10 billion in assets under management. Security Benefit offers fixed and variable annuities, money management services, retirement plans and, through its subsidiary broker/dealer, Security Distributors, Inc., a family of mutual funds.

Security Benefit would like to comment on House Bill No. 2690, which would provide for the insurance commissioner and securities commissioner to share jurisdiction with regard to regulation of variable annuity contracts. Under current law, the insurance commissioner has *sole and exclusive* jurisdiction to regulate insurance products, including variable annuity contracts. We believe that such sole and exclusive jurisdiction is appropriate and should not be changed for the reasons discussed below.

Variable annuity contracts are considered hybrid products as they have aspects of both insurance and securities products. The long-standing approach to regulating such products has been regulation of the product as insurance at the state level and as securities at the federal level. This approach applies with regard to both regulation of the product and product sales. For example, before

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an insurer may offer a variable annuity contract for sale in Kansas, the form of the contract must be approved by the Kansas Insurance Department and a registration statement describing the contract must be filed and effective with the Securities and Exchange Commission ("SEC"). Similarly, before an individual may sell a variable annuity contract in Kansas, he or she must obtain a state insurance license from the Kansas Insurance Department and must be registered with the National Association of Securities Dealers, Inc. ("NASD").

The variable annuity industry is extensively regulated at both the state and federal level as discussed above. Before offering a variable annuity contract on a national basis, an insurer such as Security Benefit must have the form of annuity contract approved by the insurance departments of the fifty states and must have an effective registration statement on file with the SEC. Similarly, individuals who are selling the product must be licensed in those states in which they will solicit sales of variable annuity contracts and must be NASD registered. We believe that additional regulation of this industry should be advanced only if the current regulatory structure is not adequate. We are not convinced that such is the case.

Currently, the insurance commissioner may revoke an agent's license under the following circumstances¹:

- License was obtained by fraud or misrepresentation

- Agent misrepresented the provisions of an insurance or annuity contract
- Agent engaged in rebating or any inducement not contained in the insurance contract
- Agent intentionally omitted a material fact
- Agent made misleading representations or incomplete comparisons for the purpose of inducing a surrender of in-force insurance
- Agent has been convicted of a misdemeanor or felony involving fraud, deceit dishonesty, intent to defraud or intent to deprive
- Agent's license does not serve the interests of the insurer or the insurable interests of the public

We believe that the powers of the insurance commissioner as set forth above are sufficient to address any wrongdoing associated with the sale of variable annuity contracts. In addition, NASD rules similarly disqualify individuals from registration on the basis of dishonest conduct. In light of the tools available to the insurance commissioner and NASD with regard to regulation of sales of variable annuity contracts, we do not believe an additional regulator is necessary.

In conclusion, we ask that you consider whether a change in a long-standing regulatory structure is justified, taking into account the following:

¹ K.S.A. 40-242.

- Variable annuity industry is currently regulated by state insurance departments, SEC and NASD
- Current regulatory structure has sufficient tools to address bad conduct on the part of industry participants
- Additional regulation imposes a burden on business with very little, if any, incremental protection of the public

I appreciate the opportunity to share our views on this bill with you. We would be happy to address any questions that you may have.



Directed By The Members We Serve

House Committee on Financial Institutions & Insurance
Regarding HB 2754

February, 9 2000
Kansas Legislature

Presented by
Steve Handke
Community Bankers Association of Kansas

Good afternoon. My name is Steve Handke and I serve as CEO of the Union State Bank of Everest. Everest is a small town of 300 people located in northeast Kansas. Our bank has served the area residents of Atchison and Brown counties since 1902. Today I'm representing the Community Bankers Association of Kansas as a member of our State Legislative Committee. The Community Bankers Association is a statewide association composed of approximately 150 member banks that believe in community-based banking.

Thank you Mr. Chairman for the opportunity to appear before your Committee on Financial Institutions. House Bill 2754 makes a technical change in K.S.A 9-1102 (a)(2), which governs the real estate Kansas banks are allowed to hold.

K.S.A. 9-1102 was enacted in 1947 and a predecessor law can be traced back to 1897. Since 1947, the statute remained intact until it was amended in 1975 to its present form.

The present language contained in (a)(2) was added in the Senate Committee, and further amended in conference committee near the end of the 1975 session. Because of banks' difficulties in complying with a rigidly defined holding period, the inflexibility of the law has caused some problems over the years. These problems have been accentuated in recent years with our industry's movement in Kansas toward branch banking with multiple locations.

The operational problem with 9-1102(a)(2) is the defined beginning point of the seven-year holding period that a bank has to dispose of unneeded real estate. This beginning point in the current statute is set out as the date of acquisition. This language makes it virtually impossible for a bank to orderly dispose of a property that has been used for banking purposes for a number of years. In my testimony today, I am using just a few examples of the many times and different situations this section of K.S.A. 9-1102 has caused assets to be unnecessarily charged off of financial records.

The St. Marys State Bank is a good example of the difficulty in complying with the current statute. The bank had operated a drive up branch facility on real estate it had owned for more than seven (7) years. When management decided to relocate the facility, there was an immediate violation triggered by its date of acquisition. The only alternative available under the current statute was a forced sale of the property or charging the asset off the bank's books. In this case the book value of the facilities was substantial and a charge off would cause a serious distortion of the bank's general ledger. It certainly is not consistent with GAAP accounting principal to charge off a valuable asset.

(Over)

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The technical change offered in House Bill 2754 would have remedied this problem by allowing the bank management a period of 7 years from the date they decided to close the existing facility, or in essence the date the purpose of the facility changed.

Not only does the current statute cause compliance problems on sale of existing bank facilities, it also causes problems with state-chartered banks and their ability to purchase real estate for potential new locations. As Kansas banks more fully develop the branch-banking marketplace, they have a much different need in acquiring real estate for potential building sites than in 1975 when this statute was enacted. In 1975 one bank meant one location. This is vastly different than our branching interstate market place in Kansas today. A need for acquiring potential building sites is especially true in small communities, like Everest, where banks may only have the opportunity once every 10 years to purchase a choice site for an additional location.

Our bank encountered this type of difficulty with the statute when the board decided to expand the main facility. The bank had been land-locked on a corner location and shared a common wall with an adjoining building whose owner who was unwilling to sell at any reasonable price. Because of the unlikely possibility of ever purchasing the adjoining building, the bank had purchased a set of lots as a potential new building site. When the owner of the adjoining building decided to sell his building, the bank purchase it and expanded into the new building. This created a violation of the statute on the lots owned for a future building. As in the first example, this violation was triggered because the bank had owned the lots for more than seven (7) years. Again the proposed bill would have given the bank seven years after the change in intent to dispose of the lots, and not created the immediate violation.

The third and final industry example I would like to share is a situation that developed with the First Option Bank of Osawatomie. Gregg Lewis, President of the Bank recalled the problem as follows,

“The bank bought about 12-14 acres in 1992 and used approximately three (3) acres for a new bank building. There is a small creek and wooded area directly behind which runs east to west through the entire property. The bank tried selling the remaining 10.85 acres, but anyone that was interested kept running into snags when the city manager told them they would have to spend a fortune rerouting the water flow. One of the bank’s competitors had done just that, about a quarter of a mile east of our location. It cost them over \$250,000 in dirt work alone.

“First Option Bank eventually sold three acres of the best property to a group doing a retirement facility and (I) think the remaining property is pretty worthless with the city's requirements on drainage. At this point, the bank doesn’t know what they can do with the property.” [end quote]

This is an industry example of a bank not being able to buy the precise tract of real estate that it needed. As a result, it had to buy larger tract to obtain the desired location. The current statute makes it difficult to resolve such situations.

In conclusion, we ask you to report House Bill 2754 favorably. This small change will make the statute more operationally consistent with the current banking marketplace in Kansas.

Thank you for your time and consideration. Are there any questions?

Kansas Bankers Association

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Topeka, KS 66612

785-232-3444 Fax - 785-232-3484 kbacs@ink.org

2-9-00

TO: House Financial Institutions Committee

FROM: Chuck Stones

RE: HB 2754

Mr. Chair and Members of the Committee:

The Kansas Bankers Association appreciates the opportunity to appear before you in support of HB 2754.

HB 2754 would give additional flexibility to banks in dealing with their "other real estate owned" category of assets. We feel that this added flexibility might help a bank caught in the bounds of the current law avoid taking an unnecessary loss.

We urge your support of HB 2754.

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