

Insurance Code Amendments and Law—Fixed Index Annuities; RBC Instructions; Enterprise Risk Reports; Fraudulent Insurance Act; HB 2177

HB 2177 creates law and amends 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 creates law permitting life insurance companies that offer FIAs to utilize an alternative methodology accounting for FIA hedging and associated reserves.

Definitions

The bill defines several terms, including:

- “Eligible derivative asset” to 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” to 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” to 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” is assigned its definition in KSA 40-2b25: 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 that 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 that the insurer has acquired or incurred or anticipates acquiring or incurring.

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

Criteria for Eligible Derivative Assets and Life Insurers

The bill will permit 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 further provides 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 establishes the following accounting practices and further states this practice will 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 requires 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 further prescribes 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 also states the Commissioner shall have the power to adopt all reasonable rules and regulations necessary to implement provisions of the bill related to fixed index annuities.

Risk-based Capital Instructions [Section 2]

The bill changes 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 from December 31, 2017, to December 31, 2018.

Enterprise Risk Reports [Section 3]

The bill amends registration requirements in the Insurance Holding Company Act related to a filing exemption for enterprise risk reports. Specifically, the bill requires 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 exempts 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 subsection. The bill specifies 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 amends provisions governing fraudulent insurance acts and associated criminal penalty provisions to add clarifying definitions (KSA 2018 Supp. 40-2,118) and repeals nearly identical provisions also addressing fraudulent insurance acts (KSA 2018 Supp. 40-2,118a).

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

- “Amount involved” to 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” to 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.