

SESSION OF 2013

SUPPLEMENTAL NOTE ON SENATE BILL NO. 166

As Amended by Senate Committee on Financial
Institutions and Insurance

Brief*

SB 166 would enact new law that would be supplemental to the Insurers Supervision, Rehabilitation and Liquidation Act and amend provisions in the Act (which relates to impaired or insolvent insurers) to state no person could be stayed, enjoined, or prohibited from exercising any contractual right to terminate, liquidate, accelerate, or close out of obligations in connection with any netting agreement or qualified financial contract due to certain conditions specified in the bill.

Under the bill, a person could not be prohibited from exercising:

- A contractual right to resolve obligations relating to a netting agreement or qualified financial contract with an insurer because of:
 - The insolvency, financial condition, or default of the insurer at any time; or
 - The commencement of a formal delinquency proceeding.
- Any right under a pledge, security, collateral, reimbursement, or guarantee agreement or arrangement, or any other similar security agreement relating to one or more netting agreements or qualified financial contracts; or

*Supplemental notes are prepared by the Legislative Research Department and do not express legislative intent. The supplemental note and fiscal note for this bill may be accessed on the Internet at <http://www.kslegislature.org>

- Any right to set off or net out any termination value, payment amount, or other transfer obligation related to one or more qualified financial contracts.

The bill also would provide that when a counterparty (another party to a master netting agreement or a qualified financial contract that is subject to a formal delinquency proceeding) terminates, liquidates, closes out, or accelerates the agreement or contract, damages must be measured at the time of the termination, liquidation, close out, or acceleration. The amount of damages would be the actual direct compensatory damages. Upon termination of a netting agreement or qualified financial contract, the net or settlement amount, if any, owed by a non-defaulting party to an insurer would be required to be transferred, even if the insurer is the defaulting party (notwithstanding a “walkaway clause” in the netting agreement or qualified financial contract).

The bill would create duties of the receiver in the circumstances of making a transfer of a netting agreement or qualified insurer subject to a formal delinquency proceeding. In making this transfer, the receiver would be required to either:

- Transfer to one party all netting agreements and qualified financial contracts between a counterparty or any affiliate of the counterparty; or
- Transfer none of the netting agreements, qualified financial contracts, rights, obligations or property.

If the receiver for an insurer transfers one or more netting agreements or qualified contracts, then the receiver would be required to attempt to notify any person who is a party to the netting agreements or qualified financial contracts of the transfer by 12 noon of the business day following the transfer.

The bill would provide further that a receiver could not

avoid a transfer of money or other property in connection with a netting agreement or qualified financial contract that is made before the commencement of a formal delinquency proceeding. A transfer, however, could be avoided if the transfer was made with actual intent to hinder, delay, or defraud the insurer, a receiver appointed for the insurer, or existing or future creditors. In exercising the rights of disaffirmance or repudiation of a receiver with respect to a netting agreement or qualified financial contract, the receiver for the insurer would be required to either:

- Disaffirm or repudiate all netting agreements and qualified financial contracts between a counterparty or any affiliate of the counterparty and the insurer that is subject to the proceeding; or
- Disaffirm or repudiate none of those netting agreements and qualified financial contracts.

Under the bill, any claim of a counterparty against the estate arising from the disaffirmance or repudiation of a netting agreement or qualified financial contract that has not been previously affirmed in a proceeding must be allowed or disallowed as if the claim had arisen before the filing date of the petition for liquidation, conservation, or rehabilitation. The amount of damages (the claim) would be the actual direct compensatory damages at the time of the disaffirmance or repudiation of the netting agreement or qualified financial contract.

***Insurers Supervision, Rehabilitation, and Liquidation Act
—Definitions***

The bill would insert definitions for the terms “commodity contract,” “formal delinquency proceeding,” “forward contract,” “netting agreement,” “qualified financial contract,” “repurchase agreement,” “securities contract,” and “swap agreement” into existing law applying to impaired or insolvent insurers.

A “qualified financial contract” would mean any commodity contract, forward contract, repurchase agreement, securities contract, swap agreement, and any similar agreement the Insurance Commissioner determines by regulation, rule, or order to be a qualified financial contract.

A “netting agreement” would mean:

- A contract or agreement involving one or more transactions between the parties to the agreement related to one or more qualified financial contracts that provides for the netting, liquidation, setoff, termination, acceleration, or close out under or in connection with one or more qualified financial contracts or present or future payment or delivery obligations or payment or delivery entitlements among the parties to the netting agreement;
- Any master settlement or bridge agreement for one or more master agreements; or
- Any security agreement or arrangement or other credit enhancement or guarantee or reimbursement obligation related to any contract or agreement.

The bill would be in effect upon publication in the *Kansas Register*.

Background

“Insolvency” as defined in the Insurers Supervision, Rehabilitation and Liquidation Act generally means when an insurance company is unable to pay its obligations when they are due or when the insurer’s assets do not exceed its liabilities plus the greater of any capital and surplus required by law or the total par of state value of the insurer’s authorized and issued capital stock (KSA 40-3607).

The bill was introduced at the request of the Security Benefit Life Insurance Company, whose representative indicated the bill would modernize and bring uniformity of a statute dealing with insurance companies and provisions established by the bill would operate only in the unlikely circumstance when an insurer becomes impaired or insolvent. The representative further stated Kansas insurers are currently operating at a competitive disadvantage because the Kansas insolvency laws do not provide for termination and netting rights under qualified financial contracts (QFCs); the bill would allow Kansas-based insurers to attract quality trading partners necessary to manage business risks. A representative for the American Council of Life Insurers indicated these amendments to Kansas insurance law are consistent with the National Association of Insurance Commissioners' Insurer Receivership Model Act and would assist domestic insurers in managing their investment portfolios. A representative of the Kansas Insurance Department also appeared in support of the bill at the Senate Committee hearing.

The Senate Committee on Financial Institutions and Insurance recommended a clarifying amendment in a provision addressing the transfer of money or other property in connection with a netting agreement, qualified contract, or other arrangements.

The fiscal note prepared by the Division of the Budget on the original bill states the Kansas Insurance Department indicates enactment of the bill would have no fiscal effect on the agency.