SENATE BILL REPORT

SHB 2097

As Reported By Senate Committee On:
Financial Institutions, Insurance & Housing, March 27, 1997

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

Brief Description: Regulating the investment practices of insurance companies.

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

Brief History:
Committee Activity: Financial Institutions, Insurance & Housing: 3/25/97, 3/27/97 [DP].

SENATE COMMITTEE ON FINANCIAL INSTITUTIONS, INSURANCE & HOUSING

Majority Report: Do pass.
Signed by Senators Winsley, Chair; Benton, Vice Chair; Finkbeiner, Hale, Heavey, Kline and Prentice.

Staff: Catherine Mele (786-7470)

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 example, 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 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 the insurance company complies with specific conditions. The primary purpose of derivatives used by insurance companies must be to hedge risk. In order to engage in derivative transactions, the insurer must demonstrate to the Insurance Commissioner the intended hedging characteristics of the derivative and its ongoing effectiveness. 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: This bill gives insurance companies the flexibility to invest in derivatives in a safe and nonspeculative manner. The use of derivatives in a nonspeculative manner is a widely accepted practice allowed by many other states. We developed this legislation using the National Association of Insurance Commissioner's Model Statute regarding derivative investment.

Testimony Against: None.

Testified: John Woodall, OIC; PRO: William D. Fritts, Garth Bernard, Northern Life; Mike Kapphahn, Farmers Insurance Group.