HOUSE BILL REPORT
SHB 2097

As Passed House
March 15, 1997

Title: An act relating to investment practices of insurance companies.

Brief Description: Regulating the investment practices of insurance companies.

Sponsors: By House Committee on Financial Institutions & Insurance (originally sponsored by Representative L. Thomas).

Brief History:
Committee Activity:
Financial Institutions & Insurance: 2/27/97, 3/3/97 [DPS].
Floor Activity:
Passed House: 3/15/97, 81-15.

HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS & INSURANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 10 members: Representatives L. Thomas, Chairman; Smith, Vice Chairman; Zellinsky, Vice Chairman; Wolfe, Ranking Minority Member; Grant, Assistant Ranking Minority Member; Benson; Constantine; DeBolt; Keiser and Wensman.

Minority Report: Do not pass. Signed by 1 member: Representative Sullivan.

Staff: Charlie Gavigan (786-7340).

Background: The Office of Insurance Commissioner oversees the corporate and financial activities of insurance companies. All companies authorized to conduct insurance operations in Washington must meet statutory requirements for capital, surplus capital, reserves, investments, and other financial and operational considerations.

Allowable investments of insurance companies are regulated by statute and rule. For instance, insurance companies cannot have investments or loans with one person, corporation, institution, or municipal corporation exceeding 4 percent of total assets, except for general obligations of states, the federal government, or certain foreign obligations. Insurance companies can invest up to 10 percent of their assets in corporate stocks. Generally, an insurance company cannot have more than 10 percent of its assets in ownership of its home office and other offices or buildings without the approval of the insurance commissioner. The type of investments allowed for capital and reserves is limited, and certain investments are prohibited.

A derivative is a financial agreement that has its value based on, or derived from, some underlying index or financial asset, such as interest rates, currencies, stock prices, or commodities. Typically, derivatives are used to hedge risks, but derivatives, especially exotic or unusual derivatives, can be used for speculation. The value of the underlying asset is called the notional amount. The major types of derivatives, which can be combined to create more complicated derivatives, include forwards and futures, options, and swaps.

The National Association of Insurance Commissioners (NAIC) has a model act on regulating investments of insurance companies; this act includes provisions regulating the use of derivatives.

Summary of Bill: An insurance company may engage in derivative transactions if specific conditions are complied with. The primary purpose of derivatives used by insurance companies must be to hedge risk; the insurer must demonstrate to the insurance commissioner the intended hedging characteristics of the derivative and its ongoing effectiveness in that regard. An insurer can use derivatives for income generation in some limited circumstances. The insurance commissioner is authorized to adopt rules regarding the use of derivatives by insurance companies.

Appropriation: None.

Fiscal Note: Available.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Testimony For: Using derivatives to hedge risk allows insurance companies to better manage risk and improves the solvency of the company. Derivatives give insurance companies more flexibility and allows them to better compete with other types of financial institutions. Several states allow insurance companies to use derivatives, and the NAIC has a model act that includes use of derivatives.

Testimony Against: While a limited use of derivatives is helpful to insurance companies, the bill is too vague and does not contain adequate safeguards. Derivatives can be risky. If derivatives are going to be allowed, a more conservative approach with specific safeguards should be considered; the NAIC model is a good place to start.

Testified: Bill Fritts, ReliaStar (supports); Garth Bernard, Northern Life Insurance (supports); and John Woodall, Office of the Insurance Commissioner (opposes).