



Ohio Legislative Service Commission

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Fiscal Note & Local Impact Statement

Bill: [S.B. 140 of the 130th G.A.](#)

Date: October 8, 2013

Status: As Introduced

Sponsor: Sen. Bacon

Local Impact Statement Procedure Required: No

Contents: To make changes to the law governing insurance holding company systems

State Fiscal Highlights

- The bill may increase the Department of Insurance's financial examination expenses to regulate and enforce the proposed alternative investment law. If there is any increase in such costs, it is likely to be minimal. Any such costs would be paid from the Superintendent's Examination Fund (Fund 5550). Any expenses from conducting such examination are paid by the company to the Superintendent and deposited into Fund 5550.
- The bill may also increase the Department of Insurance's administrative expenses related to the regulation and enforcement of the Holding Company Systems Law. If there is any increase in such costs, it is likely to be minimal. Any such costs would be paid from the Department of Insurance Operating Fund (Fund 5540).
- The bill allows the Superintendent of Insurance to impose certain penalties. All penalties would be deposited into Fund 5540. The amount of revenue collected would depend on the compliance of insurers with the bill's requirements.

Local Fiscal Highlights

- The provision allowing the Superintendent to petition the Court of Common Pleas of Franklin County for an order compelling the witness to appear and testify or produce documentary evidence related to the Holding Company Systems Law may increase the court costs. If there is any increase in such costs, it is likely to be minimal.

Detailed Fiscal Analysis

The bill proposes an alternative investment law and changes the law governing insurance holding company systems. The bill eliminates the petition requirement for domestic mutual companies that wish to merge or consolidate with another company and eliminates the commission created to hear and determine petitions for merger and consolidation. The bill also provides the requirements for maintaining a risk management framework and completing an own risk and solvency assessment, and provides guidance and instructions for filing an own risk and solvency assessment summary report with the Superintendent of Insurance. Most of the provisions have no significant fiscal effect on the state and local governments. The following provisions may have a minimal fiscal effect on the Department of Insurance Operating Fund (Fund 5540). However, it may potentially increase penalties due to any violations related to the Holding Company System Law. Any such increase would depend on the number of such violations.

Alternative investment law

Under the bill, the proposed alternative investment law would apply to the following types of insurers: small employer health care alliances, health insuring corporations, domestic legal reserve life insurance companies, mutual protective associations, mutual insurance companies, fraternal benefit societies, nonlife domestic insurance companies, and title insurance companies. The bill provides that such insurers may apply to the Superintendent of Insurance for permission to make investments based on the requirements under the proposed law, in lieu of making investments as specified under current law. However, the bill specifies that the assets of any separate account established by domestic life insurers that are to be applied to provide benefits and contractual payments under existing law must be invested using the requirements under current law.

In determining whether to permit an entity to invest pursuant to the proposed alternative investment law, the bill requires the Superintendent to consider certain requirements related to the character, reputation, and financial standing of the entity and the entity's officers; the adequacy of the expertise, experience, character, and reputation of the person or persons who will manage the investments on behalf of the entity; the quality of the enterprise risk management program implemented by the entity; and any other factor that the Superintendent considers relevant.

The bill also specifies the following minimum financial security benchmarks for insurers seeking to invest under the proposed alternative investment law:

1. 300% of the authorized control level risk-based capital applicable to the insurer, less the asset valuation reserve as defined in the risk-based capital instructions;

2. The minimum capital or minimum surplus required by statute or rule for maintenance of an insurer's certificate of authority in Ohio;
3. All invested assets of an entity organized under Ohio Mutual Protective Insurance Law;
4. For title insurers, the quotient of annualized net earned premiums divided by eight;
5. For multiple employer welfare arrangements, the greater of 300% of the risk-based capital amount reported in the annual statement or the quotient of annualized net-earned premiums divided by 12.

The bill also provides that the Superintendent may establish, by order, a minimum financial security benchmark to apply to a specific insurer that exceeds the benchmarks above. In addition, the Superintendent may adopt rules to change the minimum financial security benchmark that is a multiple of authorized control level risk-based capital, or equivalent risk-based capital calculation, to apply to any class of insurers provided the amount established by the rule is not less than the benchmarks above.

The bill requires the Superintendent to determine the amount of minimum capital or minimum surplus for determining an insurer's minimum financial security benchmark. The amount must be sufficient to provide reasonable security against contingencies affecting the insurer's financial position that are not fully covered by reserves or by reinsurance. The bill specifies that the Superintendent must consider certain factors as specified by the bill in determining the amount of minimum capital or minimum surplus and the minimum financial security benchmark for an insurer. The Superintendent may determine an insurer to be financially hazardous under the Reserve Valuation; Rehabilitation and Liquidation Law, if the insurer does not own the amount of assets needed to meet its minimum asset requirement or if the insurer is unable to apply the amount of assets needed to meet its minimum asset requirement toward compliance with the proposed alternative investment law.

The bill requires that the board of directors of an insurer making investments under the proposed alternative investment law to exercise the judgment and care and take into account the prudence evaluation criteria with respect to all of the insurer's investments. The bill requires an insurer to implement internal controls and procedures to assure compliance with its investment policies and procedures. The bill specifies that an insurer investing under the proposed law must maintain assets in an amount equivalent to the sum of its liabilities and its minimum financial security benchmark at all times (referred to as the "minimum asset requirement"). The bill also provides classes of investments that may be counted for the purposes of the minimum asset requirement.

The bill specifies that an insurer investing under the proposed law must not invest in certain investments that are prohibited for an insurer by statute or rules of the state. An insurer is also prohibited from investing in a partnership as a general partner.

In addition, the Superintendent must set a reasonable amount of time, not to exceed five years, for disposal of a prohibited investment in hardship cases if the insurer demonstrates that the investment was legal when made or the result of a mistake made in good faith, or if the Superintendent determines that the sale of the asset would be contrary to the interests of insureds, creditors, or the general public.

The bill specifies that any insurer who invests in prohibited investments is considered a violation that may be grounds for regulatory action under current law.¹ Thus, insurers that invest in prohibited investments may be subject to a rehabilitation action filed by the Superintendent with a court of common pleas.

The bill requires an insurer to file with the Superintendent a copy of its derivative use plan and internal controls, for informational purposes, prior to entering into derivative transactions. The bill requires the insurer to keep current the copy of its derivative use plan and internal controls filed with the Superintendent. The bill prohibits an insurer from entering into derivative transactions until 30 calendar days after the date on which the derivative use plan and internal controls is filed with the Superintendent. In addition, the bill requires an insurer engaging in hedging transactions or replication transactions to maintain its position in any outstanding derivative instrument used as part of a hedging transaction or replication transaction for as long as the hedging transaction or replication transaction remains in effect and demonstrate to the Superintendent, upon request, that any derivative transaction entered into and involving a hedging transaction or replication transaction is an effective hedging transaction or replication transaction.

The bill allows the Superintendent, if the Superintendent determines that an insurer does not meet the investment requirements under the proposed alternative investment law, after notification to the insurer of such determination, to order the insurer to make necessary changes to comply with the proposed law. In addition, if the Superintendent determines that the financial condition or current investment practice or plan of an insurer are or may endanger the interests of insureds, creditors, or the general public, the Superintendent may impose reasonable additional restrictions upon the admissibility or valuation of investments and may impose restrictions on the investment practices of the insurer, including prohibiting an investment or requiring the divestment of an investment.

The bill allows the Superintendent to count toward satisfaction of the minimum asset requirement any assets that an insurer is required to invest under the laws of a country other than the United States as a condition for doing business in that country if the Superintendent finds that counting them does not endanger the interests of the insurer's insureds or creditors, or the general public. In addition, if the Superintendent is satisfied by evidence of the solidity of an insurer and the competence of management and its investment advisors, the bill allows the Superintendent, after a hearing, to, by

¹ O.R.C. 3903.12.

order, adjust the investment class limitations for that insurer, to the extent that the Superintendent is satisfied that the interests of the insurer's insureds and creditors and the general public are sufficiently protected. Such adjustments, in aggregate, must be limited to an amount equal to 10% of the insurer's liabilities. The bill allows an insurer subject to a discretionary action taken by the Superintendent to request a hearing within 30 days of the date of the order. The hearing must be held privately unless the insurer requests a public hearing.

The bill authorizes the Superintendent to adopt rules interpreting and implementing the provisions of the alternative investment law. The bill also authorizes the Superintendent to adopt rules related to certain restrictions on investment. If the Superintendent is satisfied by evidence of the solidity of an insurer and the competence of management and its investment advisors, the bill authorizes the Superintendent, after a hearing, to, by order, grant an exemption to that insurer from any such restriction adopted in rules to the extent that the Superintendent is satisfied that the interests of the insurer's insureds and creditors, as well as the general public, are protected.

Insurance holding company systems

The bill provides that any controlling person of a domestic insurer seeking to divest its controlling interest in the domestic insurer must file a confidential notice of its proposed divestiture with the Superintendent at least 30 days prior to the cessation of control, and provide a copy of the confidential notice to the insurer. The bill allows the Superintendent to require the person seeking to divest the controlling interest to file for and obtain approval of the transaction. The information must remain confidential until the conclusion of the transaction unless the Superintendent, in the Superintendent's discretion, determines that the confidential treatment will interfere with enforcement of such requirements. The bill expands the information that must be included in the statement and included additional information that must be provided in the statement. The bill also provides that the requirements under this bill do not apply if the statement has been filed with the Superintendent.

The bill specifies additional information that must be included in the registration statement and other requirements related to such statement. Under existing law each insurer that is authorized to do business in Ohio and that is a member of an insurance holding company system must register with the Superintendent of Insurance.

The bill also requires the ultimate controlling person of every insurer subject to registration to file an annual enterprise risk report. Under the bill, the report must, to the best of the ultimate controlling person's knowledge and belief, identify the material risks within the insurance holding company system that could pose enterprise risk to the insurer. The ultimate controlling person is required by the bill to file the report with the lead state commissioner of the insurance holding company system as determined by the procedures within the financial analysis handbook adopted by the National Association of Insurance Commissioners (NAIC). The bill specifies that the failure to file

a required enterprise report would result in the same potential penalties by the Superintendent. The bill also makes changes to transaction standards by registered insurers with their affiliates.

The bill authorizes the Superintendent to examine any registered insurer and its affiliates to ascertain the financial condition of the insurer, including the enterprise risk to the insurer by the ultimate controlling party, or by any entity or combination of entities within the insurance holding company system, or by the insurance holding company system on a consolidated basis. The Superintendent may order any registered insurer to produce records, books, or other information papers in the possession of the insurer and its affiliates as may be reasonably necessary to determine compliance with the Holding Company Systems Law.

The bill authorizes the Superintendent to order any registered insurer to produce information not in the possession of the insurer if the insurer can obtain access to such information pursuant to a contractual relationship, statutory obligation, or other method, in order to determine compliance with the Holding Company Systems Law. If the insurer cannot obtain the information requested by the Superintendent, the insurer must provide the Superintendent a detailed explanation of the reason that the insurer cannot obtain the information and the identity of the holder of information. The bill allows the Superintendent, after notice and hearing, that the insurer pay a penalty of up to \$10,000 per day whenever it appears to the Superintendent that the detailed explanation is without merit, or the Superintendent may suspend or revoke the insurer's license. If the insurer fails to comply with an order of the Superintendent, the bill authorizes the Superintendent to issue subpoenas, administer oaths, and examine under oath any person for purposes of determining compliance with the record production provisions. Under the bill, upon the failure or refusal of any person to obey a subpoena, the Superintendent may petition the Court of Common Pleas of Franklin County for an order compelling the witness to appear and testify or produce documentary evidence. Failure to obey the court order, under the bill, must be punishable as contempt of court.

The bill authorizes the Superintendent 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 the Holding Company Systems Law. A supervisory college may be convened as either a temporary or permanent forum for communication and cooperation between the regulators charged with the supervision of the insurer or its affiliates. Each registered insurer is liable for and must pay the reasonable expenses of the Superintendent's participation in such supervisory college, including reasonable travel expenses. The Superintendent may also establish a regular assessment to the insurer for the payment of these expenses.

The bill makes changes to confidential and privileged treatment of documents, materials, or other information under the bill. The bill also requires the Superintendent to enter into written agreements with NAIC governing sharing and use of information under the Holding Company Systems Law.

The bill requires an insurer to maintain a risk management framework to assist the insurer with identifying, assessing, monitoring, managing, and reporting on its material and relevant risks. The bill specifies that the requirement may be satisfied if the insurance group of which the insurer is a member maintains a risk management framework applicable to the operations of the insurer. Upon the request of the Superintendent, and not more than once annually, an insurer must submit to the Superintendent an own risk and solvency assessment summary report, or any combination of reports that together contain the information described in the own risk and solvency assessment guidance manual, applicable to the insurer or the insurance group of which it is a member. An insurer is exempted from these requirements if it meets certain conditions.

The bill makes changes related to automated transactions in the business of insurance. The bill authorizes the Superintendent of Insurance to adopt rules as the Superintendent considers necessary to carry out the purposes of the bill's provisions relating to automated transactions in the business of insurance. The bill also revises regulations related to reinsurance law and eliminates the commission created to hear and determine petitions for merger and consolidation of an insurance company.

Fiscal effect

The bill may increase the Department of Insurance's financial examination expenses to regulate and enforce the proposed alternative investment law. Any such costs would be paid from the Superintendent's Examination Fund (Fund 5550). Currently, any expenses from conducting such examination are paid by the company to the Superintendent and deposited into Fund 5550. The bill may also increase the Department of Insurance's administrative costs to regulate and enforce the requirements related to the Holding Company Systems Law. Any increase in administrative costs would be paid from the Department of Insurance Operating Fund (Fund 5540).

Provisions related to the liquidation of an insurer that is considered financially hazardous under the Reserve Valuation, Rehabilitation, and Liquidation Law would have no fiscal effect. Currently, when an Ohio domestic insurance company becomes insolvent and requires liquidation the Superintendent of Insurance would initiate a court action to place the company in liquidation. The Office of the Ohio Insurance Liquidator is technically a private trustee's office, overseen by the Franklin County Court of Common Pleas, and it would liquidate all assets and resolve all claims against the insolvent insurance company. The Office is funded by a share of the estate left by a liquidated insurance company. Thus, the cost of liquidating such insurer would be recovered from the insurer's assets.

The bill may also increase the Franklin County Court of Common Pleas' court costs due to provisions related to the Holding Company Systems Law. The bill allows the Superintendent to petition to the Court of Common Pleas of Franklin County for an order compelling the witness to appear and testify or produce documentary evidence related to the Holding Company Systems Law.

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