

# Report of the Special Committee on Financial Institutions and Insurance to the 2013 Kansas Legislature

CO-CHAIRPERSON: Representative Richard Proehl

CO-CHAIRPERSON: Representative Clark Shultz

VICE-CHAIRPERSON: Senator Ruth Teichman

OTHER MEMBERS: Senators: Jeff Longbine, Ty Masterson, Allen Schmidt, and Vicki Schmidt; and  
Representatives: Rick Billinger, Tom Burroughs, Gail Finney, Phil Hermanson, Gene Suellentrop, and Vern  
Swanson.

## CHARGE

- Study the modernization of the laws governing insurance holding companies in Kansas, including the adoption of uniform standards consistent with the National Association of Insurance Commissioner's (NAIC) model act.
- Review streamlining state regulation, the role of the supervisory college and future oversight of the Kansas Insurance Department, anticipated costs for the state regulator and insurers, and the issues non-adoption of the domestic insurance companies subject to other states' laws.

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Senate Financial Institutions & Ins.

Date: \_\_\_\_\_

Attachment # \_\_\_\_\_



# 2012 Special Committee on Financial Institutions and Insurance

## REGULATION OF INSURANCE HOLDING COMPANIES

### Conclusions and Recommendations

On the topic of insurance holding company regulation, the Committee recommends the introduction of a bill to be drafted as a prefile with collaboration from the Kansas Insurance Department, industry representatives, and Committee staff. The bill, using 2012 HB 2077 (as further amended by Senate Committee) for its base, is to be composed of relevant insurance holding company provisions and conceptual amendments presented during the Special Committee's review. If the bill is not approved by the Legislative Coordinating Council, it should be introduced and heard concurrently in each respective chamber's appropriate committees by February 1, 2013.

**Proposed Legislation:** One bill.

### BACKGROUND

The charge to the Special Committee on Financial Institutions and Insurance was to study, review, and report on three assigned topics (two are combined into one report topic): the Securities Commissioner and agency fee funds and revenue; and the regulation of insurance holding companies.

On the subject of the regulation of insurance holding companies, the Committee was directed to study the modernization of the laws governing insurance holding companies in Kansas, including the adoption of uniform standards consistent with the National Association of Insurance Commissioners (NAIC) model act; and review streamlining state regulation, the role of the supervisory college and future oversight of the Kansas Insurance Department, anticipated costs for the state regulator and insurers, and the issues non-adoption of the model law create for accreditation and domestic insurance companies subject to other states' laws.

The topics were requested by the House Insurance Committee and were assigned by the

Legislative Coordinating Council for study and review.

### COMMITTEE ACTIVITIES

In October, the Committee received an overview of its charges and proposed legislation from Committee staff. The Committee received testimony from representatives of the Kansas Insurance Department and insurance companies and association representatives.

**Topic Overview.** The staff analyst provided a summary on recent insurance holding company legislation, including consideration of 2012 HB 2508. The bill was requested by the Kansas Insurance Department to "ensure that holding company operations outside of the domestic insurance industry do not pose a hazard to the sound operation of the domestic company, and ultimately to protect Kansas insurance consumers from such hazards." The House Committee on Insurance heard the proposed legislation in February 2012 and, after much discussion, later voted to request an interim study in lieu of working the bill. The Senate Committee on

Financial Institutions and Insurance held an informational hearing on insurance holding companies in March 2012 and later agreed to delete the contents of HB 2077, as amended by the Senate Committee (2011 Session), and to insert provisions that would create and amend the Insurance Holding Company Act (HB 2508) and provisions pertaining to the combination sale of life insurance coverage with certain health care riders (HB 2373, as amended by the House Committee). The Senate Committee also inserted amendments to HB 2508, as introduced, to delete certain references to "affiliates" and to decrease a penalty amount.

**HB 2077 (as further amended by Senate Committee, 2012).** The resulting HB 2077, among other provisions, would have established the Insurance Holding Company Act and amended the Insurance Code to modify existing provisions governing insurance holding companies. The analyst briefly summarized provisions of the bill as follows. Under the new Act (New Section 1), the Insurance Commissioner would be granted the power to participate in a supervisory college for any domestic insurance company (insurer) that is part of an insurance holding company system with international operations. Pertinent highlights contained in the bill (sections noted) include:

- The supervisory college oversight and powers assigned to the Commissioner (New Section 1);
- The added definition for "enterprise risk" contained in KSA 40-3302 (Section 3);
- The added requirements related to statements filed with the Commissioner and public hearings contained in KSA 40-3304 (Section 4);
- The amendments to the required information to be filed with registration statements under KSA 40-3305 (Section 5);
- The addition of a standard to the regulation of material transactions by registered insurers with their affiliates contained in KSA 40-3306 (Section 6);

- The clarification concerning examination, information requests, and subpoena power included in KSA 40-3307 (Section 7); and
- The specifications concerning confidential information and disclosure provisions under KSA 40-3308 (Section 8).

The fiscal note for HB 2508 (a fiscal note was not available for the Senate Substitute bill) was provided by the analyst and Committee discussion followed about the status of the contents of HB 2373 (excluded from insurance conference reports), types of carriers subject to requirements of the Insurance Holding Company Act, and Senate Committee amendments.

**Regulation of Insurance Holding Companies.** Representatives of the Kansas Insurance Department provided an overview of insurance holding companies and regulation in Kansas and commented on the substantive provisions in the proposed insurance holding company legislation.

A Department representative noted Kansas has been regulating insurance holding companies since 1974; insurance holding company law was enacted in 1974 based on an NAIC model act. The 2012 legislation also is based on an NAIC model act. The purpose of regulation is to ensure the domestic insurer is able to pay policyholders' claims. An insurance holding company is:

- A company (called a parent company) that owns other companies' outstanding stock and consists of two or more business entities including at least one insurer;
- A company could hold non-insurance companies or subsidiaries such as retailers, manufacturing, railroads, and other types of businesses;
- Subsidiaries under the ownership or common control of a parent are referred to as affiliates; and
- Collectively, the parent and subsidiaries are referred to as a holding company system.

The conferee addressed the concept of "windows" and "walls" – regulators have "windows" to scrutinize group activity and assess its potential impact on the ability of the insurer to pay its claims and "walls" to protect the capital of the insurer by requiring the insurance commissioner's approval of material related-party transactions. Examples of "windows" and "walls" were discussed in the context of current law and the proposed legislation and include:

- Windows represent access to information (KSA 40-3305) and examination authority (KSA 40-3307).
- Walls represent requirements for prior approval to acquire an insurer (KSA 40-3304) and prior approval of certain material transactions (KSA 40-3306).

The representative noted the recent financial crisis involving AIG, which resulted in insurance regulators re-evaluating their holding company system regulatory framework. Given the complexity of many holding company systems, the need was demonstrated to maintain the regulatory "walls" in place and to enhance the "windows" of the system. The representative indicated the Department would like to re-introduce the 2012 legislation (using HB 2077 as the base), with the following changes: broadening the confidentiality under Section 8 for documents filed pursuant to KSA 40-3304 as well as delaying the initial compliance date and creating a premium volume-based exemption from the new enterprise risk report requirement under Section 5. Under this proposed change, insurers with total direct and assumed annual premiums of less than \$300 million would be exempted from submitting an enterprise risk report.

**Defining the supervisory college, its role, and other Insurance Holding Company Act provisions.** Another Department representative spoke to the definition and role envisioned for the "supervisory college" – a forum for cooperation and information sharing among regulators within an international insurance holding company system. Participating regulators could include state, federal, and international regulators. The conferee reviewed the authority the Kansas Insurance Commissioner would have related to supervisory colleges and provided an example of a

supervisory college environment and discussion agenda. Additionally, supervisors have found that a range of communication channels are required for effective functioning of the colleges; these include physical meetings, video or audio conferences, secure online tools, e-mail infrastructure, and official letters. Supervisory colleges, the conferee continued, are typically held once yearly and are designed to share appropriate information with respect to the principal risks and risk management practices of the group. Information shared at supervisory colleges is confidential. Usually, the host state where an insurance company is located would provide coordination of supervisory college meetings. In discussion with the Committee, the representative emphasized the supervisory college does not delegate any authority of the Kansas Insurance Commissioner. The supervisory college functions as an information-gathering entity and holds no authority.

The Department representatives responded to Committee questions and provided additional information about the regulation of insurance holding companies, the proposed legislation, and NAIC accreditation standards. Responses included:

- *Capital requirements and material transactions.* In Kansas, a statutory provision sets minimum capital requirements for an insurance company; a risk-based capital (RBC) guideline exists which mandates action by the Department should a life, health, or accident insurer's RBC fall below 200 percent.
  - For a non-life insurance company, the Department will review any agreement that would impact 3 percent or more of an insurer's admitted assets of 25 percent of capital and surplus; for a life insurance company, the threshold is 3 percent of an insurer's admitted assets. Should these thresholds be unmet, prior approval by the Department is not required for specific material transactions.
  - The Insurance Holding Company Act does not allow the Department to

require capitalization changes of the in-state, operating company until the RBC falls beneath the statutory minimum requirements. The Act provides "windows" to request additional information from the holding company.

- *Acquisitions and mergers.* An acquiring party may be required to maintain or restore the capital of the insurer to the level required by law within 60 days after change of control. The Department has the responsibility to invoke certain requirements to ensure capital solvency; the Department controls the acquisition approval. Additionally, the Department reviews and validates five years of financial statements for companies requesting acquisition approval to ensure financial soundness of the acquiring party.
- *Accreditation and Anticipated Costs.* The proposed insurance holding company legislation presents no additional costs to the Department outside of its existing budget. The next NAIC accreditation review is scheduled for 2016, which is the deadline for implementing the Model Holding Company System Act. It is possible that Kansas' accreditation could be jeopardized without implementation of the Kansas Insurance Holding Company Act.

A Department representative also noted that there was no opposition from consumers and industry representatives and collaboration within the industry and Department continued to adjust possible future legislation.

**Industry response to amendments to insurance holding company regulation in Kansas.** A representative of the National Association of Mutual Insurance Companies (NAMIC) testified in support of the amendments to the Insurance Holding Company Act, noting his support for retaining state-based insurance regulation and the amendment exempting small companies from the enterprise risk report. A

representative for the Security Benefit Life Insurance Company spoke in support of introducing legislation, including proposed amendments to the 2012 legislation, during the 2013 Session. The legislation, the representative noted, is necessary to ensure the Department maintains its NAIC accreditation; without such legislation, an insurer would be required to undergo multiple, duplicative financial condition examinations in each state in which the parent company holds domiciled companies. Additionally, the representative noted, the amendments will prevent highly confidential financial documents from being disclosed and inappropriately available to competitors. A representative of the American Council of Life Insurers indicated the proposed legislation enhances the Insurance Commissioner's ability to monitor and protect the financial strength of Kansas insurers while strengthening and preserving state-based regulation.

Additional written support of the proposed legislation, including the amendments presented to the Special Committee, was provided by representatives of the American Insurance Association, the Kansas Association of Property and Casualty Insurance Companies, and Polsinelli Shughart, PC.

#### CONCLUSIONS AND RECOMMENDATIONS

On the topic of insurance holding company regulation, the Committee recommends the introduction of a bill to be drafted as a prefile with collaboration from the Kansas Insurance Department, industry representatives, and Committee staff. The bill, using 2012 HB 2077 (as further amended by Senate Committee) for its base, is to be composed of relevant insurance holding company provisions and conceptual amendments presented during the Special Committee's review. If the bill is not approved by the Legislative Coordinating Council, it should be introduced and heard concurrently in each respective chamber's appropriate committees by February 1, 2013.