

SESSION OF 2019

**CONFERENCE COMMITTEE REPORT BRIEF
HOUSE BILL NO. 2177**

As Agreed to April 2, 2019

Brief*

HB 2177 would create law and make several amendments to the Insurance Code to:

- Permit life insurance companies that offer fixed index annuities (FIAs) to utilize an alternative methodology accounting for certain reserves;
- Amend the effective date specified for risk-based capital (RBC) instructions;
- Amend registration requirements in the Insurance Holding Company Act related to a filing exemption for enterprise risk reports; and
- Amend provisions governing fraudulent insurance acts and associated criminal penalty provisions to add clarifying definitions and repeal nearly identical provisions also addressing fraudulent insurance acts.

Fixed Index Annuities [New Section 1]

The bill would create law permitting life insurance companies that offer FIAs to utilize an alternative methodology accounting for FIA hedging and associated reserves.

*Conference committee report briefs are prepared by the Legislative Research Department and do not express legislative intent. No summary is prepared when the report is an agreement to disagree. Conference committee report briefs may be accessed on the Internet at <http://www.kslegislature.org/kldr>

Definitions

The bill would define several terms, including:

- “Eligible derivative asset” would mean an option (as defined in law relating to financial futures contracts [KSA 40-2b25]) that is purchased or written to hedge the growth in interest credited to an indexed product as a direct result of changes in each related external index;
 - “Option,” as defined by KSA 40-2b25, means an agreement giving the buyer the right to buy or receive, sell or deliver, enter into, extend or terminate, or effect a cash settlement based on the actual or expected price, level, performance, or value of one or more underlying interests;
- “External index” would mean a list of securities, commodities, or other financial instruments that is published or disseminated by a source other than an insurance company, including Standard & Poor’s, NASDAQ, and Dow Jones; and
- “Indexed annuity products” and “indexed life products” would each mean life insurance policies that:
 - Provide a minimum guaranteed interest accumulation on a portion of all premium payments; and
 - Include provisions under which interest is credited based upon the performance of one or more external indices.

The term “hedging transaction” would be assigned its definition in KSA 40-2b25 and means a financial instrument transaction which is entered into and maintained to reduce the risk of a change in the value, yield, price, cash flow, or quantity of assets or liabilities which the insurer has acquired

or incurred or anticipates acquiring or incurring, or the currency exchange-rate risk or the degree of exposure as to assets or liabilities which the insurer has acquired or incurred or anticipates acquiring or incurring.

The bill would also define “indexed products” and “interest-crediting period.”

Criteria for Eligible Derivative Assets and Life Insurers

The bill would allow insurance companies to account for eligible derivative assets at amortized cost if the insurer can demonstrate these assets meet the following criteria for an economic hedge at the inception of the hedge, or as of the date the insurer begins using the accounting practices established by the bill:

- There must be a formal documentation of the economic hedging relationship and the insurer’s risk management objective and strategy for undertaking the economic hedge, including certain information described by the bill; and
- At the end of each quarterly reporting period, the insurer must maintain documentation that the economic hedge is expected to be and continues to be highly effective in achieving offsetting changes in fair value attributable to the hedged risk during the period the economic hedge is designated.

The bill would further provide that eligible derivative assets purchased or written within a year or less to maturity or expiration shall not be required to be amortized.

Accounting Practices Applying to FIA Reserves

The bill would establish the following accounting practices and would further state this practice would not apply to the calculation of indexed life insurance product reserves:

- Indexed annuity product reserve calculations must be based on Actuarial Guideline XXXV assuming the market value of the eligible derivative assets associated with the current interest crediting period is zero, regardless of the observable market for the eligible derivative assets; and
- At the conclusion of each interest-crediting period, the interest credited to such product must be reflected in the indexed annuity product reserve as realized, based on the actual performance of the relevant external index or internal indices.

Reporting Requirements; Rules and Regulations

The bill would require insurers opting to use the alternative accounting practices established in the bill to report quarterly to the Commissioner of Insurance (Commissioner) for analysis purposes, the market value of its eligible derivative assets, and what the Actuarial Guideline XXXV reserve would be, using the market value of such assets. The bill would further prescribe that an insurer electing to use this methodology shall not change its accounting practices back to those that would apply in the absence of the statute without the prior approval of the Commissioner.

The bill would also state the Commissioner shall have the power to adopt all reasonable rules and regulations necessary to implement provisions of the bill.

Risk-based Capital Instructions [Section 2]

The bill would also amend the effective date specified in the Insurance Code for the RBC instructions promulgated by the National Association of Insurance Commissioners (NAIC) for property and casualty companies and for life insurance companies. The instructions currently specified became effective on December 31, 2017. The bill would update the effective date on the RBC instructions to December 31, 2018.

Enterprise Risk Reports [Section 3]

The bill would amend registration requirements in the Insurance Holding Company Act related to a filing exemption for enterprise risk reports. Specifically, the bill would require an enterprise risk report filed by the ultimate controlling person of every insurer subject to registration to be appropriate to the nature, scale, and complexity of the insurer.

The bill would exempt the ultimate controlling person of a domestic insurer from submitting an enterprise risk report if the domestic insurer is authorized, admitted, or eligible to engage in the business of insurance only in Kansas with total direct and assumed annual premiums of less than \$300.0 million, unless the ultimate controlling person of the domestic insurer also controls other insurers not meeting the requirements of the section. The bill would specify an insurer is not considered to be authorized, admitted, or eligible to engage in the business of insurance only in Kansas if the insurer directly or indirectly writes or assumes insurance in any other manner in another state.

Fraudulent Insurance Acts [Section 4; repealer]

The bill would also amend provisions governing fraudulent insurance acts and associated criminal penalty provisions to add clarifying definitions (KSA 2018 Supp. 40-2,118) and repeal nearly identical provisions also addressing fraudulent insurance acts (KSA 2018 Supp. 40-2,118a).

The bill would create the following definitions and update references in criminal penalty provisions to specify “amount involved” as the term relates to the severity level of the crime:

- “Amount involved” would mean the greater of:
 - The actual pecuniary harm resulting from the fraudulent insurance act;
 - The pecuniary harm that was intended to result from the fraudulent insurance act; or
 - The intended pecuniary harm that would have been impossible or unlikely to occur, such as in a government sting operation or a fraud in which the claim for payment or other benefit pursuant to an insurance policy exceeded the allowed value. The aggregate dollar amount of the fraudulent claims submitted to the insurance company shall constitute *prima facie* evidence of the amount of intended loss and is sufficient to establish the aggregate amount involved in the fraudulent insurance act, if not rebutted; and

- “Pecuniary harm” would mean harm that is monetary or that otherwise is readily measurable in money, and does not include emotional distress, harm to reputation, or other non-economic harm.

The bill would make technical amendments.

Conference Committee Action

The Conference Committee agreed to the Senate amendments to HB 2177 and agreed to further amend the bill by adding provisions pertaining to exemptions from filing enterprise risk reports (SB 66, as recommended by the Senate Committee on Financial Institutions and Insurance); and adding provisions pertaining to fraudulent insurance acts (SB 28, as amended by the House Committee on Insurance).

Background

The Conference Committee Report includes the provisions of HB 2177, SB 66, and SB 28.

HB 2177 (Fixed Index Annuities; Risk-based Capital)

HB 2177 was introduced by the House Committee on Insurance at the request of its chairperson, Representative Vickrey, on behalf of Security Benefit. In the House Committee on Insurance and Senate Committee on Financial Institutions and Insurance hearings, the Vice President and Associate General Counsel for the Security Benefit Life Insurance Company stated the purpose of the bill is to allow life insurance companies to utilize certain accounting practices that provide a truer and fairer representation of their capital position and financial results in connection with hedging of fixed index annuity products (referred to as FIAs). The representative noted Security Benefit has used the accounting practice allowed by the bill since 2011 through an annual request and authorization as a “permitted practice” by the Kansas Insurance Department (Department). Passage of HB 2177, the representative continued, would put Kansas life insurers on the same footing, without the need to seek a permitted practice annually, and would level the playing field with competitors from other states. At the time the House Committee considered its action on the bill, a representative

of the Department appeared before the House Committee and offered support for HB 2177.

The Senate Committee amended HB 2177 to add provisions relating to RBC instructions (HB 2143, as recommended by the House Committee). [Note: The Conference Committee retained this amendment.]

According to the fiscal note prepared by the Division of the Budget, the Department indicates enactment of HB 2177 would require the agency to analyze insurance companies' capital under alternative accounting methods. The agency states it would be able to absorb this analysis within its existing analysis with a negligible effect on workload and expenditures. Any fiscal effect associated with enactment of HB 2177, as introduced, is not reflected in *The FY 2020 Governor's Budget Report*.

According to the fiscal note prepared by the Division of the Budget, the Department indicates enactment of HB 2143, as introduced, would have no fiscal effect.

SB 66 (Enterprise Risk Reports)

SB 66 was introduced by the Senate Committee on Financial Institutions and Insurance at the request of the Department.

In the Senate Committee on Financial Institutions and Insurance and House Committee on Insurance hearings, a representative of the Department testified in favor of the bill, noting its purpose is to repeal the small group exemption currently in statute. The representative stated Kansas is the only state that maintains an exemption for small groups and, absent repeal of this provision, the Department would be out of compliance with the NAIC accreditation standards. The representative noted repeal of this provision would impact ten companies. The representative also provided a letter from the NAIC outlining the history of the enterprise risk report filing

requirements. No neutral or opponent testimony was provided.

The House Committee on Insurance amended SB 66 to add the provisions of SB 28 (RBC instructions). [*Note:* The Conference Committee receded from this amendment, since identical provisions pertaining to RBC instructions were included in HB 2177, as amended by the Senate Committee and adopted by the Conference Committee.]

According to the fiscal note prepared by the Division of the Budget, the Department indicates enactment of SB 66, as introduced, would result in additional expenditures from the increased processing time required for submissions of Form F-Enterprise Risk Report. However, the Department indicates the additional expenditures would be negligible and could be absorbed within existing resources. Any fiscal effect associated with enactment of SB 66, as introduced, is not reflected in *The FY 2020 Governor's Budget Report*.

SB 28 (Fraudulent Insurance Acts)

SB 28, as introduced, addressed RBC instructions. This Conference Committee Report includes SB 28, as amended by the House Committee, which pertains only to fraudulent insurance acts (HB 2213, as amended by the House Committee on Insurance).

The provisions previously contained in SB 28 were placed in SB 66 by the House Committee on Insurance. [*Note:* SB 66, as recommended by the Senate Committee is included in this report; provisions pertaining to RBC are included in the underlying bill for this report, HB 2177.]

HB 2213 (Fraudulent Insurance Acts)

HB 2213 was introduced by the House Committee on Corrections and Juvenile Justice at the request of the Office

of the Attorney General. The bill was referred to the House Committee on Insurance.

In the House Committee hearing on February 25, 2019, an Assistant Attorney General in the Fraud and Abuse Litigation Division (Division) provided testimony in support of the bill, noting as of July 1, 2017, the Department began forwarding all cases of criminal insurance fraud to the Division for potential criminal prosecution. The conferee also noted the bill codifies and clarifies what “amount involved” means and mirrors the definition for “aggregate amount of payments illegally claimed” in the Kansas Medicaid Fraud Control Act. Both statutes, the conferee continued, criminalize the making of fraudulent claims. The conferee also noted the repeal of the second statute pertaining to fraudulent insurance acts (KSA 2018 Supp. 40-2,118a) is requested as the only present difference between the two statutes is the means by which the fraudulent insurance act is presented to the insurance company.

On February 25, 2019, the House Committee on Insurance amended HB 2213 to expand one of the provisions associated with the term “amount involved.” The amendment was requested by the Office of the Attorney General. On February 28, 2019, HB 2213 was stricken from the Calendar pursuant to House Rule 1507. On March 13, 2019, the House Committee on Insurance amended SB 28 by removing its contents related to RBC instructions. The House Committee then inserted provisions of HB 2213 in SB 28. [Note: The Conference Committee retained these amendments.]

According to the fiscal note prepared by the Division of the Budget on HB 2213, as introduced, the Office of Judicial Administration and the Department indicate enactment of the bill would have no fiscal effect.

insurance; fixed index annuities; risk-based capital; enterprise risk reports; fraudulent insurance acts

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