Approved: 4-4-02
Date

MINUTES OF THE HOUSE COMMITTEE ON INSURANCE.

The meeting was called to order by Chairman Representative Robert Tomlinson at 3:30 p.m. on March 12, 2002 in Room 527-S of the Capitol.

All members were present except: Representative Gene O'Brien
Representative John Edmonds

Committee staff present: Bill Wolff, Legislative Research
Ken Wilke, Legislative Revisor
Mary Best, Administrative Assistant

Conferees appearing before the committee: Mr. Pat Mulvihill, Kansas Insurance Department
Ms. Linda DeCoursey, Kansas Insurance Department
Mr. David Hansen, Kansas Insurance Agents
Ms. Kathy Damron, Prudential Insurance Company

Others attending: See Attached Guest List

SB 388 - Insurance; Risk based capital requirements

Upon calling the meeting to order the Chairman recognized Mr. Pat Mulvihill, Kansas Insurance Department. Mr. Mulvihill gave Proponent Testimony to the committee on the above-mentioned bill. A copy of the written testimony is (Attachment # 1) attached hereto and incorporated into the Minutes by reference.

Mr. Mulvihill came before the committee with the proposed amendment to K.S.A. 40-2c01(j), which is the definition of "RBC" instructions for life and property and casualty insurance companies. He explained to the committee that "Risk-based capital" is a method used by the Kansas Insurance Department for several years for the means of evaluating financial solvency of insurance companies doing business in Kansas, and also for prescribing various forms of regulatory action used in the event that a company's RBC meets certain thresholds.

He continued on to discuss how companies are committed to filing financial reports with KID using certain instructions and formulas developed by the National Association of Insurance Commissioners. He then followed up with current law.

Mr. Mulvihill summarized his presentation by stating, "The Kansas Insurance Department believes that the passage of Senate Bill No. 388 would be beneficial in our efforts to monitor and regulate the insurance industry and would, in turn, be in the best interest of policyholders."

Questions were held until all testimony was presented.

The next Conferee was Ms. Linda DeCoursey, Kansas Insurance Department. Ms. DeCoursey offered Proponent Testimony and a copy of the written testimony is (Attachment # 2) attached hereto and incorporated into the Minutes by reference.

Ms DeCoursey brought forth another amendment to correct an oversight when the Uniform Licensing Act was passed last year. When combining the NAIC model law and K.S.A. 40-242 the word "*deny*" was inadvertently left out of paragraph (a) of the statute.

She stated the intent to have it included is made clear by the wording in the statute referring to "the applicant" in paragraph (a) of the statute as well as using "denies" in paragraph (f) of the statute. She had attached a copy of the balloon to her testimony and again made the request of the

committee to make the corrections.

Mr. David Hanson, Kansas Insurance Associations, was the next Conferee to offer Proponent Testimony to the committee. A copy of the testimony and three are (Attachments # 3,) attached hereto and included in the Minutes by reference.

Mr. Hanson also discussed what the "Risk Base Capital" program was all about. He stated they had requested the reference date in the statutory definition of "RBC instructions" so they would be able to make sure the adopted instructions and formula were limited to those which they had the opportunity to review. They were in hope that this would help hold back any future revisions, which would affect their companies "RBC" and the resulting action or control levels. His clients felt the instructions and formula that were going too significantly changed would be carefully considered before being adopted here in Kansas.

Mr. Hanson also offered a copy of the "changes to K.S.A. 40-428a", "Executive Summary for Proposal to Lower Minimum Nonforfeiture Rate," and the "Proposal for Reduction of Standard Nonforfeiture Rate Minimum for Individual Fixed Annuities."

Ms. Kathy Damron, Prudential Insurance Company, offered written testimony only. A copy of Ms. Damron's written testimony is (Attachment # 4) attached hereto and incorporated into the Minutes by reference. Ms. Damron wrote of her support for the bill and the amendments regarding the minimum annuity guarantee rate. She felt it "is important that insurers are able to offer product guarantees for added stability in the marketplace."

With the testimonies concluded, the committee was opened for questions to the conferees. The Chairman asked the Kansas Insurance Department if they were comfortable with the proposals, to which Linda DeCoursey stated they were.

SB 390: Reinsurance statute - information sharing by commissioner.

The next bill before the committee was **SB 390:** Reinsurance statute - information sharing by commissioner.

Mr. Patrick Mulvihill, Kansas Insurance Department, gave Proponent Testimony in the bill. A copy of the written testimony is (Attachment # 5) attached hereto and incorporated into the Minutes by reference.

Mr. Mulvihill explained the amendment to K.S.A. 40-221a allows consistency in the use of the term "qualified United States financial institution" throughout the statute, as defined in the National Association of Insurance Commissioners (NAIC) Credit for Reinsurance Model Law. He also stated they were currently amending a reinsurance regulation (K.A.R. 40-1-43) to incorporate additional language from the NAIC Credit for Reinsurance Model Regulation.

Mr. Mulvihill also included in his presentation information relating to K.S.A. 40-121a currently providing for Kansas domestic insurer taking reserve credit on business ceded to an unauthorized insurer in an amount not exceeding the amount of a letter of credit or the amount of funds that are held in a trust arrangement.

He also stated the definition of the term "qualified United States financial institution: has a different definition within the NAIC Credit for Reinsurance Model with regards to institutions that issue letters of credit versus an institution that holds funds under a trust agreement. Both definitions are incorporated into the proposed amendment to K.S.A. 40-211a.

He also stated the bill deletes a provision in K.S.A. 221-a prohibiting title insurance companies from being able to take reserve credit business ceded to an unauthorized insurer under alternatives, set for in K.S.A. 40-221a, that are available now to other types of insurance companies. The proposal deletes this provision making the playing field more even.

Mr. Mulvihill stood for questions. The Revisor had a question about adoption of the regulation before July 9, 2002. There were no further questions. Public hearings were closed on the bill.

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

The Chairman called the attention of the committee to **SB 390** and the committee's pleasure on the bill. Representative Grant made the motion to pass out the bill marked favorably for passage, and place on consent. Representative McCreary seconded the motion. There was no discussion. The vote was taken and the motion passed.

The committee's attention was then next called to **SB 388** -Insurance; Risk-based capital requirements. There were amendments on this bill. Representative Vickery made the motion to adopt the amendments and balloon. Representative Dreher seconded the motion. There was no discussion and the motion passed. Representative Grant made the motion to pass the bill out as amended, Representative Toelkes seconded the motion. There was no discussion and the motion passed.

Chairman Tomlinson then called the committee's attention to **HB 2879** - Automobile insurance - cancellation of policy for nonpayment of dues to organization. The Revisor brought forth a technical amendment showing changes in lines 35 through 37. A copy of the amendment is (Attachment # 6) attached hereto and incorporated into the Minutes by reference. Other changes were words stricken from line 16, and three words stricken from line 19. There was no further discussion. Representative Vickery made the motion to amend the bill with the balloon. The motion was seconded by Representative Sharp. There was no discussion. The vote was taken and the motion carried. Back on the bill Representative Phelps made the motion to pass the bill out as amended marked favorable for passage. Representative Ostmeyer seconded the motion. There was some discussion with Representative Kirk. The vote was taken and the motion carried.

The next item for business was the approval of the Minutes for February 5,12, 19. The motion was made by Representative Sharp to accept the Minutes as they are. Representative Toelkes seconded the motion. The motion carried.

With no further business the meeting was adjourned. Time 4:05 p.m.

The next meeting is scheduled for March 14, 2002.

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

HOUSE INSURANCE COMMITTEE GUEST LIST

DATE: March 12, 2002

NAME	REPRESENTING
Tony Kimmi	Farm Bureau Mutual Ins. Co
David Hanson	Ks Insur. Assns.
Robert Choromanski	KTLA
Linda De Coursey	Ks Ins. Dept
Pat Mulvihill	Ks Ins. Dept
Terry Tiede	American Investors Life
Larry Bruning	American Investors Life
Kellen Brennan	Security Benefit Group
Bill Sneed	Amerus Fin.
Chris Collins	KMS
Kevin Davis	
Larry Magill	KAIA
Bonnie Van Roner	KAHP
Cecilia Harris	Leadership Dickinson County
Rosemary Harris	Leadership Dickinson County

Kathleen Sebelius
Commissioner of Insurance
Kansas Insurance Department

March 12, 2002

TO: House Committee on Insurance

FROM: Patrick J. Mulvihill
Assistant Director, Financial Surveillance Division

RE: S.B. 388 – RBC Instructions

Mr. Chairman and members of the Committee:

Thank you for the opportunity to discuss Senate Bill No. 388 with you. This bill proposes to amend K.S.A. 40-2c01(j), which is the definition of "RCB instructions" for life and property and casualty insurance companies.

Risk-based capital (RBC) is a method that has been used by the Kansas Insurance Department for several years to evaluate the financial solvency of insurance companies doing business in this state. The RBC statutes also prescribe various forms of regulatory action that may be taken, or shall be taken, in the event that a company's calculated RBC meets certain thresholds.

Companies must file financial reports with the Department by using RBC instructions and formulas developed by the National Association of Insurance Commissioners (NAIC). These instructions, including the formulas, are amended each year to address various matters, such as changes to line references in the annual statement blanks and to reflect any necessary modification or adjustments to the formulas.

420 SW 9th Street
Topeka, Kansas 66612-1678

785 296-3071
Fax 785 296-2283

Printed on Recycled Paper

HOUSE INSURANCE
DATE: March 12, 2002
ATTACHMENT # 1

The current law requires companies to use the December 31, 2000 version of the "RBC instructions". Senate Bill No. 388 would reflect a change in the date of the standard so that companies would use the "RBC instructions", including the formulas, in effect as of December 31, 2001.

Summary

The Kansas Insurance Department believes that the passage of Senate Bill No. 388 would be beneficial in our efforts to monitor and regulate the insurance industry and would, in turn, be in the best interests of policyholders.

Kathleen Sebelius
Commissioner of Insurance
Kansas Insurance Department

March 12, 2002

TO: House Committee on Insurance

FROM: Linda J. De Coursey, Director of Government Affairs

RE: HB 388 – RBC Instructions

Mr. Chairman and members of the Committee:

The Kansas Insurance Department would like to amend HB 388 to correct another situation that we just discovered that is a chapter 40 issue, but not one pertaining to RBC.

Last year when we passed the uniform licensing act, we repealed our previous law dealing with the denial of an agent's license (K.S.A. 40-240). K.S.A. 40-4909 is a combination of our old disciplinary statute (K.S.A. 40-242) and the NAIC model law and includes the denial of licenses. However, the word *deny* was inadvertently left out of paragraph (a) of the statute. Yet, the intent to have it there is made clear by the statute referring to "the applicant" in paragraph (a) of the statute as well as using "denies" in paragraph (f) of the statute. Therefore, we would like to make the following amendment to K.S.A. 40-4909(a): The commissioner may *deny,* suspend, revoke or refuse renewal of any license issued under this act if the commissioner finds that the applicant or license holder has…

I have attached a balloon for the suggested amendment, and appreciate your consideration for this amendment.

420 SW 9th Street
Topeka, Kansas 66612-1678

785 296-3071
Fax 785 296-2283
Printed on Recycled Paper
Consumer Assis
1 800 432-2484

HOUSE INSURANCE
DATE: March 12, 2002
ATTACHMENT # 2

40-4909. Same; suspension revocation or refusal to renew license; grounds; hearing; powers of commissioner. (a) The commissioner may **deny,** suspend, revoke or refuse renewal of any license issued under this act if the commissioner finds that the applicant or license holder has:

(1) Provided incorrect, misleading, incomplete or untrue information in the license application.

(2) Violated:

(A) Any provision of chapter 40 of the Kansas Statutes Annotated, and amendments thereto, or any rule and regulation promulgated thereunder;

(B) any subpoena or order of the commissioner;

(C) any insurance law or regulation of another state; or

(D) any subpoena or order issued by the regulatory official for insurance in another state.

(3) Obtained or attempted to obtain a license under this act through misrepresentation or fraud.

(4) Improperly withheld, misappropriated or converted any moneys or properties received in the course of doing insurance business.

(5) Intentionally misrepresented the provisions, terms and conditions of an actual or proposed insurance contract or application for insurance.

(6) Been convicted of a misdemeanor or felony.

(7) Admitted to or been found to have committed any insurance unfair trade practice or fraud in violation of K.S.A. 40-2404 and amendments thereto.

(8) Used any fraudulent, coercive, or dishonest practice, or demonstrated any incompetence, untrustworthiness or financial irresponsibility in the conduct of business in this state or elsewhere.

(9) Had an insurance agent license, or its equivalent, denied, suspended or revoked in any other state, district or territory.

(10) Forged another person's name to an application for insurance or to any document related to an insurance transaction.

(11) Improperly used notes or any other reference material to complete an examination for an insurance license issued under this act.

(12) Knowingly accepted insurance business from an individual who is not licensed.

(13) Failed to comply with any administrative or court order imposing a child support obligation upon the applicant or license holder.

(14) Failed to pay any state income tax or comply with any administrative or court order directing payment of state income tax.

(15) Rebated the whole or any part of any insurance premium or offered in connection with the presentation of any contract of insurance any other inducement not contained in the contract of insurance.

(16) Made any misleading representation or incomplete comparison of policies to any person for the purposes of inducing or tending to induce such person to lapse, forfeit or surrender such person's insurance then in force.

(b) In addition, the commissioner may suspend, revoke or refuse renewal of any license issued under this act if the commissioner finds that the interests of the insurer or the insurable interests of the public are not properly served under such license.

(c) Any action taken under this section which affects any license or imposes any administrative penalty shall be taken only after notice and an opportunity for a hearing conducted in accordance with the provisions of the Kansas administrative procedures act.

(d) The license of any business entity may be suspended, revoked or refused renewal if the insurance commissioner finds that any violation committed by an individual licensee employed by or acting on behalf of such business entity was known by or should have been

known by one or more of the partners, officers or managers acting on behalf of the business entity and:

(1) Such violation was not reported to the insurance commissioner by such business entity; or

(2) such business entity failed to take any corrective action.

(e) None of the following actions shall deprive the commissioner of any jurisdiction or right to institute or proceed with any disciplinary proceeding against such license, to render a decision suspending, revoking or refusing to renew such license, or to establish and make a record of the facts of any violation of law for any lawful purpose:

(1) The imposition of an administrative penalty under this section;

(2) the lapse or suspension of any license issued under this act by operation of law;

(3) the licensee's failure to renew any license issued under this act; or

(4) the licensee's voluntary surrender of any license issued under this act. No such disciplinary proceeding shall be instituted against any licensee after the expiration of two years from the termination of the license.

(f) Whenever the commissioner imposes any administrative penalty or denies, suspends, revokes or refuses renewal of any license pursuant to subsection (a), any costs incurred as a result of conducting an administrative hearing authorized under the provisions of this section shall be assessed against the person who is the subject of the hearing or any business entity represented by such person who is the party to the matters giving rise to the hearing. As used in this subsection, "costs" shall include witness fees, mileage allowances, any costs associated with the reproduction of documents which become a part of the hearing record and the expense of making a record of the hearing.

(g) No person whose license as an agent or broker had been suspended or revoked shall be employed by any insurance company doing business in this state either directly, indirectly, as an independent contractor or otherwise to negotiate or effect contracts of insurance, suretyship or indemnity or perform any act toward the solicitation of or transaction of any business of insurance during the period of such suspension or revocation.

(h) In lieu of taking any action under subsection (a), the commissioner may:

(1) Censure the person; or

(2) issue an order imposing an administrative penalty up to a maximum of $500 for each violation but not to exceed $2,500 for the same violation occurring within any six consecutive calendar months from the date of the original violation unless such person knew or should have known that the violative act could give rise to disciplinary action under subsection (a). If such person knew or reasonably should have known the violative act could give rise to any disciplinary proceeding authorized by subsection (a), the commissioner may impose a penalty up to a maximum of $1,000 for each violation but not to exceed $5,000 for the same violation occurring within any six consecutive calendar months from the date of the imposition of the original administrative penalty.

KANSAS INSURANCE ASSOCIATIONS

DAVID A. HANSON, LEGISLATIVE COUNSEL
800 S.W. JACKSON, SUITE 900
TOPEKA, KS 66612-1259

TELEPHONE NO. (785) 232-0545
FAX NO. (785) 232-0005

House Insurance Committee
Testimony on Senate Bill 388
Presented by David A. Hanson

March 12, 2002

Kansas Association of Property & Casualty Ins. Cos.

Member Companies:

Armed Forces Insurance Exchange
Ft. Leavenworth

Bremen Farmers Mutual Insurance Co.
Bremen

Columbia Insurance Group
Salina

Farm Bureau Mutual Insurance Company
Manhattan

Farmers Alliance Mutual Insurance Company
McPherson

Farmers Mutual Insurance Co.
Ellinwood

Federated Rural Electric Insurance Exchange
Lenexa

Kansas Mutual Insurance Co.
Topeka

Marysville Mutual Insurance Co.
Marysville

Mutual Aid Association of the Church of the Brethren
Abilene

Mutual Aid eXchange
Overland Park

Upland Mutual Insurance Co.
Chapman

Kansas Life Insurance Association

Member Companies:

The American Home Life Insurance Company
Topeka

American Investors Life Insurance Company
Topeka

Employers Reassurance Corporation
Overland Park

First Life America Corpora
Topeka

Kansas Blue Cross/Blue Sh
Topeka

Preferred Health Systems
Wichita

The Pyramid Life Insurance Company
Shawnee Mission

Security Benefit Life Insura Company
Topeka

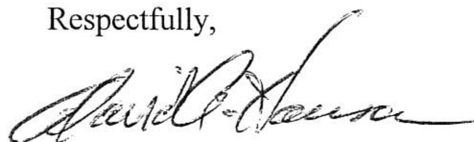
Chairman Tomlinson and Members of the Committee:

Thank you for this opportunity to present information on behalf of the Kansas Association of Property and Casualty Insurance Companies and the Kansas Life Insurance Association, whose members are domestic insurance companies in Kansas.

The risk-based capital provisions referenced in Senate Bill 388 were developed by the NAIC for adoption and use by the states as a standardized method of monitoring the solvency of insurers and assessing the need for corrective action. We had requested the reference date in the statutory definition of "RBC instructions" to make sure that the adopted instructions and formula were limited to those that we had had an opportunity to review, rather than potential future revisions, which could adversely affect our companies' risk-based capital and the resulting action or control levels. While we believe our companies' remain in good standing under the previously adopted NAIC instructions and formula, we also believe any significant changes in those instructions and formula by the NAIC should be carefully considered before adoption in Kansas.

Our companies have been reviewing the proposed changes and we do not believe there will be any substantial adverse effect from the latest revisions referred to in the Bill before you. Thank you for your consideration.

Respectfully,



DAVID A. HANSON

F:\PROGRAMS\WPWIN60\SEC'Y\Crystal\Ltrs\TestBill388.HOUSE.wpd

HOUSE INSURANCE
DATE: March 12, 2002
ATTACHMENT # 3

40-428a. ~~Standard—nonforfeiture—law for individual deferred annuities~~. (a) This section shall be known as the standard nonforfeiture l[illegible] for individual deferred annuities.

[illegible] This section shall not apply to any reinsurance, group annuity purchased under a retirement plan or plan of deferred compensation established or maintained by an employer (including a partnership or sole proprietorship) or by an employee organization, or by both, other than a plan providing individual retirement accounts or individual retirement annuities under section 408 of the internal revenue code, as now or hereafter amended, premium deposit fund, variable annuity, investment annuity, immediate annuity, any deferred annuity contract after annuity payments have commenced, or reversionary annuity, nor to any contract which shall be delivered outside this state through an agent or other representative of the company issuing the contract.

(c) In the case of contracts issued on or after the operative date of this section as defined in [subsection (1)] paragraph (1) of this subsection no contract of annuity, except as stated in subsection (b), shall be delivered or issued for delivery in this state unless it contains in substance the following provisions, or corresponding provisions which in the opinion of the commissioner are at least as favorable to the contract-holder, upon cessation of payment of considerations under the contract.

(1) That upon cessation of payment of considerations under a contract, the company will grant a paid-up annuity benefit on a plan stipulated in the contract of such value as is specified in subsection (e), (f), (g), (h), and (j).

(2) If a contract provides for a lump sum settlement at maturity, or at any other time, that upon surrender of the contract at or prior to the commencement of any annuity payments, the company will pay in lieu of any paid-up annuity benefit a cash surrender benefit of such amount as is specified in subsections (e), (f), (h), and (j). The company shall reserve the right to defer the payment of such cash surrender benefit for a period of six [(6)] months after demand therefor with surrender of the contract.

(3) A statement of the mortality table, if any, a[illegible] [illegible]rest rates used in calculating any minim[illegible] paid-up annuity, cash surrender or death benefits that are guaranteed under the contract,

together with sufficient information to determine the amounts of such benefits.

(4) A statement that any paid-up annuity, cash surrender or death benefits that may be available ur he contract are not less than the minimum be s required by any statute of the state in which the contract is delivered and an explanation of the manner in which such benefits are altered by the existence of any additional amounts credited by the company to the contract, any indebtedness to the company on the contract or any prior withdrawals from or partial surrenders of the contract. Notwithstanding the requirements of this subsection, any deferred annuity contract may provide that if no considerations have been received under a contract for a period of two [(2)] full years and the portion of the paid-up annuity benefit at maturity on the plan stipulated in the contract arising from considerations paid prior to such period would be less than [twenty dollars ($20)] monthly, the company may at its option terminate such contract by payment in cash of the then present value of such portion of the paid-up annuity benefit, calculated on the basis of the mortality table, if any, and interest rate specified in the contract for determining the paid-up annuity benefit, and by such payment shall be relieved of any further obligation under such contract.

[$20

(d) The minimum values as specified in subsections (e), (f), (g), (h) and (j) of any paid-up annuity, cash surrender or death benefits available under an annuity contract shall be based upon minimum nonforfeiture amounts as defined in this subsection.

(1) With respect to contracts providing for flexible considerations, the minimum nonforfeiture amount at any time at or prior to the commencement of any annuity payments shall be equal to an accumulation up to such time at a rate of interest of [three percent (3%)] per annum of percentages of the net considerations (as hereinafter defined) paid prior to such time, decreased by the sum of

[3%

[(A)

[(i)] Any prior withdrawals from or partial surrenders of the contract accumulated at a rate of interest of [three percent (3%)] per annum, and

[3%

[(ii)] the amount of any indebtedness to the company on the contract, including interest due an ied, and increased by any existing additio nounts credited by the company to the contract.

[(B)

... minimum nonforfeiture amount shall be an amount not less than zero and shall be equal to the corresponding gross considerations credited to the contract during that contract year less an annual contract charge of [thirty ($30)] and less a collection charge of [one and twenty-five cents ($1.25)] per consideration credited to the contract during that contract year. The percentages of net considerations shall be [sixty-five percent (65%)] of the net consideration for the first contract year and [eighty-seven and one-half percent (87 ½%)] of the net considerations for the second and later contract years. Notwithstanding the provisions of the preceding sentence, the percentage shall be [sixty-five percent (65%)] of the portion of the total net consideration for any renewal contract year which exceeds by not more than two times the sum of those portions of the net considerations in all prior contract years for which the percentage was [sixty-five percent (65%)].

$30

$1.25

65%

87.5%

65%

65%.
Notwithstanding any other provision of this paragraph, for any contract issued on or after July 1, 2002 and before July 1, 2005, the interest rate at which net considerations, prior withdrawals and partial surrenders shall be accumulated, for the purpose of determining nonforfeiture amounts, shall be 1.5% per annum.

(2) With respect to contracts providing for fixed scheduled considerations, minimum nonforfeiture amounts shall be calculated on the assumption that considerations are paid annually in advance and shall be defined as for contracts with flexible considerations which are paid annually with two exceptions:

[(a)] The portion of the net consideration for the first contract year to be accumulated shall be the sum of [sixty-five percent (65%)] of the net consideration for the first contract year plus [twenty-two and one-half percent (22 ½%)] of the excess of the net consideration for the first contract year over the lesser of the net considerations for the second and third contract years.

[(b)] The annual contract charge shall be the lesser of (i) [thirty dollars ($30)] or (ii) [ten percent (10%)] of the gross annual consideration.

(A)

65%

22.5%

(B)

$30

10%

(3) With respect to contracts providing for a single consideration, minimum nonforfeiture amounts shall be defined as for contracts with flexible considerations except that the percentage of net consideration used to determine the minimum nonforfeiture amount shall be equal to [ninety percent (90%)] and the net consideration shall be the gross consideration less a contract charge of [seventy-five dollars ($75)].

90%

$75

(e) ... paid-up annuity benefit available under a ... contract shall be such that its present value

on the date annuity payments are to commence is at least equal to the minimum nonforfeiture amount on that date. Such present value shall be computed using the mortality table, if any, and the interest rate specified in the contract for determining the minimum paid-up annuity benefits guaranteed in the contract.

(f) For contracts which provide cash surrender benefits, such cash surrender benefits available prior to maturity shall not be less than the present value as of the date of surrender of that portion of the maturity value of the paid-up annuity benefit which would be provided under the contract at maturity arising from considerations paid prior to the time of cash surrender reduced by the amount appropriate to reflect any prior withdrawals from or partial surrenders of the contract, such present value being calculated on the basis of an interest rate not more than [one percent (1%)] higher than the interest rate specified in the contract for accumulating the net considerations to determine such maturity value, decreased by the amount of any indebtedness to the company on the contract, including interest due and accrued, and increased by any existing additional amounts credited by the company to the contract. In no event shall any cash surrender benefit be less than the minimum nonforfeiture amount at that time. The death benefit under such contracts shall be at least equal to the cash surrender benefit.

1%

(g) For contracts which do not provide cash surrender benefits, the present value of any paid-up annuity benefit available as a nonforfeiture option at any time prior to maturity shall not be less than the present value of that portion of the maturity value of the paid-up annuity benefit provided under the contract arising from considerations paid prior to the time the contract is surrendered in exchange for, or changed to, a deferred paid-up annuity, such present value being calculated for the period prior to the maturity date on the basis of the interest rate specified in the contract for accumulating the net considerations to determine such maturity value, and increased by any existing additional amounts credited by the company to the contract. For contracts which do not provide any death benefits prior to the commencement of any annuity payments, such present values shall be calculated on the basis of such interest rate and the mortality table specified in the contract for determining the maturity value of the paid-up annuity benefit. However, in no event

... the present value of a paid-up annuity benefit be less than the minimum nonforfeiture amount at that time.

(h) For the purpose of determining the benefits calculated under subsections (f) and (g), in the case of annuity contracts under which an election may be made to have annuity payments commence at optional maturity dates, the maturity date shall be deemed to be the latest date for which election shall be permitted by the contract, but shall not be deemed to be later than the anniversary of the contract next following the annuitant's seventieth birthday or the tenth anniversary of the contract, whichever is later.

(i) Any contract which does not provide cash surrender benefits or does not provide death benefits at least equal to the minimum nonforfeiture amount prior to the commencement of any annuity payments shall include a statement in a prominent place in the contract that such benefits are not provided.

(j) Any paid-up annuity, cash surrender or death benefits available at any time, other than on the contract anniversary under any contract with fixed scheduled considerations, shall be calculated with allowance for the lapse of time and the payment of any scheduled considerations beyond the beginning of the contract year in which cessation of payment of considerations under the contract occurs.

(k) For any contract which provides, within the same contract by rider or supplemental contract provision, both annuity benefits and life insurance benefits that are in excess of the greater of cash surrender benefits or a return of the gross considerations with interest, the minimum nonforfeiture benefits shall be equal to the sum of the minimum nonforfeiture benefits for the annuity portion and the minimum nonforfeiture benefits, if any, for the life insurance portion computed as if each portion were a separate contract. Notwithstanding the provisions of subsections (e), (f), (g), (h) and (j), additional benefits payable (1) in the event of total and permanent disability, (2) as reversionary annuity or deferred reversionary annuity benefits, or (3) as other policy benefits additional to life insurance, endowment, and annuity benefits, and considerations for all such additional benefits shall be disregarded in ascertaining the minimum nonforfeiture amounts, paid-up annuity, cash surrender and death benefits that may be required by this section. The inclusion of such additional benefits shall not be required in any paid-up benefits, unless such additional benefits separately would require minimum nonforfeiture amounts, paid-up annuity, cash surrender and death benefits.

(l) After July 1, 1978, any company may file with the commissioner a written notice of its election to comply with the provisions of this section after a specified date before July 1, 1980. After the filing of such notice, then upon such specified date, which shall be the operative date of this section for such company, this section shall become operative with respect to annuity contracts thereafter issued by such company. If a company makes no such election, the operative date of this section for such company shall be July 1, 1980.

History: L. 1978, ch. 175, § 4; July 1.

EXECUTIVE SUMMARY FOR PROPOSAL TO LOWER MINIMUM ANNUITY NONFORFEITURE RATE

Background:

- The 3% guarantee was adopted by the NAIC in 1976. Then, the benchmark Five Year Treasury yield was between 7 and 7.5%, having risen above 8% during the two prior years. Today, the yield on Five Year Treasuries is around 4%.
- The NAIC rate was adopted with the full expectation that interest rates would remain high and that Treasury yields would never return to the 4 to 6% range of the early 1960's.
- Treasury yields are currently at the low end of that 1960's range.
- On December 11, 2001, the Federal Reserve cut short-term interest rates below 2% for the first time in forty years.

Interest Rates Must Be Reduced:

- In the mid-1970's, Treasury rates ranged between 3 to 4.5% higher then the 3% guarantee. Today, Five Year Treasuries are now less than one percent above the minimum. One Year Treasuries are below the minimum. Negative spreads are a reality.
- Japan is illustrative of the potential consequences. Since 1997, at least eight Japanese insurers, seven of them life, have become insolvent or entered rehabilitation. Six have failed since January 2000. A significant contributor to these failures has been negative spreads.
- Responsible planning requires that regulators and insurers account for the (perhaps) low probability but extremely high severity of a continuing low interest rate environment.

Risks of Inaction:

- Loss of consumer choice.
- Disintermediation-To meet their obligations, insurers may be required to invest in longer term maturities. Disintermediation will occur if rates rise.
- Arbitrage-Consumers will park their money at 3%.

Two-Pronged Proposal:

- Immediate legislative reduction of nonforfeiture minimum rate to 1.5% in states. Successful 2002 legislative activity, supported by the NAIC, will allow companies to offer appropriate guarantees about '03. The potential risks associated with legislative delay are high.
- NAIC to consider a long-term rate dynamic solution for subsequent adoption.

PROPOSAL FOR REDUCTION OF STANDARD NONFORFEITURE RATE MINIMUM FOR INDIVIDUAL FIXED ANNUITIES

I. Issue:

The 3% minimum interest rate guarantee required by the Standard Nonforfeiture Law ["SNFL"] for Individual Deferred Annuities is incompatible with the current low interest rate environment which may extend for a protracted time.

II. Contrast of Era Triggering Adoption of 3% SNFL Minimum with Current Realities:

A. Historical Context For Three Percent [3%] Choice:

The 3% "floor" for annuities in SNFL was adopted by the NAIC in December of 1976. Since late 1972 the Five Year Treasury Rate, a benchmark for annuity credited rates, had remained well over 6%, attained mid 8% levels repeatedly during '74 and '75, and was hovering at the time of the NAIC's action in the 7 – 7 ½% range[1]. Prior to 1976, the individual deferred annuity market was small; few states even had a nonforfeiture law applicable to annuities, and those which did generally required a nonforfeiture minimum lower than 3%[1].

In the mid 1970's, the predominant expectation--and the paradigm under which most regulators and economists operated--was that of continuing higher interest rates and potential inflation. A draft proposal from the ACLI at that time stated,

> "Economists generally indicate that interest rates are likely to continue to fluctuate around their current high levels [then around 7.5% for 5 year Treasury Bills] for the indefinite future. Therefore, it is recommended that the statutory interest rates in the Standard Valuation and Nonforfeiture Laws ***again be increased*** [emphasis added] to bring these laws more into line with current economic realities and with those of the foreseeable future."[2]

The 1970's "mindset" that higher interest rates would continue as the norm for the foreseeable future was also documented in the following NAIC Proceedings text:

> "Economists today generally view long-term interest rates as consisting of two parts, a basic "real" rate of interest and an inflation premium. The

---

[1] NAIC Proceedings – 1976 Vol. 2. Attachment E-1, at page 628.
[2] NAIC Proceedings – 1977 Vol. I, Attachment G4, at page 600

basic "real" rate of interest...has remained relatively stable over several decades at about 3 ½%. However, some economists believe that a growing capital shortage may push the basic "real" rate about **one-half percent higher** in future years ...Translating expectations of inflation averaging about 5 ½% and a basic "real" rate of return on capital of 3 ½% or more into yields on high grade long term bones leads most economists to believe that yields will be in the 8% or 9% range for the foreseeable future. **In fact there is a general consensus among economists that we are unlikely ever again to see the 4% to 6% yields that characterized high grade bonds during the 1960's** [emphasis added]."[3]

NAIC testimony portrays the environment within which regulators chose 3% as a true "floor" [that bottom level below which nothing can reasonably go] for nonforfeiture rates. Such minimum was the result of the open acknowledgment that the threshold assumption of any future "real" rate of interest available to the insurer would always be at least 3 ½%. Three percent was fifty basis points **below** that threshold. The 3% legislative mandate was therefore an intentionally conservative floor, chosen with the expectation that it would never be reached.

B. Today's Realities:

- Today, the five year Treasury rate --at 7 ½% in 1977-- now hovers around 4%.
- On December 11th, the Federal Reserve cut short-term interest rates below 2% for the first time in 40 years;
- Federal regulators "left the door open for more cuts, signaling that while officials see glimmers of hope, they remain skeptical of the idea that the recession is almost over."[4]
- The Federal Reserve cut rates eleven [11] consecutive times during 2001[5].
- The eleven cuts are the most in any one calendar year since the Fed started targeting the federal funds rate as an instrument of monetary policy in the 1970s.[6]
- Each decrease during 2001 was either 25 basis points or 50 basis points.
- Cumulative reductions during 2001 totaled 4.75 percentage points.[7]

III. Key Factors Driving the Need for Change

A. Loss of Acceptable Range Between Imposed Minimums and Current Market Rates:

---

[3] Ibid. at page 602
[4] Greg Ip, *Fed Slices Interest Rates to 1.75%, Leaves Door Open for More Cuts*, WSJ, December 12, 2001 ["Ip article"]
[5] Ibid.
[6] *Fed cuts rates a quarter point*, CNNfn, December 11, 2001
[7] Ip article

The following graphs compare Treasury Rates [One and Five Year, separately] in effect from 2000 through 2001, in relationship to the required minimum rate of 3%, as well as to an alternative minimum rate of 1 ½%.

Min_Guar_1227.xls

Also displayed in each graph are three "adjusted minimums" from identified time periods leading to the adoption of the 3% SNFL minimum; the "Assumptions" page on the attached document lists the average interest rate for each of the three periods. These three entries in each graph illustrate the established relationship during the mid 1970s between then-current Treasury Rates and the required SNFL minimum, as well as the erosion in the past year of such range between current Treasury Rates and the mandated 3%.

For example the average Five Year Treasury Rate in 1975-1976 was 7.25%; that number, minus the minimum mandated 3%, is 4.25%. That result [4.25%] is the "constant" difference between the mid-70's current and the mandated minimum rate. As shown in the graphs, during the early to mid 1970s, then-current One Year and Five Treasury Rates were **always higher** than the mandated minimum SNFL rate by a range of about 3 to 4 ½ %.

In contrast, consider the relationship during the years 2000-2001 between the current One Year/Five Year Treasury Rates and the mandated 3% minimum. In the Five Year graph, the gap between Treasury rates and that minimum shrank from about 3 ½% at the beginning of 2000, to as little as ½% in late 2001. The One Year Treasury rates, while more volatile, hovered around 3% higher than the minimum until 2001, at which time rates plunged to **below the minimum required by the SNFL** by about one percentage point.

These charts, in simplified fashion, illustrate the significant breach of an "acceptable" gap between Treasury rates and interest minimum requirements. Such erosion acts to negate a threshold aspect of annuity product designs during the last 30 years.

B. Japan Offers a Further Illustration of the Potential Consequences of the Problem

Since 1997, at least eight Japanese insurers, seven of them life, have either become insolvent or entered rehabilitation; six have failed since January 2000[8]. As a result, benefits to more than 10 million policies, previously guaranteed, have been reduced.[9]

---

[8] Michael Freeman and Masahiko Fujiki, Ph.D. *Why Some Japanese Insurers Are Failing*, Emphasis Magazine, 2001/3

[9] Ibid.

A significant contributor to these failures is the cumulative effects of "negative spreads". Japanese insurers have faced a prolonged period during which market yields on fixed income instruments were 200 or more basis points below their own contractual guarantees. In June of 2001, Japan's top 10 life insurers reported declines in their solvency margins, "the result of severe business conditions marked by negatives spreads between their guaranteed yields to policyholders and returns on their own investments". [10]

While significant differences exist between the situations of Japanese financial services organizations versus those within the US, Japan's experiences offer thought-provoking insight re: potential consequences of a protracted low interest rate environment.

C. Responsible Planning for Low Probability/High Severity Event

Given the historic lows and high volatility of recent interest rates, fluctuations in the stock market and other problematic economic indicators, it is of course not possible to state with absolute certainty whether interest rate levels, going forward, will remain dramatically low. As part of responsible planning for future contingencies, however, insurers **must** be prepared for the [perhaps] low probability but extremely high severity impact of interest rates remaining low and perhaps dropping lower. Japan is a sobering object lesson of problems to be faced by insurers forced, in a protracted low interest rate environment, to offer contractual minimums in excess of actual market rates.

Going forward, it is important to note that experts disagree as to the prospects for a recovery or on the direction of interest rates. The Wall Street Journal recently noted:

> Trading in the futures markets suggests that investors put 38% odds on another quarter point cut at the Fed's Jan.29-30 meeting, and that they expect the Fed to start raising rates during the second quarter. That puzzles many economists who **expect the Fed to at least keep rates low through most of the next year, if not to continue cutting** [emphasis added]. "It's hard to find the individuals who have the actual policy expectations that seem to be implied by market rates", said Lou Crandall, chief economist at Wrightson Associates, a fixed-income research concern.[11]

IV. Risks Triggered By Maintenance of Three Percent Minimum

- Potential loss of consumer choice in annuity marketplace both of certain, usually shorter duration contract designs and "consumer friendly" contract options, such as surrender penalty free withdrawals.

---

[10] Takeshi Sato, *Major Life Insurers' solvency margins decline*, Kyoto News Service, June 4, 2001

[11] Ip article

- Disintermediation: as interest rates remain low in relation to required contract minimums, companies may be forced, especially with today's steep yield curve, to invest in longer maturities in order to support the 3% guaranteed rate. This triggers disintermediation risk if rates subsequently rise.
- Arbitrage against insurers as the interest rate floor becomes more meaningful to savvy contractholders.

V. Two-Pronged Proposal:

- Immediately change the nonforfeiture law to lower the required interest rate to 1½ % on new products **[in force contracts are not at issue]**; and
- Initiate a study at the NAIC of a more durable solution, which would include consideration of an indexed approach.

VI. Need For Immediate Legislative Action:

Legislative action is required during 2002 within the states to lower the minimum annuity guarantee rate to 1 ½%, with the acknowledgment that such statutory reduction must include a provision for a longer term solution to make the minimum fluctuate responsively between its current 3% and the proposed 1 ½ %, as market forces alter.

VII. Timing:

NAIC support of responsive state legislation to lower the interest rate during the 2002 legislative season is requested, so that insurers can offer appropriate product guarantees beginning about 2003. Delay of legislative action beyond 2002 will trigger delay to necessary relief.

Kathy
Damron

(785) 235-2525
800 SW JACKSON STREET, SUITE 1100
Topeka, Kansas 66612-2205
(785) 354-8092 FAX
E-MAIL: MKDTopeka@aol.com

House Insurance Committee
Testimony on behalf of
Prudential Insurance Company
Supporting Amendments to
Senate Bill 388

Chairman Tomlinson and
Members of the House Insurance Committee:

I appreciate having the opportunity to submit testimony supporting Senate Bill 388 and the amendments regarding the minimum annuity guarantee rate. This support is expressed on behalf of The Prudential Insurance Company. The lowering of this rate is a reflection of today's realities in the economy. Those factors have been clearly articulated in the memo distributed by the Kansas Insurance Associations as prepared by the American Council of Life Insurers (ACLI) and attached to the testimony of Mr. Dave Hanson. It is important that insurers are able to offer product guarantees for added stability in the marketplace.

HOUSE INSURANCE
DATE: March 12, 2002
ATTACHMENT # 4

Kathleen Sebelius
Commissioner of Insurance
Kansas Insurance Department

March 12, 2002

TO: House Committee on Insurance

FROM: Patrick J. Mulvihill
Assistant Director, Financial Surveillance Division

RE: Senate Bill No. 390 --- Reinsurance

Mr. Chairman and members of the Committee:

Thank you for the opportunity to discuss Senate Bill No. 390 with you. Senate Bill No. 390 is a proposal to amend K.S.A. 40-221a, which is our primary statute pertaining to reinsurance.

K.S.A. 40-221a presently includes references to both a "bank" and a "qualified United States financial institution". Senate Bill No. 390 amends K.S.A. 40-221a in order to consistently use the term "qualified United States financial institution" throughout this statute, as that term is defined in the National Association of Insurance Commissioners (NAIC) Credit for Reinsurance Model Law. Please note that we are currently amending a reinsurance regulation (K.A.R. 40-1-43) to incorporate some additional language from the NAIC Credit for Reinsurance Model Regulation. The Model Regulation contemplates that the use of the term "qualified United States financial institution" is as defined in the NAIC Credit for Reinsurance Model Law.

K.S.A. 40-221a currently provides that a Kansas domestic insurer may take reserve credit on business ceded to an unauthorized insurer in an amount not exceeding the amount of a letter of credit or the amount of funds that are held in a trust arrangement. The definition of the term "qualified United States financial institution" is defined differently within the NAIC Credit for Reinsurance Model Law regarding an institution that issues a letter of credit as compared to an

HOUSE INSURANCE
DATE: March 12, 2002
ATTACHMENT #5

420 SW 9th Street
Topeka, Kansas 66612-1678

785 296-3071
Fax 785 296-2283

Printed on Recycled Paper

Consı
1 800

institution that holds funds under a trust arrangement. Therefore, both definitions are incorporated into the proposed amendment to K.S.A. 40-221a.

Senate Bill No. 390 also deletes a provision in K.S.A. 40-221a which presently prohibits a title insurance company from being able to take reserve credit on business ceded to an unauthorized insurer under alternatives, set forth in K.S.A. 40-221a, that are presently available to other types of insurance companies. The proposal to delete this provision would be beneficial to title insurance companies because it would provide them with the same alternatives and safeguards, for taking reserve credit on business ceded to unauthorized insurers, that are presently available to other types of insurance companies.

Summary:

The Kansas Insurance Department believes that the passage of Senate Bill No. 390 would be beneficial in our efforts to monitor and regulate the insurance industry and would, in turn, be in the best interests of policyholders.

U:\Legislation\2002\SB 390 Testimony.doc

Session of 2002

HOUSE BILL No. 2879

By Committee on Insurance

2-13

9 AN ACT concerning insurance; relating to cancellation of automobile
10 insurance policies; amending K.S.A. 40-276a and repealing the existing
11 section.
12
13 *Be it enacted by the Legislature of the State of Kansas:*
14 Section 1. K.S.A. 40-276a is hereby amended to read as follows: 40-
15 276a. *(a)* Any insurance company that denies renewal of an automobile
16 liability insurance policy in this state shall give at least ~~thirty (30)~~ *30* days
17 written notice to the named insured, at his last known address, or cause
18 such notice to be given by a licensed agent of its intention not to renew
19 such policy~~: *Provided, however,* That~~. No insurance company shall deny
20 the renewal of an automobile liability insurance policy except in one or
21 more of the following circumstances *or as permitted in subsection (b)*:
22 ~~(a)~~ *(1)* When such insurance company is required or has been per-
23 mitted by the commissioner of insurance, in writing, to reduce its pre-
24 mium volume in order to preserve the financial integrity of such insurer;
25 ~~(b)~~ *(2)* when such insurance company ceases to transact such business
26 in this state;
27 ~~(c)~~ *(3)* when such insurance company is able to show competent med-
28 ical evidence that the insured has a physical or mental disablement that
29 impairs his ability to drive in a safe and reasonable manner;
30 ~~(d)~~ *(4)* when unfavorable underwriting factors, pertinent to the risk,
31 are existent, and of a substantial nature, which could not have reasonably
32 been ascertained by the company at the initial issuance of the policy or
33 the last renewal thereof;
34 ~~(e)~~ *(5)* when the policy has been continuously in effect for a period
35 of five ~~(5)~~ years~~: *Provided,* That such five-year period shall begin at the~~
36 ~~first policy anniversary date following the effective date of this act: *Pro-*~~
37 ~~*vided further,* That~~*, except that* if such policy is renewed or continued in
38 force after the expiration of such period or any subsequent five-year pe-
39 riod, the provisions of this subsection shall apply in any such subsequent
40 period; or
41 ~~(f)~~ *(6)* when any of the reasons specified as reasons for cancellation
42 in K.S.A. 40-277 are existent~~: *Provided,* That (1)~~, *except that (A)* when
43 failure to renew is based upon termination of agency contract, obligation

. Such five-year period shall begin at the first policy anniversary date following the effective date of the policy

HOUSE INSURANCE
DATE: March 12, 2002
ATTACHMENT #6