Kansas Insurance Department
Sandy Praeger, Commissioner of Insurance

RISK-BASED CAPITAL

Purpose

Kansas' Risk-Based Capital (RBC) laws operate as an early warning system that gives the Department clear legal authority to intervene with an insurer when the insurer triggers one of four "action levels" specified by law. RBC alerts the Department to undercapitalized companies while there is still time for the Department to react quickly and effectively to avoid insolvencies and to ensure such companies are able to pay policyholders' claims. Kansas' RBC laws are based on uniform laws adopted by the NAIC and are an accreditation standard.

Background

Risk-Based Capital is a method of measuring the minimum amount of capital appropriate for a company to support its overall business operations in consideration of its size and certain risk factors. RBC limits the amount of risk a company can assume. It requires a company with a higher amount of risk to hold a higher amount of capital. Capital provides a cushion to a company against insolvency. RBC is intended to be a minimum regulatory capital standard and not necessarily the full amount of capital that an insurer would want to hold to meet its safety and competitive objectives. In addition, RBC is not designed to be used as a stand-alone tool in determining financial solvency or stability of an insurance company; rather it is one of multiple tools available to the Department.

Before RBC was created, regulators used fixed capital standards as a primary tool for monitoring the financial solvency of insurance companies. Under fixed capital standards, owners are required to supply the same minimum amount of capital, regardless of the financial condition of the company. The requirements required by the states ranged from $500,000 to $6 million and was dependent upon the state and the line of business that an insurance carrier wrote. Companies had to meet these minimum capital and surplus requirements in order to be licensed and write business in the state. As insurance companies changed and grew, fixed capital standards were no longer effective in providing a sufficient cushion for many insurers.

RBC laws were developed in the early 1990s driven by a string of large-company insolvencies that occurred in the late 1980s and early 1990s. RBC is now a standard regulatory tool nationwide. Kanas adopted its first RBC laws in 1994.

How RBC works

RBC regulation has two main components: (1) the risk-based capital formula that establishes a hypothetical minimum capital level that is compared to a company's actual capital level; and (2) a risk-based capital laws that grants authority to the Department to take specific actions based on a company's level of impairment.

Senate Financial Institutions & Ins.

Date:____________________

Attachment #____________________

420 SW 9th Street
Topeka, Kansas 66612-1678

785-296-7803 Phone
785-296-7805 Fax

Consumer I
800-432-

Formula –

The Risk Based Capital Formula was developed to establish a minimum capital requirement based on the types of risks a company assumes. Separate RBC models have been developed for each of the primary insurance types: Life, Property/Casualty, Health and Fraternal. This reflects the differences in the economic environments facing these companies.

The risk factors for the RBC formulas focus on three major areas: 1) Asset Risk; 2) Underwriting Risk; and 3) Other Risk. The emphasis on these risks differs from one formula to the next. As a generic formula, every single risk exposure of a company is not necessarily captured in the formula. The formula focuses on the material risks that are common for the particular insurance type. For example, interest rate risk is included in the Life RBC formula because the risk of losses due to changes in interest rate levels is a material risk for many life insurance products.

Authority –

Under the Kansas' RBC laws, the Department is authorized and mandated to take preventive and corrective measures that vary depending on the level of deficiency in the company's RBC. These preventive and corrective measures are designed to provide for early intervention to correct problems before insolvencies become inevitable, thereby minimizing the number and adverse impact of insolvencies.

The RBC formula generates the minimum amount of capital that a company is required to maintain to avoid regulatory action. There are four levels of action that a company can trigger under the formula: company action, regulatory action, authorized control, and mandatory control levels. Each RBC level requires some particular action on the part of the Department, the company, or both. For example, an insurer that breaches the Company Action Level must produce a plan to restore its RBC levels. This could include adding capital, purchasing reinsurance, reducing the amount of insurance it writes, or pursuing a merger or acquisition.

Kansas Insurance Department

Proposed amendments to Kansas Insurance Holding Company System Act

What is an insurance holding company system?

- A holding company system consists of two or more business entities.
- An insurance holding company system is a holding company system that includes at least one insurer.
- Common for one or more companies within a holding company to be non-insurance company.

2

History of Insurance Holding Company Systems

- In 1960's, increased inflation created interest in equity-based investments (e.g., stocks).
- P&C insurance business profits had declined, leaving many P&C insurers in need of additional capital.
- Increased attention given to the idea of "one-stop" financial service.
- These factors led to interest in diversification.
- Numerous companies merged and formed holding companies.

3

What does an insurance holding company system look like?

- Parent company that owns or controls one or more subsidiaries.
- Subsidiaries under the ownership or common control of a parent are referred to as affiliates.
- Collectively the parent and subsidiaries are referred to as the holding company system.
- An Insurance holding company system has at least one insurance company in the system.

4

Example: Zurich US Insurance Pool Group

- Ultimate Controlling Person – Zurich Insurance Group, Ltd. (Switzerland)
- 5 US Life Insurance Companies
- 67 US Property and Casualty Companies
- Numerous insurance companies (180+) in other countries along with management service companies

5

Zurich US Insurance Pool Group Abbreviated Organizational Chart

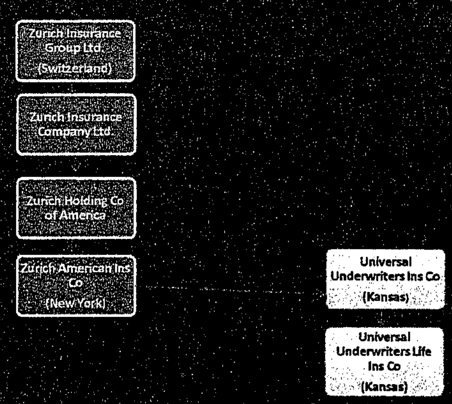
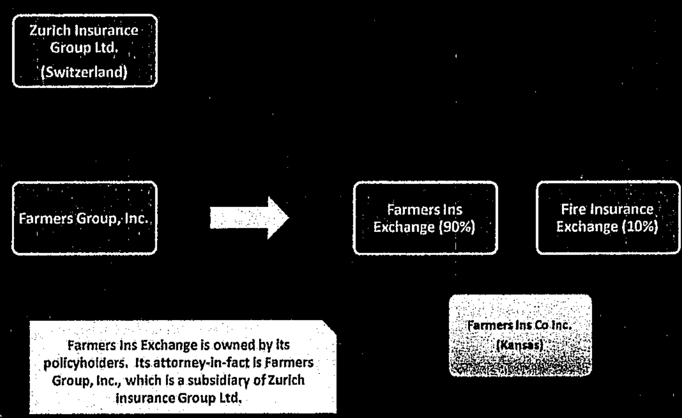


Chart excludes Farmers Ins Co, Inc. (Kansas Domestic P&C Company)

6

Farmers Insurance Group
Abbreviated Organizational Chart



History of Insurance
Holding Company System Regulation

- Under the state-based insurance regulation system in the U.S., the need for holding company supervision was recognized early on with the first National Association of Insurance Commissioners (NAIC) model law adopted in 1969.
- In 1974, Kansas enacted insurance holding company laws based on the NAIC model.

3

Purpose and Need

- The basic purpose of insurance holding company regulation is to ensure holding company operations outside of an insurer incorporated in a U.S. state (domestic insurer) do not jeopardize the solvency of the domestic insurer.
- Financial surveillance of domestic insurers is a core function of state insurance regulators.

9

State-Based Regulation

- State-based regulation of insurance requires a cooperative approach between regulators to adequately assess the financial risks posed to an domestic insurer within a holding company.
- This reality led to "windows and walls" approach.

10

Windows and Walls

- Regulators have "windows" from the insurer to the holding company activity to assess its potential impact on the ability of the insurer to pay its claims.

- "Windows" include documents required to be filed with the NAIC, states, and publicly available information, as well as information learned in discussions with key leaders, company employees, and financial regulators.

COMMISSIONER OF INSURANCE OF KANSAS

11

Windows and Walls

- Regulators have "walls" to protect the capital of the insurer by requiring the insurance commissioner's approval for "material transactions" between the insurer and other entities within a holding company.

COMMISSIONER OF INSURANCE OF KANSAS

12

Windows and Walls

- With regulatory "walls," money can still flow between the admitted insurer and the holding company, but regulators must assess the risk of large monetary transactions that take funds out of the insurance company's capital reserves.
- Regulators assess whether a transaction is fair and reasonable and does not jeopardize the protection of policyholders before approving the transaction.

COMMISSIONER OF INSURANCE OF KANSAS

13

Current Kansas Holding Company Laws

Windows:

1) Access to information about:
   - Structure, management, financial condition, ownership, and management of any "controlling person";
   - Identity and relationship of all members of the insurance holding company system;
   - Certain recent transactions and agreements between the insurer and its affiliates (K.S.A. 40-3305).
2) Examination authority (K.S.A. 40-3307).

COMMISSIONER OF INSURANCE OF KANSAS

14

Current Kansas Holding Company Laws

Walls:

1) Requirements for prior approval to acquire an insurer (K.S.A. 40-3304); and

2) Prior approval of certain material transactions (K.S.A. 40-3306).

15

See A-1 for a current list of Kansas insurance companies that are part of a holding company

16

Recent Financial Crisis and AIG

- Importance of state-based insurance regulation highlighted by the circumstances involving AIG and the recent financial crisis.
- During the 2007-2008 financial crisis, the U.S. holding company regulatory framework was tested when American International Group (AIG) faced financial uncertainty.

17

Recent Financial Crisis and AIG

- In 2008, the AIG holding company was comprised of 71 U.S.-based insurance entities and 176 other financial service companies throughout the world.
- The AIG Financial Products unit based in London, a non-insurance component of the AIG holding company system, took on huge losses from risky investments in collateralized debt instruments.

18

Recent Financial Crisis and AIG

- This loss crippled AIG's financial operations and led to the federal bailout of the AIG holding company.
- U.S. state insurance regulators did not directly regulate the AIG holding company, but were heavily involved in the AIG discussions due to the need for funds from the AIG insurance subsidiaries to rectify AIG's liquidity problem.

19

Recent Financial Crisis and AIG

- Had it not been for the regulatory "walls" that were established in the U.S., the funds protecting policyholders in the AIG insurance companies in the U.S. could have been used by the AIG holding company, thereby threatening insurance policyholder protection.
- These "walls" gave the insurance commissioners options when working with banking regulators on AIG holding company's financial issues.

20

Recent Financial Crisis and AIG

US Ins. Companies (71)

Other Financial Services Companies (176)

AIG Financial Products

AIG Financial Products had $440 billion of credit default swaps outstanding on September 12, 2008

Credit rating agencies announced potential rating downgrades for AIG

Downgrades required billions of dollars of demands for cash collateral on the credit default swaps (i.e., liquidity risk)

Federal government rescued AIG, not because of stable and well capitalized insurance companies

21

Regulatory Improvements

- The contagion effects experienced by U.S. insurers in the AIG holding company system's near collapse caused U.S. insurance regulators to reevaluate their holding company system regulatory framework.

- The complexity of many holding company systems, including international operations, illustrated the need to maintain the regulatory "walls" in place, and to enhance the "windows" of the system.

22

Regulatory Improvements

- The amendments to NAIC's model holding company system act are a result of lessons learned from the recent financial crisis.
- The amendments proposed by KID generally provide additional "windows" for KID to gather and evaluate information needed to effectively protect policyholders of insurers in a holding company system, while enhancing protection of confidential information.

23

2012 Legislation

- Amendments proposed in 2012 HB 2508.
- HB 2508 language amended into Sub HB 2077 As Further Amended by the Sen. Comm.
- Sub HB 2077 language was the same as HB 2508, except for two changes to (b)(2) of Section 7 as a result of discussions with Industry representatives:
  - Struck references to "affiliates."
  - Reduced penalty from $5,000 to $1,000.

24

2013 Legislation

- KID anticipates introducing language that is the same as Sub HB 2077, but with three potential changes:
  - Broaden confidentiality under Section 8 for documents filed pursuant to K.S.A. 40-3304.
  - Delay initial compliance date for and create premium volume-based exemption from the new enterprise risk report requirement under Section 5.

COMMISSIONER OF INSURANCE OF KANSAS

25

Amendments to the Kansas Insurance Holding Company System Act

Supervisory Colleges

Section 1, p. 5, l. 18

COMMISSIONER OF INSURANCE OF KANSAS

26

What is a supervisory college?

- Regulatory "window" into international operations of a holding company system.
- Provides a forum for cooperation and information sharing between the various regulators of entities within an insurance holding company system with international operations.

27

What is a supervisory college?

- Regulators involved are those that regulate the various companies within the insurance holding company system, which could include state, federal, and international regulators.
- State insurance regulators have been conducting a similar process with other state and federal regulators within the U.S. for decades. Supervisory colleges would allow for similar activity at the international level.

28

Why are supervisory colleges needed?

- At the heart of the lessons learned from the recent global financial crisis was the need for regulators to enhance their ability to assess risk posed to domestic insurers by other activities in the holding company system.
- Consideration of any international operations is necessary to fully assess such risk.
- Ultimate purpose is to ensure domestic insurers are solvent so they can pay policyholders' claims.

29

Supervisory Colleges (Sec. 1)

- Authorizes participation.

"(T)he commissioner of insurance shall have the power to participate in a supervisory college for any domestic insurer that is part of an insurance holding company system with international operations in order to determine compliance by the insurer with this act." Sec. 1, p. 5, l. 20-23.

30

Supervisory Colleges (Sec. 1)

- Allows insurance commission to enter agreements to facilitate participation.

"The commissioner of insurance may enter into agreements in accordance with Section 8...providing the basis for cooperation between the commissioner of insurance and the other regulatory agencies, and the activities of the supervisory college." Sec. 1, p. 6, l. 7-11.

31

Supervisory Colleges (Sec. 1)

- Authorizes commissioner to establish, manage, and coordinate participation in a supervisory college as a lead state.

"The powers of the commissioner of insurance with respect to supervisory colleges include, but are not limited to, the following...(1) Initiating the establishment of a supervisory college; (2) clarifying the membership and participation of other supervisors in the supervisory college; (3) clarifying the functions of the supervisory college and the role of other regulators, including the establishment of a group-wide supervisor; (4) coordinating the ongoing activities of the supervisory college, including planning meetings, supervisory activities and processes for information sharing; (5) establishing a crisis management plan; and (6) establishing a regular assessment to the insurer for the payment of expenses incurred pursuant to subsection (c)." Sec. 1, p. 5, l. 24-36.

32

Supervisory Colleges (Sec. 1)

- Domestic insurer is required to pay reasonable expenses, including necessary travel, incurred by the commissioner.

"Each registered insurer subject to this section shall be liable for and shall pay the expenses, including reasonable expenses for necessary travel, the commissioner of insurance reasonably incurred with respect to the participation in a supervisory college in accordance with subsection (d)." Sec. 1, p. 5, l. 37-41.

COMMISSIONER OF INSURANCE OF KANSAS

33

Supervisory Colleges (Sec. 1)

- Participation in a supervisory college is discretionary and does not delegate any authority of the commissioner.

"Nothing in this section shall delegate to the supervisory college the authority of the commissioner of insurance to regulate or supervise the insurer or its affiliates within the jurisdiction of the supervisory college." Sec. 1, p. 6, l. 11-14.

COMMISSIONER OF INSURANCE OF KANSAS

34

Supervisory Colleges (Sec. 1)

- Information shared by KID with other regulators in a supervisory college is confidential.

"(T)he commissioner of insurance...(m)ay share documents, materials or other information, including the confidential and privileged documents, materials or information...with...members of any supervisory college...provided that the recipient agrees in writing to maintain the confidentiality and privileged status of the document, material or other information, and has verified in writing the legal authority to maintain confidentiality..." Sec. 8, p. 23, l. 4-14.

35

Kansas companies currently part of an insurance holding company system with international operations include:

AmTrust Insurance Company of Kansas, Inc.
CIGNA Dental Health of Kansas, Inc.
Employers Reassurance Corp.
  Union Fidelity Life Ins., Co.
  Heritage Casualty Ins., Co.
Farmers Ins. Co., Inc.
Financial American Life Ins. Co.
Homesite Indemnity Co.
Kansas Bankers Surety Co.
MutualAid eXchange
Pyramid Life Ins. Co.
Security Benefit Life Ins. Co.
Travel Air Ins. Co., Ltd.
  Travel Air Ins. Co. (Kansas)
UniCare Health Plan of Kansas, Inc.
Union Security Insurance Company
Universal Underwriters Ins. Co.
  Universal Underwriters Life Ins. Co.
WellCare of Kansas, Inc.

36

What does a supervisory college look like?

Example: *Zurich Insurance Group Ltd.*

- Location: Zurich, Switzerland
- Two days of meetings (Nov. 7-8, 2012)
- Participants:
  - KID: Dir. of Financial Surveillance and General Counsel
  - Other state insurance regulators:
    - New York, California, Texas, Michigan, Illinois, Pennsylvania, Maryland
  - International insurance regulators:
    - Switzerland, Germany, Italy, Spain, United Kingdom, Canada

37

What does a supervisory college look like?

Possible Agenda

Day one (11/7/2012):

- Overview of holding company operations and strategic plan
  - Holding company/insurance operations
    - Holding company strategic plan and impact on insurance company operations
    - Enterprise risk management plan
    - Company acquisitions/formations/disposals
    - Intercompany transactions
      - Reinsurance
      - Investments
      - Other (e.g., restructure of holding company)

  Regulatory/supervisory actions and activities

38

What does a supervisory college look like?

Possible Agenda

Day two (11/8/2012):

- Significant investment activities
- Changes in product or business units
- Changes in perceived strengths and weaknesses
- Key insurance companies:
  - Changes in perceived strengths and weaknesses
  - Specific group-wide concerns
- International supervisory concerns
- US regulatory concerns
- Executive session of US regulators and International supervisors

39

Amendments to the Kansas Insurance Holding Company System Act

Registration

(Enterprise Risk Reporting)

Sec. 5, p. 13, l. 20

40

Registration (Sec. 5)

- Under current Kansas law, every insurer authorized to do business in Kansas that is a member of an insurance holding company system must register with the commissioner of insurance.
- The insurer must file a registration statement that includes certain information about the finances and operations of the insurer and its holding company.
- These regulatory "windows" into the holding company system help KID access enterprise risk.

41

Why assess enterprise risk?

- "Enterprise risk" is an activity or event that would have a material adverse effect on an insurer's financial condition or liquidity or its holding company system as a whole.
- Financial surveillance of domestic companies is core function of KID.
- Ultimate purpose is to ensure domestic insurers can pay policyholders' claims.

42

Why do enterprise risk regulations need enhancement?

- Response to economic downturns and worldwide discussions on contagion risk within the financial sector.
- Response to regulators' experience regarding the financial impact that non-insurance entities within the group can have on an insurance company's financial solvency; e.g., AIG.
- Proposed amendments to the Registration requirements of Section 5 add features that would better enable KID to identify enterprise risks in a holding company system.

Registration (Sec. 5)

- The key changes to Section 5 include:

  1) Enterprise risk reporting;
  2) Broader requirements for financial statements of affiliates; and
  3) Statements regarding governance and internal control.

Enterprise Risk Reporting (Sec. 5)

- "Enterprise risk report" is a new regulatory "window" to better enable KID to assess enterprise risk in a holding company system.
- "Ultimate controlling person" of a holding company system must file an annual enterprise risk report.
- "Ultimate controlling person" means the entity in a holding company system that is not controlled by any other entity.

45

Enterprise Risk Reporting (Sec. 5)

- Enterprise risk report must identify the material risks within the insurance holding company system that could pose enterprise risk to the insurer.
- Insurer files "Form F."
- Report is filed with the "lead state" commissioner of insurance of the insurance holding company system.

46

Enterprise Risk Reporting (Sec. 5)

"(T)he ultimate controlling person of every insurer subject to registration also shall file an annual enterprise risk report. The report, to the best of the ultimate controlling person's knowledge and belief, shall identify the material risks within the insurance holding company system that could pose enterprise risk to the insurer. The report shall be filed with the lead state commissioner of insurance of the insurance holding company system as determined by the procedures within the financial analysis handbook adopted by the national association of insurance commissioners." Sec. 5, p. 16, l. 8-16.

COMMISSIONER OF INSURANCE OF KANSAS

47

Form F

Enterprise Risk Report (Form F) includes the following information:

- Any material developments regarding strategy, internal audit findings, compliance or risk management affecting the insurance holding company system;
- Acquisition or disposal of insurance entities and reallocating of existing financial or insurance entities within the insurance holding company system;
- Any changes of shareholders of the insurance holding company system exceeding ten percent (10%) or more of voting securities;
- Developments in various investigations, regulatory activities or litigation that may have a significant bearing or impact on the insurance holding company system;
- Business plan of the insurance holding company system and summarized strategies for next 12 months;
- Identification of material concerns of the insurance holding company system raised by supervisory college, if any, in last year;
- Identification of insurance holding company system capital resources and material distribution patterns;
- Identification of any negative movement, or discussions with rating agencies which may have caused, or may cause, potential negative movement in the credit ratings and individual insurer financial strength ratings assessment of the insurance holding company system (including both the rating score and outlook);
    - Information on corporate or parental guarantees throughout the holding company and the expected source of liquidity should such guarantees be called upon; and
    - Identification of any material activity or development of the insurance holding company system that, in the opinion of senior management, could adversely affect the insurance holding company system.

COMMISSIONER OF INSURANCE OF KANSAS

48

Enterprise Risk Reporting (Sec. 5)

Potential changes to Sub HB 2077 language:

- Initial enterprise risk report must be filed by *May 1, 2015*.
- The ultimate controlling person of an insurer with total direct and assumed annual premiums of less than $300 million is not required to submit an enterprise risk report under this subsection.

COMMISSIONER OF INSURANCE OF KANSAS

49

Financial Statements (Sec. 5)

- A new requirement of the annual registration statement is that the insurer must provide financial statements of all affiliates if requested by the commissioner.
- This "window" into the financial health of a domestic insurer's affiliates is vital to assessing a holding company system's enterprise risk.

COMMISSIONER OF INSURANCE OF KANSAS

50

Financial Statements (Sec. 5)

"(I)f requested by the commissioner of insurance, the insurer shall include financial statements of or within an insurance holding company system, including all affiliates. Financial statements may include, but are not limited to, annual audited financial statements filed with the U.S. Securities and Exchange Commission (SEC) pursuant to the securities act of 1933, as amended, or the securities exchange act of 1934, as amended. An insurer required to file financial statements pursuant to this paragraph may satisfy the request by providing the commissioner of insurance with the most recently filed parent corporation financial statements that have been filed with the SEC..." Sec. 5, p. 14, l. 25-34.

COMMISSIONER OF INSURANCE OF KANSAS

51

Governance & Internal Control (Sec. 5)

- As a part of the annual registration, the insurer must provide statements that the insurer's board of directors and principal officers have approved, implemented, and continue to maintain and monitor corporate governance and internal control procedures.
- Ensures an insurer has developed proper governance and internal controls.

"(S)tatements that the insurer's board of directors and principal officers oversee corporate governance and internal controls and that the insurer's principal officers have approved, implemented and continue to maintain and monitor corporate governance and internal control procedures..." Sec. 5, p. 14, l. 35-39.

COMMISSIONER OF INSURANCE OF KANSAS

52

See A-2.1 – list of companies that would qualify for a possible exemption to the Enterprise Risk Report requirement.

See A-2.2 – Form F (Enterprise Risk Report).

See A-3 – Form B (Insurance Holding Company Annual Registration Statement).

See A-3 – Form C (Summary of Changes to Registration Statement).

COMMISSIONER OF INSURANCE OF KANSAS

53

Amendments to the Kansas Insurance Holding Company System Act

Acquisitions & Mergers

Sec. 4, p. 7, l. 34

COMMISSIONER OF INSURANCE OF KANSAS

54

Acquisitions & Mergers (Sec. 4)

- The enhancements to Section 4 essentially align procedures for acquisitions and mergers involving a domestic insurer that is subject to registration under Section 5 with the enterprise risk reporting requirements of Section 5.

55

Acquisitions & Mergers (Sec. 4)

- Additional information required for an acquisition or merger:
  - Agreement by acquiring entity to file the enterprise risk report required in Section 5.
  - Acknowledgement to provide such information necessary to evaluate enterprise risk to the insurer.

56

Acquisitions & Mergers (Sec. 4)

"The statement to be filed with the commissioner of insurance hereunder...shall contain the following information...an agreement by the person required to file the statement referred to in subsection (a) that it will provide the annual report, specified in subsection (l) of K.S.A. 40-3305, and amendments thereto, for so long as control exists...(and) an acknowledgment by the person required to file the statement referred to in subsection (a) that the person and all subsidiaries within its control in the insurance holding company system will provide to the commissioner of insurance upon request such information as the commissioner of insurance deems necessary to evaluate enterprise risk to the insurer..." Sec. 4, p. 8, l. 21-24, p. 10, l. 13-22.

57

Acquisitions & Mergers (Sec. 4)

- Process for handling multiple department approvals of an acquisition or merger of a number of insurers; e.g., holding a public hearing on a consolidated basis.

"If the proposed acquisition of control will require the approval of more than one commissioner of insurance, the public hearing referred to in paragraph (2) may be held on a consolidated basis upon request of the person filing the statement referred to in subsection (a). Such person shall file the statement referred to in subsection (a) with the national association of insurance commissioners within five days of making the request for a public hearing. A commissioner of insurance may opt out of a consolidated hearing, and shall provide notice to the applicant of the opt-out within 10 days of the receipt of the statement referred to in subsection (a). A hearing conducted on a consolidated basis shall be public and shall be held within the United States before the commissioners of insurance of the states in which the insurers are domiciled. Such commissioners of insurance shall hear and receive evidence. A commissioner of insurance may attend such hearing, in person or by telecommunication." Sec. 4, p. 12, l. 9-23.

58

Acquisitions & Mergers (Sec. 4)

- Acquiring party may be required to maintain or restore the capital of the insurer to the level required by law within 60 days after the change in control.

"As a condition of a change of control of a domestic insurer, any determination by the commissioner of insurance that the person acquiring control of the insurer shall be required to maintain or restore the capital of the insurer to the level required by the laws and regulations of this state shall be made not later than 60 days after the date of notification of the change in control submitted pursuant to subsection (a) of this act." Sec. 4, p. 12, l. 24-29.

59

See A-4 – Form A (Statement Regarding the Acquisition and Control or Merger with a Domestic Insurer).

60

Amendments to the Kansas Insurance Holding Company System Act

Material Transactions

Sec. 6, p. 16, l. 25

61

Material Transactions (Sec. 6)

- Section 6 generally requires prior approval by the commissioner of certain material transactions between a registered insure and its affiliates.
- Prior approval of material transactions is a regulatory "wall" used to protect the capital of the insurer from financial risks within a holding company system.
- Similar rules protected AIG's insurance operations from removal of their capital by the AIG holding company.

62

Material Transactions (Sec. 6)

- The amendments subject the following material transactions to prior approval:
  - Reinsurance pooling agreements;
  - Reinsurance agreements in which the projected reinsurance premium or a projected change in the insurer's liabilities in any of the next three consecutive years equals or exceeds 5% of the insurer's surplus; and
  - Tax allocation agreements.
- Added clarity regarding determination of extraordinary dividend for insurers (non-life).

63

Material Transactions (Sec. 6)

"The following transactions involving a domestic insurer and any person in such insurer's insurance holding company system may not be entered into unless the insurer has notified the commissioner in writing of such insurer's intention to enter into such transaction at least 30 days prior thereto, or such shorter period as the commissioner may permit, and the commissioner has not disapproved such transaction within such period...Reinsurance agreements or modifications thereto, including...(a)ll reinsurance pooling agreements...and...agreements in which the reinsurance premium or a change in the insurer's liabilities, or the projected reinsurance premium or a projected change in the insurer's liabilities in any of the next three consecutive years equals or exceeds 5% of the insurer's surplus as regards policyholders, as of December 31 next immediately preceding, including those agreements which may require as consideration the transfer of assets from an insurer to a nonaffiliate, if an agreement or understanding exists between the insurer and nonaffiliate that any portion of such assets will be transferred to one or more affiliates of the insurer...(and)...all management agreements, service contracts, tax allocation agreements and all cost-sharing arrangements..." Sec. 6, p. 17, l. 4-10, 29-42.

64

See A-5 – Form D (Prior Notice of Transaction).

55

Amendments to the Kansas Insurance Holding Company System Act

Examinations

Sec. 7, p. 20, l. 22

66

Examinations (Sec. 7)

- Section 7 provides commissioner authority to examine registered insurers.
- Amendments strengthen the commissioner's authority to examine a registered insurer's affiliates, creating a larger "window" for information.

"Subject to the limitation contained in this section and in addition to the powers which the commissioner of insurance has under K.S.A. 40-222 and K.S.A. 40-222a, and amendments thereto, relating to the examination of insurers, the commissioner of insurance shall...have the power to...examine any insurer registered under K.S.A. 40-3305, and amendments thereto, and such insurer's affiliates to ascertain the financial condition, including enterprise risk, of such Insurer." Sec. 7, p. 20, l. 23-35.

67

Examinations (Sec. 7)

- Strengthens authority to order an insurer and its affiliates to produce information not in their possession, if information can be obtained through contractual relationships, statutory obligations, or another method.
- Adds power to issue subpoenas, administer oaths, and examine under oath any person for purposes of determining compliance with Section 7.

68

Examinations (Sec. 7)

"To determine compliance with this act, the commissioner of insurance may order any insurer registered under K.S.A. 40-3305, and amendments thereto, to produce information not in the possession of the insurer, if the insurer can obtain access to such information pursuant to contractual relationships, statutory obligations or another method. In the event the insurer cannot obtain the information requested by the commissioner of insurance, the insurer shall provide the commissioner of insurance a detailed explanation of the reason that the insurer cannot obtain the information and the identity of the holder of information. Whenever it appears to the commissioner of insurance that the detailed explanation is without merit, the commissioner of insurance may require, after notice and hearing, the insurer to pay a penalty of not more than $1,000 for each day's delay, or may suspend or revoke the license of the insurer." Sec. 7, p. 21, l. 1-14.

"The commissioner of insurance shall have the power to issue subpoenas, administer oaths and examine under oath any person for purposes of determining compliance with this section..." Sec. 7, p. 21, l. 27-29.

69

Amendments to the Kansas Insurance Holding Company System Act

Confidentiality

Sec. 8, p. 21, l. 41

70

Confidentiality (Sec. 8)

- With increased information sharing with additional regulatory "windows" comes increased concern about protection of confidential and privileged information.
- Changes include enhanced confidentiality provisions, which are strongly supported by Industry.

71

Confidentiality (Sec. 8)

- Any information reported by an insurer pursuant to Sections 4, 5, and 6, and in the course of an examination or investigation under Section 7 is confidential and privileged, not subject to disclosure under the Kansas Open Records Act, not subject to subpoena, and not subject to discovery or admissible as evidence in any private civil action.

72

Confidentiality (Sec. 8)

"Documents, materials or other information obtained by or disclosed to the commissioner of insurance of insurance or any other person in the course of an examination or investigation made pursuant to K.S.A. 40-3307, and amendments thereto, and all information reported pursuant to K.S.A. 40-3304, 40-3305 and 40-3306, and amendments thereto, shall:

(1) Be confidential and privileged;

(2) not be subject to disclosure under the Kansas open records act, K.S.A. 45-215 et seq., and amendments thereto;

(3) not be subject to subpoena; and

(4) not be subject to discovery or admissible in evidence in any private civil action." Sec. 8, p. 22, l. 16-27.

73

Confidentiality (Sec. 8)

- Generally, confidential documents, materials, or other information cannot be made public without the prior written consent of the insurer.
- Commissioner can make confidential information public, after opportunity for notice and hearing, if doing so is in the interest of policyholders, shareholders, or public.

74

Confidentiality (Sec. 8)

"The commissioner of insurance shall not otherwise make the documents, materials or other information public without the prior written consent of the insurer to which it pertains unless the commissioner of insurance, after giving the insurer and its affiliates who would be affected thereby, notice and opportunity to be heard in accordance with the provisions of the Kansas administrative procedure act, determines that the interests of policyholders, shareholders or the public would be served by the publication thereof, in which event the commissioner of insurance may publish all or any part thereof in such a manner as the commissioner of insurance may deem appropriate. In making such determination, the commissioner of insurance also shall take into consideration any potential adverse consequences of the disclosure thereof." Sec. 8, p. 22, l. 28-39.

75

Confidentiality (Sec. 8)

- Commissioner or other person cannot be required to testify in any private civil action.
- Commissioner may share confidential information with other regulators and NAIC with agreement in writing to maintain confidentiality and privileged status of such information.
- Commissioner may only share confidential documents reported with the Registration Statement under Section 5 to states having substantially similar confidentiality laws and that agree in writing not to disclose the information.

76

Confidentiality (Sec. 8)

"Neither the commissioner of insurance nor any person who received documents, materials or other information while acting under the authority of the commissioner of insurance or with whom such documents, materials or other information are shared pursuant to this section shall be permitted or required to testify in any private civil action concerning any confidential documents, materials or information subject to subsection (a)." Sec. 8, p. 22, l. 40-43, p. 23, l. 1-2.

"(T)he commissioner of insurance...may share documents, materials or other information...with other state, federal and international regulatory agencies, with the national association of insurance commissioners and its affiliates and subsidiaries, and with state, federal and international law enforcement authorities, including members of any supervisory college described in section 1...provided that the recipient agrees in writing to maintain the confidentiality and privileged status of the document, material or other information, and has verified in writing the legal authority to maintain confidentiality." Sec. 8, p. 23, l. 4-14.

"(N)otwithstanding the provisions of paragraph (l)...the commissioner of insurance may only share confidential and privileged documents, material or information reported pursuant to subsection (1) of K.S.A. 40-3305...with the commissioner of insurance of states having statutes or regulations substantially similar to subsections (a) and (b), and who have agreed in writing not to disclose such information." Sec. 8, p. 23, l. 15-21.

77

Confidentiality (Sec. 8)

- Commissioner must maintain confidential or privileged status of information received based on the laws of the jurisdiction that is the source.

"(The commissioner)...may receive documents, materials or information, including otherwise confidential and privileged documents, materials or information from the...(NAIC)..., and its affiliates and subsidiaries, and from regulatory and law enforcement officials of other foreign or domestic jurisdictions, and shall maintain as confidential or privileged any document, material or information received with notice or the understanding that it is confidential or privileged under the laws of the jurisdiction that is the source of the document, material or information." Sec. 8, p. 23, l. 22-30.

78

Confidentiality (Sec. 8)

- Commissioner must enter into written agreements with NAIC governing sharing and use of information, including procedures and protocols regarding confidentiality and security of information shared with NAIC.

79

Confidentiality (Sec. 8)

"(The commissioner)...shall enter into written agreements with the national association of insurance commissioners governing sharing and use of information provided pursuant to this act consistent with this subsection that shall...(s)pecify procedures and protocols regarding the confidentiality and security of information shared with the...(NAIC)...and its affiliates and subsidiaries pursuant to this act, including procedures and protocols for sharing by the...(NAIC)...with other state, federal or international regulators;...specify that ownership of information shared with the...(NAIC)...and its affiliates and subsidiaries pursuant to this act remains with the commissioner of insurance and the...(NAIC's)...use of the information is subject to the direction of the commissioner of insurance;...require prompt notice to be given to an insurer and its affiliates whose confidential information in the possession of the...(NAIC)..., pursuant to this act, is subject to a request or subpoena to the...(NAIC)...for disclosure or production; and...require the...(NAIC)...and its affiliates and subsidiaries to consent to intervention by an insurer in any judicial or administrative action in which the...(NAIC)...and its affiliates and subsidiaries may be required to disclose confidential information about the insurer and its affiliates shared with the...(NAIC)...and its affiliates and subsidiaries pursuant to this act." Sec. 8, p. 23, l. 33-43, p. 24, l. 1-15.

80

Confidentiality (Sec. 8)

- Sharing of information does not constitute delegation of regulatory authority by the commissioner.
- No waiver of any applicable privilege or claim of confidentiality as a result of disclosure.
- Clarification of the confidential and privileged nature of information in the possession of the NAIC pursuant to the act.

81

Confidentiality (Sec. 8)

"The sharing of information by the commissioner of insurance, pursuant to this act, shall not constitute a delegation of regulatory authority or rulemaking, and the commissioner of insurance is solely responsible for the administration, execution and enforcement of the provisions of this act." Sec. 8, p. 24, l. 16-20.

"No waiver of any applicable privilege or claim of confidentiality in the documents, materials or information shall occur as a result of disclosure to the commissioner of insurance under this act or as a result of sharing as authorized in subsection (d)." Sec. 8, p. 24, l. 21-24.

"Documents, materials or other information in the possession or control of the national association of insurance commissioners, pursuant to this act, shall be confidential by law and privileged, shall not be subject to the open records act, K.S.A. 45-215 et seq., and amendments thereto, shall not be subject to subpoena, and shall not be subject to discovery or admissible in evidence in any private civil action." Sec. 8, p. 24, l. 25-30.

82

*

Confidentiality (Sec. 8)

- Documents received pursuant to the act are not subject to the Kansas Open Records Act, K.S.A. 45-215, et seq.

"Documents received pursuant to this section shall not be subject to disclosure pursuant to the open records act, K.S.A. 45-215 et seq., and amendments thereto." Sec. 8, p. 23, l. 30-32.

83

Reg. TAX?

KID's Anticipated Costs

- The domestic insurer would be responsible for paying KID's reasonable costs associated with attending the supervisory college.

- The amendments present no additional costs to KID outside of its existing budget.

84

Accreditation Issues

- The next NAIC accreditation review in 2016.
- This is effectively the deadline for implementing the Model Holding Company System Act revisions in order to maintain accreditation.
- Accreditation is necessary for KID's company examinations to be accepted by other state insurance regulators; otherwise, companies would be subject to duplicitous examinations by other states.

85

Adoption and Industry Support

- To date, ten states have adopted the insurance holding company system revisions:
  - CA, CT, IN, KY, LA, NE, PA, RI, TX, WV
- The insurance holding company system act amendments proposed in 2012 Sub HB 2077 enjoyed strong Industry support, including:

  Polsinelli Shughart, PC, American Council of Life Insurers (ACLI), Kansas Association of Property and Casualty Insurers, American Insurance Association (AIA), Security Benefit Life Insurance Company, Farmers Alliance Mutual Ins. Co., Farmers Ins. Co., American International Group, Inc. (AIG).

86

Summary

- Kansas has been regulating insurance holding companies since 1974.
- Experiences of the recent financial crisis, especially with AIG, led to scrutiny of insurance holding company regulation.
- The conclusion was that regulators need enhanced "windows" to look into the operations and financial health of insurance holding company systems, including international operations.

87

Summary

- The key amendments include authorization to participate in supervisory colleges, enterprise risk reporting requirements, and enhanced confidentiality provisions.
- The goal in monitoring insurance holding companies is to ensure domestic insurers remain solvent and are able to pay policyholders' claims.
- Such financial surveillance of domestic companies is a core function of KID, as is protecting consumers who rely upon domestic companies to pay their claims.

88

Glossary of Insurance Terms

ACT OF GOD - An unpreventable accident or event that is the result of natural causes; for example, floods, earthquakes, or lightning.

ANTISELECTION – The tendency of individuals who believe they have a greater than average likelihood of loss to seek insurance protection to a greater extent than do those who believe they have an average or a less than average likelihood of loss.

ANNUITY – Contract sold by insurance companies that pays a monthly (or quarterly, semiannual, or annual) income benefit for the life of a person (annuitant), for the lives of two or more persons, or for a specified period of time.

APPRAISAL - A survey by a claims representative or claims appraiser estimating the amount of damage to property and the cost to repair or the determination of a complete loss.

ASSESSED VALUE - The monetary worth of real or personal property as a basis for its taxation. This value, established by a governmental agency, is rarely used by insurers as a means to determine indemnification.

ASSET RISK – A measure of an asset's default of principal or interest or fluctuation in market value as a result of changes in the market.

AUTHORIZED CONTROL LEVEL RISKED BASED CAPITAL – insurance company's theoretical capital amount and surplus that is should maintain.

AVALANCHE - A slippage of built-up snow down an incline possibly mixed with ice, rock, and soil or plant life in what is called a debris avalanche. Avalanches are a major danger in the mountains during the winter as a large one can run for miles, and can create massive destruction of the lowered forest and anything else in its path.

BCEGS - Building Code Effectiveness Grading Schedule. A classification of communities by the Insurance Services Office based on how well they have implemented and enforced building codes in their community.

BENEFICIARY – The person or party named by the owner of a life insurance policy to receive the policy benefit.

BINDER – Temporary insurance contract providing coverage until a permanent policy is issued.

BROAD FORM INSURANCE - Coverage for numerous perils.

CALENDAR YEAR – Earned premiums and loss transactions occurring with the calendar year beginning Jan. 1, irrespective of the contractual dates of the policies to which the transactions relate and regardless of the dates of the accidents.

CALENDAR/ACCIDENT YEAR – The accumulation of loss data on all accidents with the date of occurrence falling within a given calendar year. The earned premium is the same as in calendar year.

CASH VALUE – The savings element of a permanent life insurance policy, which represents the policy owner's interest in the policy.

CATACLYSM - Any great upheaval that causes sudden and violent changes, as an earthquake, war, great flood, etc. (New World)

CATASTROPHIC RISK - The risk of a large loss by reason of the occurrence of a peril to which a very large number of insured are subject. (Gloss.)

CATASTROPHIC LOSS- Damage resulting from a catastrophe.

CATEX - An exchange through which insurers trade "standardized catastrophe units."

CLAIM – A formal request for payment related to an event or situation that is covered under an in-force insurance policy.

COINSURANCE CLAUSE - A clause requiring the insured to maintain insurance on the property at least equal to a stipulated percentage of its value in order to collect partial losses in full.

COMMERCIAL LINES – Insurance coverages for businesses, commercial institutions, and professional organizations.

CONCENTRATION FACTOR – All companies are subject to an asset concentration factor that reflects the additional risk of high concentrations in single exposures

CONSUMER PRICE INDEX - An index of consumer prices based on the typical market basket of goods and services consumed by all urban consumers during a base period.

CONTINGENT BENEFICIARY – The party designated to receive proceeds of a life insurance policy following the insured's death if the primary beneficiary predeceased the insured.

CONVERTIBLE TERM INSURANCE POLICY – A term life insurance policy that gives the policy owner the right to convert the policy to a permanent plan of insurance.

CORRECTIVE ORDER – An order issued by the commissioner specifying corrective actions that the commissioner has determined are required.

CREDIT LIFE INSURANCE – Insurance issued to a creditor (lender) to cover the life of a debtor (borrower) for an outstanding loan.

CREDIT RISK – A measure of the default risk on amounts that is due from policyholders, reinsures or creditors.

DECLINED RISK – A proposed insured who is considered to present a risk that is too great for an insurer to cover.

DEGREE OF CARE – Minimum of care owed by one party for the physical safety of another.

DIRECT WRITTEN PREMIUM - The total premiums received by a property and liability insurance company without any adjustments for the ceding of any portion of these premiums to the reinsures.

DIRECT INCURRED LOSS - The property loss in which the insured peril is the proximate cause of damage or destruction.

DISASTER - A natural or man-made event that negatively affects life, property, livelihood or industry often resulting in permanent changes to human societies, ecosystems and the environment.

DROUGHT - A drought is a long lasting weather pattern consisting of dry conditions with very little or no precipitation. During this period, food and water supplies can run low, and other conditions, such as famine, can result. Droughts can last for several years and particularly damaging in areas where residents depend on agriculture for survival.

EARNED EXPOSURES – The portion of the total amount of exposure (risk) corresponding to the coverage provided during a given time period.

EARNED PREMIUMS – The portion of the total premium amount corresponding to the coverage provided during a given time period.

EARTHQUAKE - A sudden shift or movement in the tectonic plate in the Earth's crust. On the surface, this is manifested by a moving and shaking of the ground, and can be massively damaging to poorly built structures.

EVIDENCE OF INSURABILITY – Proof that a person is an insurable risk.

EXCLUSIONS, HOMEOWNERS INSURANCE - Part of an insurance contract that excludes coverage of certain perils, persons, property or locations.

EXPERIENCE RATING – A method of calculating group insurance premium rates by which the insurer considers the particular group's prior claims and expense experience.

FACE AMOUNT – The amount of the death benefit payable under a life insurance policy.

FEMA - Federal Emergency Management Agency - A former independent agency that became part of the new Department of Homeland Security in March 2003 - is tasked with responding to, planning for, recovering from and mitigating against disasters

FLOODPLAIN - A land area adjacent to a river, stream, lake, estuary or other water body that is subject to flooding. These areas, if left undisturbed, act to store excess floodwater.
FRIENDLY FIRE - Fire intentionally set in a fireplace, stove, furnace or other containment that has not spread beyond it.

FREE LOOK PROVISION – An individual life insurance and annuity provision that gives the policy owner a stated time, usually 10 days after the policy is delivered, in which to cancel the policy and receive a full refund on the initial premium payment.

GENERAL LIABILITY INSURANCE – Coverage for an insured when negligent acts and/or omissions result in bodily injury and/or property damage on the premises of a business, when someone is injured as the result of using the product manufactured or distributed by a business, or when someone is injured in the general operation of a business.

GRACE PERIOD – A specified length of time within which a renewal premium that is due may be paid without penalty.

GROSS NEGLIGENCE – Reckless action without regard to life, limb, and/or property.

HAZARD – Circumstance that increases the likelihood or probable severity of a loss.

HURRICANE - A hurricane is a low pressure cyclonic storm system which forms over the oceans. It is caused by evaporated water which comes off of the ocean and becomes a storm. The Coriolis Effect causes the storms to spin, and a hurricane is declared when this spinning mass of storms attains a wind speed greater than 74mph.

INSURANCE TO VALUE - The amount of insurance written on property is approximately equal to its value. An insured most always wants to insure all property to value.

INCONTESTABILITY PROVISION – An insurance and annuity provision that limits the time within which the insurer has the right to avoid the contract on the ground of material misrepresentation in the application for the policy.

INCURRED BUT NOT REPORTED LOSSES (IBNR) – Insured losses that have occurred but have not been reported to a primary insurance company.

INCURRED CLAIMS – The total number of claims associated with insured events/situations occurring during a given time period.

INCURRED LOSSES – The total dollar amount of losses associated with insured events/situations occurring during a given time period. A portion of incurred claims and losses represent insurers' estimates of the final costs of pending claims that are still open during the reporting period, as well as estimates of losses associated with claims that have yet to be reported.

IRREVOCABLE BENEFICIARY – A life insurance policy beneficiary who has a vested interest in the policy proceeds even during the insured's lifetime because the policy owner has the right to change the beneficiary designation only after obtaining the beneficiary's consent.

INSURABLE INTEREST – The interest an insurance policy owner has in the risk that is insured. The owner of a life insurance policy has an insurable interest in the insured when the policy owner is likely to benefit if the insured continues to live and is likely to suffer some loss or detriment if the insured dies.

LANDSLIDE - A disaster closely related to an avalanche, but instead of occurring with snow, it occurs involving actual elements of the ground, including rocks, trees, parts of houses, and anything else which may happen to be swept in.

LIABILITY INSURANCE - Insurance coverage that offers protection against claims alleging that a property owner's negligence or inappropriate action resulted in bodily injury or property damage to another party.

LIFE AND HEALTH GUARANTEE ASSOCIATION – An organization that operates under the supervision of a state insurance commissioner to protect policy owners, insured's, beneficiaries, and specified others against losses that result from the financial impairment or insolvency of a life insurer that operates in the state.

LIMNIC ERUPTION - A sudden release of asphyxiating or inflammable gas from a lake.

LONG TAIL LIABILITY – One where an injury or other harm takes time to become known and a claim may be separated from the circumstances that caused it by as many as 25 years or more.

LOSS – The dollar amount associated with a claim.

LOSS ADJUSTMENT EXPENSE – Cost involved in an insurance company's adjustment of losses under a policy.

LOSS OF USE INSURANCE - Compensation for loss caused because the policyholder has lost the use of his property.

LOSS PAYABLE CLAUSE - A policy condition that enables an insured to direct the company to pay any loss that may be due to a third party.

LOSS RATIO – Relationship of incurred losses plus loss adjustment expense to earned premiums.

MATERIAL MISREPRESENTATION – A misrepresentation that would effect the insurance company's evaluation of a proposed insured.

MEDIATION – Situation in which parties agree to take part in a structured settlement negotiation through the guidance of a neutral expert. By participating in this process, the parties do not agree that they will actually settle and the mediator does not have the authority to impose such a settlement.

MORTALITY TABLES – Charts that show the death rates an insurer may reasonably anticipate among a particular group of insured lives at certain ages.

MORTGAGE INSURANCE - A contract that insures the lender against loss caused by a mortgagor's default on a government mortgage or conventional mortgage.

MORTGAGEE CLAUSE - A clause in an insurance policy that makes a claim jointly payable to the policyholder and the party that holds a mortgage on the property.

MUDSLIDE - A mudslide is a slippage of mud because of poor drainage of rainfall through soil. An underlying cause is often deforestation or lack of vegetation.

MULTI PERIL INSURANCE - Personal and business property insurance that combines in one policy several types of property insurance covering numerous perils.

NAMED PERIL POLICY - The insurance contract under which covered perils are listed. Benefits for a covered loss are paid to the policy-owner. If an unlisted peril strikes, no benefits are paid.

NATURAL AND PROBABLE CONSEQUENCES - Consequences from a given act that a reasonable person could foresee.

NEGATIVE TREND – With respect to a life and/or health insurer, negative trend over a period of time, as determined in accordance with the "Trend Test Calculation" included in the RBC instructions

NEGLIGENCE – Failure to act within the legally required degree of care for others, resulting in harm to them.

NFIP-NATIONAL FLOOD INSURANCE PROGRAM (NFIP) - The program of flood insurance coverage and floodplain management administered under the Act and applicable Federal regulations promulgated in Title 44 of the Code of Federal Regulations, Subchapter B.

OFF-BALANCE SHEET RISK – A measure of risk due to excessive rates of growth, contingent liabilities or other items not reflected on the balance sheet.

100 YEAR FLOOD - A flooding condition which has a one percent chance of occurring each year. The 100-year flood level is used as the base planning level for floodplain management in the National Flood Insurance Program.

ORIGINAL AGE CONVERSION – A conversion of a term life insurance policy to a permanent plan of insurance at a premium rate, based on the insured's age when the original term policy was purchased.

PERMANENT LIFE INSURANCE – Life insurance that provides coverage throughout the insured's lifetime and also provides a savings element.

POLICY ANNIVERSARY – As a general rule, the date on which coverage under an insurance policy became effective.

POLICYHOLDER SURPLUS – excess of an insurance company's assets above its legal obligations to meet the benefits (liabilities) payable to its policyholders. Also, the net worth in an insurance company adjusted for the overstatement of liabilities.

POLICY RIDER – An amendment to an insurance policy that becomes part of the insurance contract and either expands or limits the benefits payable under the contract.

POOLING – method by which each member of an insurance pool shares in each and every risk written by the other members of the pool.

PREFERRED RISK – A proposed insured who presents a significantly less than average likelihood of loss and who is charged a lower than standard premium rate.

PREMIUM - The dollar amount paid for an insurance policy.

PRIMARY INSURANCE – first layer property or liability coverage carried by the insured that provides benefits up to the limits of a policy, regardless of other insurance policies in effect.

REINSURANCE – form of insurance that insurance companies buy for their own protection, "a sharing of insurance." An insurer (the reinsured) reduces its possible maximum loss on either an individual risk or a large number of risks by giving (ceding) a portion of liability to another insurance company (reinsurer).

REINSURER – insurance company that assumes all or part of an Insurance or Reinsurance policy written by a primary insurance company.

REPLACEMENT COST - The cost of replacing property without a reduction for depreciation. By this method of determining value, damages for a claim would be the amount needed to replace the property using new materials.

RESIDUAL MARKET – Consists of insurance consumers unable to obtain coverage in the voluntary market.

RETENTION LIMIT – A specified maximum amount of insurance that a life insurer is willing to carry at its own risk on any one life without transferring some of the risk to a reinsurer.

RISK – uncertainty of a financial loss; term used to designate an insured or a peril insured against.

RISK BASED CAPITAL (RBC) – the amount of required capital that the insurance company must maintain based on the inherent risks in the insurer's operations

RBC INSTRUCTIONS – the RBC Report including risked based capital instruction adopted by the NAIC, as such RBC Instructions may be amended by the NAIC from time to time in accordance with procedures adopted by the NAIC.

RBC RATIO – measurement of the amount of capital (assets minus liabilities) an insurance company has as a basis of support for the degree of risk associated with it s company operations and investments. This ratio identifies the companies that are inadequately capitalized by dividing the company's by the minimum amount of capital that the regulatory authorities feel is necessary to support the insurance operations.

RBC STATISTIC – ratio of authorized control level risked based capital of an insurance company to its total adjusted capital. This statistic determines regulatory action taken by the state's insurance commissioner

SAFFIR SIMPSON SCALE - A 1-5 rating based on a hurricane's present intensity. This is used to give an estimate of the potential property damage and flooding expected along the coast from a hurricane landfall. Wind speed is the determining factor in the scale.

SCHEDULED PROPERTY - Listing specific personal property for a stated insured value. This is usually considered for valuable items that are subject to limited coverage.

SINK HOLE - A sinkhole is a localized depression in the surface topography, usually caused by the collapse of a subterranean structure, such as a cave. Although rare, large sinkholes that develop suddenly in populated areas can lead to the collapse of buildings and other structures.

STORM SURGE - A storm surge is an onshore rush of water associated with a low pressure weather system, typically a tropical cyclone. Storm surge is caused primarily by high winds pushing on the ocean's surface. The wind causes the water to pile up higher than the ordinary sea level. Storm surges are particularly damaging when they occur at the time of high tide, combing the effects of the surge and the tide.

SOLAR FLARE - A solar flare is a violent explosion in the Sun's atmosphere with an energy equivalent to tens of millions of hydrogen bombs. Solar flares take place in the solar corona and chromosphere, heating the gas to tens of millions of kelvins and accelerating electrons, protons and heavier ions to near the speed of light. They produce electromagnetic radiation across the spectrum at all wavelengths from long-wave radio signals to the shortest wavelength gamma rays. Solar flare emissions are a danger to orbiting satellites, manned space missions, communications systems, and power grid systems.

SYNTHETIC GUARANTEED INVESTMENT CONTRACT – modified guaranteed investment contract in which the underlying assets of the synthetic contract are owed by the plan itself rather than the insurance company as is the case with the GIC. This ownership rights is of particular importance if there is a concern about the long term financial soundness of an insurance company. The synthetic plan segregates the plan's assets from the assets of the insurance company.

SUBROGATION - The circumstance where an insurance company takes the place of an insured in bringing a liability suit against a third party who caused injury to the insured.

SUBSIDENCE - Movement of the land on which property is situated. A structure built on a hillside may slide down the hill due to earth movement caused by heavy rains.

TENANTS INSURANCE - Coverage for the contents of renter's home or apartment and for liability. Tenant policies are similar to homeowners insurance, except that they do not cover the structure.

Total Adjusted Capital - commonly refers to an insurance company's capital base under Standard & Poor's capital adequacy model. It includes shareholders' funds and adjustments on equity, asset values and reserves.

UMBRELLA POLICY - Umbrella coverage is insurance coverage that extends the terms of a regular insurance policy once coverage limits for the regular policy have been reached. Specifically, umbrella coverage is for people who want protection against a large jury award that is not covered in their standard policy.

UNDERWRITING – The process of identifying and classifying the degree of risk represented by a proposed insured.

UNDERWRITING RISK – a measure of the risk that arises from under-estimating the liabilities from business already written or inadequately pricing current or prospective business.

UNFRIENDLY FIRE - A fire that escapes from its normal contained area. For example, fire in the fireplace leaps onto the sofa.

VOLUNTARY MARKET – Consists of insurance consumers that insurers select to be provided coverage, using underwriting guidelines that are not unfairly discriminatory. The voluntary market is also called the normal or regular market.

WRITTEN EXPOSURE – The total number of exposures of all policies issued during a given time period.

WRITTEN PREMIUMS - The total premiums generated from all policies written by an insurance company within a given period of time.