

SECOND REGULAR SESSION  
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SENATE SUBSTITUTE FOR  
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# SENATE BILL NO. 1009

## 91ST GENERAL ASSEMBLY

INTRODUCED BY SENATOR ROHRBACH.

Offered February 18, 2002.

Senate Substitute adopted, February 21, 2002.

Taken up for Perfection February 21, 2002. Bill declared Perfected and Ordered Printed, as amended.

TERRY L. SPIELER, Secretary.

2551S.04P

### AN ACT

To repeal sections 375.345 and 376.311, RSMo, relating to investments by insurance companies, and to enact in lieu thereof two new sections relating to the same subject.

*Be it enacted by the General Assembly of the State of Missouri, as follows:*

Section A. Sections 375.345 and 376.311, RSMo, are repealed and two new sections enacted in lieu thereof, to be known as sections 375.345 and 376.311, to read as follows:

375.345. 1. As used in this section, the following words and terms mean:

(1) ["Call option", an exchange-traded option contract under which the holder has the right to buy (or to make a cash settlement in lieu thereof) a fixed number of shares of stock, a fixed amount of an underlying security, or an index of underlying securities at a stated price on or before a fixed expiration date;

(2) "Commodity Futures Trading Commission", the federal regulatory agency charged and empowered under the Commodity Futures Trading Commission Act of 1974, as amended, with the regulation of futures trading in commodities;

(3) "Financial futures contract", an exchange-traded agreement to make or take delivery of (or to make cash settlement in lieu thereof) a fixed amount of an underlying security, or an index of underlying securities, on a specified date or during a specified period of time, or a call

**EXPLANATION--Matter enclosed in bold-faced brackets [thus] in this bill is not enacted and is intended to be omitted in the law.**

or put option on such an agreement, made through a registered futures commission merchant on a board of trade which has been designated by the Commodity Futures Trading Commission as a contract market. Such financial futures contracts shall include the following categories: United States treasury bills, bonds and notes; securities or pools of securities issued by the Government National Mortgage Association; bank certificates of deposit; Standard and Poor's 500 Stock Price Index; NYSE Composite Index; KC Value Line Index; and such other agreements which have been approved by and which are governed by the rules and regulations of the Commodity Futures Trading Commission and the respective contract markets on which such financial futures contracts are traded;

(4) "Margin", any type of deposit or settlement made or required to be made with a futures commission merchant, clearinghouse, or safekeeping agent to insure performance of the terms of the financial futures contract. For the purposes of this section, "margin" includes initial, maintenance and variation margins as such terms are commonly and customarily employed in the futures industry;

(5) "Put option", an exchange-traded option contract under which the holder has the right to sell (or to make a cash settlement in lieu thereof) a fixed number of shares of stock, fixed amount of an underlying security, or an index of underlying securities at a stated price on or before a fixed expiration date;

(6) "Securities and Exchange Commission", the federal regulatory agency charged and empowered under the Securities Exchange Act of 1934, as amended, with the regulation of trading in securities; and

(7) "Underlying security", the security subject to being purchased or sold upon exercise of a call option or put option, or the security subject to delivery under a financial futures contract.] **"Admitted assets", assets permitted to be reported as admitted assets on the statutory financial statement of the insurance company most recently required to be filed with the director, but excluding assets of separate accounts, the investments of which are not subject to the provisions of law governing the general investment account of the insurance company;**

(2) **"Cap", an agreement obligating the seller to make payments to the buyer, with each payment based on the amount by which a reference price, level, performance, or value of one or more underlying interests exceeds a predetermined number, sometimes called the strike rate or strike price;**

(3) **"Collar", an agreement to receive payments as the buyer of an option, cap, or floor and to make payments as the seller of a different option, cap, or floor;**

(4) **"Counterparty exposure amount":**

(a) **The amount of credit risk attributable to an over-the-counter derivative instrument. The amount of credit risk equals:**

**a. The market value of the over-the-counter derivative instrument if the liquidation of the derivative instrument would result in a final cash payment to the insurance company; or**

**b. Zero if the liquidation of the derivative instrument would not result in a final cash payment to the insurance company;**

**(b) If over-the-counter derivative instruments are entered into under a written master agreement which provides for netting of payments owed by the respective parties, and the domicile of the counterparty is either within the United States or within a foreign jurisdiction listed in the Purposes and Procedures of the Securities Valuation Office as eligible for netting, the net amount of credit risk shall be the greater of zero or the net sum of:**

**a. The market value of the over-the-counter derivative instruments entered into under the agreement, the liquidation of which would result in a final cash payment to the insurance company; and**

**b. The market value of the over-the-counter derivative instruments entered into under the agreement, the liquidation of which would result in a final cash payment by the insurance company to the business entity;**

**(c) For open transactions, market value shall be determined at the end of the most recent quarter of the insurance company's fiscal year and shall be reduced by the market value of acceptable collateral held by the insurance company or placed in escrow by one or both parties;**

**(5) "Derivative instrument", an agreement, option, instrument, or a series or combination thereof that makes, takes delivery of, assumes, relinquishes, or makes a cash settlement in lieu of a specified amount of one or more underlying interests, or that has a price, performance, value, or cash flow based primarily upon the actual or expected price, level, performance, value or cash flow of one or more underlying interests. Derivative instruments also include options, warrants used in a hedging transaction and not attached to another financial instrument, caps, floors, collars, swaps, forwards, futures and any other agreements, options or instruments substantially similar thereto, and any other agreements, options, or instruments permitted under rules or orders promulgated by the director;**

**(6) "Derivative transaction", a transaction involving the use of one or more derivative instruments;**

**(7) "Director", the director of the department of insurance of this state;**

**(8) "Floor", an agreement obligating the seller to make payments to the buyer in which each payment is based on the amount by which a predetermined number, sometimes called the floor rate or price, exceeds a reference price, level, performance,**

or value of one or more underlying interests;

(9) "Forward", an agreement other than a future to make or take delivery of, or effect a cash settlement based on the actual or expected price, level, performance or value of, one or more underlying interests, but not including spot transactions effected within customary settlement periods, when issued purchases or other similar cash market transactions;

(10) "Future", an agreement traded on an exchange to make or take delivery of, or effect a cash settlement based on the actual or expected price, level, performance or value of one or more underlying interests and which includes an insurance future;

(11) "Hedging transaction", a derivative transaction that is entered into and maintained to reduce:

(a) The risk of economic loss due to a change in the value, yield, price, cash flow or quantity of assets or liabilities that the insurance company has acquired or incurred or anticipates acquiring or incurring;

(b) The currency exchange rate risk or the degree of exposure as to assets or liabilities that the insurance company has acquired or incurred or anticipates acquiring or incurring; or

(c) Risk through such other derivative transactions as may be specified to constitute hedging transactions by rules or orders adopted by the director;

(12) "Income generation transaction":

(a) A derivative transaction involving the writing of covered call options, covered put options, covered caps or covered floors that is intended to generate income or enhance return; or

(b) Such other derivative transactions as may be specified to constitute income generation transactions in rules or orders adopted by the director;

(13) "Initial margin", the amount of cash, securities or other consideration initially required to be deposited to establish a futures position;

(14) "NAIC", the National Association of Insurance Commissioners;

(15) "Option", an agreement giving the buyer the right to buy or receive, sell or deliver, enter into, extend, terminate or effect a cash settlement based on the actual or expected price, level, performance or value of one or more underlying interests;

(16) "Over-the-counter derivative instrument", a derivative instrument entered into with a business entity other than through an exchange or clearinghouse;

(17) "Potential exposure", the amount determined in accordance with the NAIC Annual Statement Instructions;

(18) "Replication transaction", a derivative transaction effected either separately or in conjunction with cash market investments included in the insurer's

**investment portfolio and intended to replicate the investment characteristic of another authorized transaction, investment or instrument or to operate as a substitute for cash market transactions. A derivative transaction that is entered into as a hedging transaction or an income generation transaction shall not be considered a replication transaction;**

**(19) "SVO", the Securities Valuation Office of the NAIC or any successor office established by the NAIC;**

**(20) "Swap", an agreement to exchange or to net payments at one or more times based on the actual or expected price, level, performance or value of one or more underlying interests;**

**(21) "Underlying interest", the assets, liabilities, other interests, or a combination thereof underlying a derivative instrument, such as any one or more securities, currencies, rates, indices, commodities or derivative instruments;**

**(22) "Warrant", an instrument that gives the holder the right to purchase an underlying financial instrument at a given price and time or at a series of prices and times outlined in the warrant agreement.**

2. [The purchase and sale of put options or call options may take place] **An insurance company may, directly or indirectly through an investment subsidiary, engage in derivative transactions pursuant to this section** under the following conditions:

(1) [An insurance company may purchase put options or sell call options with regard to underlying securities owned by the insurance company, underlying securities which the insurance company may reasonably expect to obtain through exercise of warrants or conversion rights owned by the insurance company at the time the put option is purchased or the call option is sold, or to reduce the economic risk associated with an insurance company asset or liability, group of such assets or liabilities, or assets, liabilities or groups of assets or liabilities reasonably expected to be acquired or incurred by the insurance company in the normal course of business. Such assets or liabilities must be subject to an economic risk, such as changing interest rates or prices.

(2) An insurance company may sell put options or purchase call options to reduce the economic risk associated with an insurance company asset or liability, group of such assets or liabilities, or assets, liabilities or groups of assets or liabilities reasonably expected to be acquired or incurred by the insurance company in the normal course of business, or to offset obligations and rights of the insurance company under other options held by the insurance company pertaining to the same underlying securities, or index of underlying securities.

(3) An insurance company may purchase or sell put options or call options only on underlying securities, or an index of underlying securities, which are eligible for investment by an insurance company under the laws of the state of Missouri.

(4) An insurance company may purchase or sell put or call options only through an exchange which is registered with the Securities and Exchange Commission as a national securities exchange pursuant to the provisions of the Securities Exchange Act of 1934, as amended.

(5) An insurance company shall not purchase call options or sell put options, if such purchase or sale could result in the acquisition of an amount of underlying securities which, when aggregated with current holdings, exceeds applicable limitations imposed under the laws of the state of Missouri for investment in those particular underlying securities by the type or kind of insurance company involved.

(6) The premiums paid for all option contracts purchased, less the premiums received for all option contracts sold, plus amounts calculated pursuant to subdivision (3) of subsection 3 of this section, shall not at any one time exceed in the aggregate five percent of the insurance company's admitted assets.

3. The purchase and sale of financial futures contracts may take place under the following conditions:

(1) An insurance company may purchase or sell financial futures contracts for the purpose of hedging against the economic risk associated with an insurance company asset or liability, group of such assets or liabilities, or assets, liabilities or groups of assets or liabilities reasonably expected to be acquired or incurred by the insurance company in its normal course of business. Such assets or liabilities must be subject to an economic risk, such as changing interest rates or prices.

(2) An insurance company shall not purchase or sell financial futures contracts or options on such contracts, if such purchase or sale could result in the acquisition of an amount of underlying securities which, when aggregated with current holdings, exceeds applicable limitations imposed under the laws of the state of Missouri for investment in those particular underlying securities by the type or kind of insurance company involved.

(3) For all purchased or sold financial futures contracts together, plus amounts calculated pursuant to subdivision (6) of subsection 2 of this section, an insurance company shall not invest at any one time an aggregate amount of more than five percent of its admitted assets. For the purposes of transactions in financial futures contracts, such admitted assets limitation shall be calculated by taking the net asset value of the property used to margin the financial futures contract positions, plus option premiums paid on financial futures contracts, less option premiums received on financial futures contracts.

**4.] In general:**

**(a) An insurance company may use derivative instruments pursuant to this chapter to engage in hedging transactions and certain income generation transactions;**

**(b) Upon request, an insurance company shall demonstrate to the director, the intended hedging characteristics and the ongoing effectiveness of the derivative transaction or combination of the transactions through cash flow testing or other appropriate analyses;**

**(2) An insurance company shall only maintain its position in any outstanding derivative instrument used as part of a hedging transaction for as long as the hedging transaction continues to be effective;**

**(3) An insurance company may enter into hedging transactions if as a result of and after giving effect to the transaction:**

**(a) The aggregate statement value of options, caps, floors and warrants not attached to another financial instrument purchased and used in hedging transactions then engaged in by the insurer does not exceed seven and one-half percent of its admitted assets;**

**(b) The aggregate statement value of options, caps and floors written in hedging transactions then engaged in by the insurer does not exceed three percent of its admitted assets; and**

**(c) The aggregate potential exposure of collars, swaps, forwards and futures used in hedging transactions then engaged in by the insurer does not exceed six and one-half percent of its admitted assets;**

**(4) An insurance company may only enter into the following types of income generation transactions if as a result of and after giving effect to an income generation transaction, the aggregate statement value of the fixed income assets that are subject to call or that generate the cash flows for payments under the caps or floors, plus the face value of fixed income securities underlying a derivative instrument subject to call, plus the amount of the purchase obligations under the puts, shall not exceed ten percent of its admitted assets:**

**(a) Sales of covered call options on noncallable fixed income securities, callable fixed income securities if the option expires by its terms prior to the end of the noncallable period, or derivative instruments based on fixed income securities;**

**(b) Sales of covered call options on equity securities if the insurance company holds in its portfolio or can immediately acquire through the exercise of options, warrants or conversion rights already owned, the equity securities subject to call during the complete term of the call option sold;**

**(c) Sales of covered puts on investments that the insurance company is permitted to acquire under the applicable insurance laws of the state, if the insurance company has escrowed or entered into a custodian agreement segregating cash or cash equivalents with a market value equal to the amount of its purchase obligations**

**under the put during the complete term of the put option sold; or**

**(d) Sales of covered caps or floors if the insurance company holds in its portfolio the investments generating the cash flow to make the required payments under the caps or floors during the complete term that the cap or floor is outstanding;**

**(5) An insurance company may use derivative instruments for replication transactions only after the director promulgates reasonable rules that set forth methods of disclosure, reserving for risk-based capital, and determining the asset valuation reserve for these instruments. Any asset being replicated is subject to all the provisions and limitations on the making thereof specified in chapters 375, 376, and 379, RSMo, with respect to investments by the insurer as if the transaction constituted a direct investment by the insurer in the replicated asset;**

**(6) An insurance company shall include all counterparty exposure amounts in determining compliance with this state's single-entity investment limitations;**

**(7) The director may approve, by rule or order, additional transaction conditions involving the use of derivative instruments for other risk management purposes.**

**3.** Written investment policies and recordkeeping procedures shall be approved by the board of directors of the insurance company or by a committee authorized by such board before the insurance company may engage in the practices and activities authorized by this section. These policies and procedures must be specific enough to define and control permissible and suitable investment strategies with regard to [put options, call options, and financial futures contracts] **derivative transactions** with a view toward the protection of the policyholders. The minutes of any such committee shall be recorded and regular reports of such committee shall be submitted to the board of directors.

[5.] **4.** The director [of the department of insurance] may promulgate **reasonable** rules[, guidelines] and regulations **pursuant to the provisions of chapter 536, RSMo, not inconsistent with this section and any other insurance laws of this state**, establishing standards and requirements relating to practices and activities authorized in this section, **including, but not limited to, rules which impose financial solvency standards, valuation standards, and reporting requirements.**

376.311. 1. In addition to the investments permitted by other provisions of the laws, the capital reserve and surplus of all life insurance companies of whatever kind and character, organized or doing business pursuant to this chapter, may be invested in an investment pool meeting the requirements set out below, and any other provision of law relating to investments made by life insurance companies.

2. As used in this section, the following terms mean:

(1) "Business entity", a corporation, limited liability company, association, partnership,



joint stock company, joint venture, mutual fund trust, or other similar form of business organization, including such an entity when organized as a not-for-profit entity;

(2) "Qualified bank", a national bank, state bank or trust company that at all times is no less than adequately capitalized as determined by the standards adopted by the United States banking regulators and that is either regulated by state banking laws or is a member of the Federal Reserve System.

3. (1) Qualified investment pools shall invest only in investments which an insurer may acquire pursuant to this chapter and other provisions of law. The insurer's proportionate interest in these investments may not exceed the applicable limits of this section and other provisions of law.

(2) An insurer shall not acquire an investment in an investment pool pursuant to this subsection if, after giving effect to the investment, the aggregate amount of investments in all investment pools then held by the insurer would exceed thirty percent of its assets.

(3) For an investment in an investment pool to be qualified pursuant to this chapter, the investment pool shall not:

(a) Acquire securities issued, assumed, guaranteed or insured by the insurer or an affiliate of the insurer;

(b) Borrow or incur any indebtedness for borrowed money, except for securities lending and reverse repurchase transactions;

(c) Lend money or other assets to participants in the pool.

(4) For an investment pool to be qualified pursuant to this chapter, the manager of the investment pool shall:

(a) Be organized pursuant to the laws of the United States or a state and designated as the pool manager in a pooling agreement;

(b) Be the insurer; an affiliated insurer; **a business entity affiliated with the insurer**; a qualified bank; a business entity registered pursuant to the Investment Advisors Act of 1940 (15 U.S.C. Sec. 80a-1 et seq.) as amended; or, in the case of a reciprocal insurer or interinsurance exchange, its attorney-in-fact.

(5) The pool manager, or an agent designated by the pool manager, shall compile and maintain detailed accounting records setting forth:

(a) The cash receipts and disbursements reflecting each participant's proportionate investment in the investment pool;

(b) A complete description of all underlying assets of the investment pool including amount, interest rate, maturity date (if any) and other appropriate designations; and

(c) Other records which, on a daily basis, allow third parties to verify each participant's investments in the investment pool.

(6) The pool manager shall maintain the assets of the investment pool in one **or more**

custody [account] **accounts**, in the name of or on behalf of the investment pool, under [a] **one or more** custody [agreement] **agreements** with a qualified bank. [All custodial agreements shall be filed with the department of insurance for prior approval. The] **Each** custody agreement shall:

(a) State and recognize the claims and rights of each participant;

(b) Acknowledge that the underlying assets of the investment pool are held solely for the benefit of each participant in proportion to the aggregate amount of its investments in the investment pool; and

(c) Contain an agreement that the underlying assets of the investment pool shall not be commingled with the general assets of the qualified bank or any other person.

(7) The pooling agreement for each investment pool shall be in writing and shall provide that:

(a) An insurer and its [affiliated insurers] **affiliates** shall, at all times, hold one hundred percent of the interests in the investment pool;

(b) The underlying assets of the investment pool shall not be commingled with the general assets of the pool manager or any other person;

(c) The aggregate amount of each pool participant's interest in the investment pool shall be in proportion to:

a. Each participant's undivided interest in the underlying assets of the investment pool; and

b. The underlying assets of the investment pool held solely for the benefit of each participant;

(d) A participant or, in the event of the participant's insolvency, bankruptcy or receivership, its trustee, receiver, conservator or other successor-in-interest may withdraw all or any portion of its investment from the investment pool under the terms of the pooling agreement;

(e) Withdrawals may be made on demand without penalty or other assessment on any business day, but settlement of funds shall occur within a reasonable and customary period thereafter, provided:

a. In the case of publicly traded securities, settlement shall not exceed five business days; and

b. In the case of all other securities and investments, settlement shall not exceed ten business days.

Distributions pursuant to this paragraph shall be calculated in each case net of all then applicable fees and expenses of the investment pool.

(8) The pooling agreement shall provide that the pool manager shall distribute to a participant, at the discretion of the pool manager:

(a) In cash, the then fair market value of the participant's pro rata share of each

underlying asset of the investment pool; or

(b) In-kind, a pro rata share of each underlying asset; or

(c) In a combination of cash and in-kind distributions, a pro rata share in each underlying asset;

(9) The pool manager shall make the records of the investment pool available for inspection by the director.

4. The pooling agreement and any other arrangements or agreements relating to an investment pool, and any amendments thereto, shall be submitted to the department of insurance for prior approval pursuant to section 382.195, RSMo. Individual financial transactions between the pool and its participants in the ordinary course of the investment pool's operations shall not be subject to the provisions of section 382.195, RSMo. Investment activities of pools and transactions between pools and participants shall be reported annually in the registration statement required by section 382.100, RSMo.

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