

MINUTES OF THE House COMMITTEE ON Insurance

The meeting was called to order by Rep. Rex B. Hoy at _____
Chairperson

3:30 XX a.m./p.m. on March 3, 1986 in room 521-S of the Capitol.

All members were present except:
Rep. Blumenthal, excused
Rep. Graeber, excused
Rep. King, excused

Committee staff present:

Ms. Melinda Hanson, Research Department
Mr. Gordon Self, Revisor's Office
Ms. Deanna Willard, Committee Secretary

Conferees appearing before the committee:

Mr. Dick Brock, Kansas Insurance Department
Mr. Bud Cornish, Kansas Life Association

Hearing on: HB 3088 - relating to the Kansas life and health insurance guaranty association act

HB 2933 will not be needed if HB 3088 is enacted. It will not be heard at this time.

Mr. Dick Brock, Kansas Insurance Department, explained the provisions of the bill to the committee. It is a mechanism established by law to assist policyholders that have paid money into insurance companies which then become insolvent. He gave as an example the Baldwin Company which had no penalty for early withdrawals. As interest rates dropped, they could not lower their rates too fast or people would pull their business. They became insolvent.

This bill was drafted from a model by the NAIC. It goes far to protect policyholders yet doesn't take away the right to make a claim against a receiver. It suggests three significant changes in the life and health insurance guaranty fund act. 1) Amends the guaranty fund law so that it would generally apply only to Kansas residents. (This would encourage other states to enact their own guaranty fund acts.) 2) Provides that the guaranty fund would cover annuity contracts, except unallocated ones. 3) Sets limitations on coverage to provide reasonable protection from an insurance company insolvency, while not guaranteeing extraordinary profits from quasi-speculative purchases.

He discussed the act, section by section, elaborating on some sections. Those elaborations include: Sec.2. Tells what persons and what products are covered; Sec.3. Mechanism it triggered allowing association to function when an insurer is declared insolvent. One main benefit would be that a substitute policy could be issued, which would continue coverages with no additional waiting periods; Sec.4. Creates three accounts (health, life, and annuity) so persons protected because of one account would not have to pay for protection for persons covered by other accounts; assistance is made on an account basis; Sec.6. States that the association primarily is to act upon the finding of insolvency, but it may act in the case of an impaired member; Sec.7. "2% maximum" is 2% of premiums written in the state

CONTINUATION SHEET

MINUTES OF THE House COMMITTEE ON Insurance,
room 521-S, Statehouse, at 3:30 ~~a~~^xm./p.m. on March 3, 1986.

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per year; Sec.9. The words "of an impairment" should be stricken to "that if the impairment is not corrected within a certain amount of time, mechanism will be triggered"; Sec.13. Allows that associations of two or more states may cooperatively administer a particular impairment or insolvency. (Attachment 1.)

He mentioned "clean ups" on the following lines:

0077,0078: the words "in the case of unallocated annuity contracts," should be stricken.

0164: strike "in excess of \$5,000,000"

0192: "four" should read "three"

0504, 0505: commas should be removed

1033: "impaired" should not be stricken and should be followed by "or"

Mr. Brock said there would be a possible amendment of Lines 0198 - 0200. The association's board of directors may be subject to the open meetings law.

It was determined that Line 0589 on Page 16 would need to be reconciled with HB 2661; currently is reads that "in no event shall the association be liable to expend more than \$300,000 in the aggregate with respect to any one life."

Mr. Bud Cornish, Kansas Life Association, stated that the association supports the bill.

The minutes of the previous meeting were approved.

The meeting was adjourned at 4:40 p.m. by the Chairman.

House Bill No. 3088

This proposal suggests a number of changes in the life and health insurance guaranty fund act; however, there are three that are particularly significant.

First, the proposal would amend the guaranty fund law so that it would generally apply only to Kansas residents. If a Kansas domestic life insurer became insolvent, this amendment would provide protection to Kansas residents. Similarly, the law, as amended, would protect Kansas residents with respect to contracts issued by a foreign insurer even though the insurer's state of domicile had no guaranty fund law.

Second, annuity contracts are again proposed to be covered by the life and health guaranty fund. By action of the 1984 legislature, annuity contracts were removed from coverage effective July 1, 1985; however, this proposal, in effect, suggests a reversal of the 1984 legislative action except that unallocated annuities will continue to be excluded from coverage.

Finally, a number of limitations on coverage under the guaranty fund are suggested by this proposal. There seems to be a growing belief that guaranty funds should provide reasonable protection from the adverse results of an insurance company insolvency but that such protection should not be so comprehensive that extraordinary profits from quasi-speculative purchases are guaranteed. The restrictions suggested are intended to accommodate this concept.

Section by Section Description

Section 1. The basic purpose of this act is to protect policyowners, insureds, beneficiaries, annuitants, payees, and assignees against losses (both in terms of paying claims and continuing coverage) which might otherwise occur due to an impairment or insolvency of an insurer. Unlike the property and liability situations, life and annuity contracts in particular are long term arrangements for security. An insured may have impaired health or be at an advanced age so as to be unable to obtain new and similar coverage from other insurers. The payment of cash values alone does not adequately meet such needs. Thus, it is essential that coverage be continued. In like manner, an insured may be unable to obtain new health insurance or, at least, he or she may lose protection for prior illness.

Section 2. Protection of this act is primarily extended to resident persons but certain nonresidents under specific circumstances will be protected by this act if the insolvent insurer was domiciled in this state.

This act does not apply to reinsurance unless assumption certificates were issued to the direct insureds. Furthermore, it applies only to direct individual or group certificate insurance issued by insurers licensed to transact insurance in this state at any time. Coverage issued by insurers or other entities which have not submitted to the application of a state's regulatory safeguards applying to insurers is excluded from protection by this act.

The act covers life, health, and annuity policies and contracts and contracts supplemental thereto. The term health insurance includes "accident and health" insurance, "sickness and accident" insurance, "disability" insurance, etc. Certificateholders under group contracts are explicitly covered, but group contractholders are not covered; this avoids the possibility of double coverage and indirect coverage of non-resident certificateholders through a resident group contractholder.

Section 3. This section contains the definitions. Of particular interest are the definitions of "insolvent" and "impaired" insurers. This act covers "insolvent insurers" which are defined to include an insolvent insurer under an order of liquidation issued by a court of competent jurisdiction. An "impaired insurer" is an insurer deemed by the Commissioner to be unable or potentially unable to fulfill its contractual obligations. As will be noted in section 6 on the powers and duties of the association, this bill enables the association to become involved prior to an actual court order. The finding by the Commissioner that an insurer is impaired, even though not

subject to a court proceeding, serves as a triggering mechanism enabling the association to function.

Section 4. Subsection 9(a) creates three accounts, for both administration and assessment purposes, the health insurance account, the life insurance account and the annuity account. These three categories of coverage are significantly different, so that persons protected by virtue of one account should not be required to pay for the protection afforded persons protected by the other accounts.

Supplementary contracts would be covered under the account in which the basic policy is covered for purposes of assessment. For example, settlement options under a life insurance contract would be covered under the life insurance account.

Section 5. Subsection (a) provides for the number and term of the members of the board of directors.

Section 6. Along with section 2, this section is a key to the specific responsibilities of the association toward covered persons. That responsibility varies by type of policy or contract involved.

The association is primarily intended to act after the entry of an order of liquidation with the finding of insolvency against a member insurer. However, the association may act in the case of an impaired member insurer to guarantee, assume or reinsure any or all policies or otherwise provide money to the member insurer. Action under this subsection is not limited to resident policyholders but to all policies or contracts issued by the insurer.

The association must act under this section (section 6 (b)(1)) even without an order of liquidation if several conditions exist, (section (b)(2)) the most important being a statutory provision for the repayment of the association prior to the return of the company to shareholder or private control. The association's role here is the payment of benefits and "hardship" cash withdrawals to covered persons.

Subsection 6 (c) through (e) details the main role of the association in the instance of an order of liquidation against an insolvent member insurer. The responsibilities of the association vary depending on the kind of coverage and type of policy -- group or individual. The association may offer alternative policies or change the premiums or benefits of existing contracts. "New contracts" shall be offered without new underwriting and with coverage for most existing conditions. In order to facilitate the sale of blocks of business for which the association is responsible, the cooperation of the domestic receiver will be necessary.

Subsections (g) through (i) relate to the imposition of policy and contract liens, moratoriums, etc.

Subsections (j) and (k) permit the Commissioner to assume the role of the association if it (the association) fails to act with respect to an impairment or insolvency within a reasonable period of time.

Subsection (l) enables the association to protect its interest and the best interests of the policyholders in the handling of an impairment or insolvency, provides that the association shall have standing to appear in courts with jurisdiction over an insolvent insurer and such standing will extend to any matters concerning the duties of the association.

Subsection (m) gives the association the rights possessed by a person receiving benefits under the act to bring an action or intervene in any court proceeding against the liquidation or rehabilitation of the impaired or insolvent insurer.

Subsections (n) and (o) sets forth the exclusions and limitations of coverage. \$300,000 death benefit -- \$100,000 per account -- \$300,000 total

Subsections (p) and (q) permit the association to sue or be sued, joint with other associations in administrative functions, etc.

Section 7. When an insurer is impaired or insolvent the member insurers will be assessed on the basis of the premiums they write in the state. This corresponds to the association's liability which, in most cases, is limited to covered policies of residents. This assessment system provides a base broad enough to meet fairly large demands on the association. Equally important, since it reflects the market share of each member in the state considered, it is an equitable method of apportioning the burden of the assessments.

The 2% maximum should produce an adequate amount while at the same time not impose an undue strain in any given year on the assessed companies and their policyholders.

In order to prevent further financial difficulties caused by an assessment, subsection (d) permits abatement of assessments when such financial difficulties might result. Subsections (d) and (e) provide some limitation on the amounts which can be assessed in any given year. If these limitations are reached, to fulfill its responsibilities the association is empowered to borrow funds which later can be repaid out of future assessments.

Subsection (g) provides that a member insurer may consider in its premium rates and dividend scale an amount reasonably necessary to meet its assessment obligations.

Section 8. Requires the association to submit a plan of operation which will set out the manner in which the association will fulfill its responsibilities.

Section 9. Subsection (a)(2) requires that the Commissioner give notice of an impairment to the impaired insurer.

Subsection (a)(3) provides that the Commissioner shall be appointed liquidator or rehabilitator of a domestic insurer and conservator of a foreign or alien insurer being liquidated or rehabilitated.

Section 10. This section sets forth various provisions and procedures the association and the Commissioner may follow in an effort to prevent future insolvencies.

Section 11. Subsection (a) will preserve the assessment liability of the insureds of assessment mutuals.

Subsection (b) requires that records be kept of negotiations and actions by the association. The association should be held publicly accountable for its actions. On the other hand, effective handling of the rehabilitation or liquidation effort requires minimum publicity. Thus, such records will be made public only after the liquidation, rehabilitation or conservation proceeding is terminated, the impairment or insolvency is terminated or there is a prior order by a court of competent jurisdiction.

Since this act imposes the obligation upon the association to continue coverage for policyholders of insolvent insurers, the assets of the insolvent insurer ought to be used, to the extent available, for the purpose of continuing such coverage. Subsection (c) is designed to accomplish this purpose.

Subsection (d), in conjunction with section 11 (1)(b), is intended to prevent the shareholders of an impaired insurer from sitting back and doing nothing and then reaping the benefits of funds put up by the association. These stockholders should not obtain a more advantageous position than they would have occupied in the absence of this act. The court is empowered to modify and distribute the ownership rights of an impaired insurer in order to do equity as between the interested parties.

Subsection (e) is designed to recapture excessive dividend payments to affiliates that exercised control over the insolvent insurer. The Holding Company Regulatory Act (Chapter 40, Article 33) in large measure prevents improper distribution of dividends by an insurer to its holding company since extraordinary dividends are subject to the prior approval of the Commissioner, and ordinary dividends are required to be reported to the Commissioner. If, however, dividends are paid under circumstances that the

insurer should have reasonably known that such payment could reasonably be expected to affect its ability to perform its contractual obligation to its policyholders, the holding company and affiliates should be required to repay such dividends subject to certain reasonable limitations.

Section 12. The association shall be subject to the examination and regulation by the Commissioner. The board of directors shall submit to the Commissioner each year, not later than 120 days after the association's fiscal year, a financial report in a form approved by the Commissioner and a report of its activities during the preceding fiscal year.

Section 13. This is the immunity section and has been amended only to recognize that associations of two or more states may cooperatively administer a particular impairment or insolvency.

Section 14. Provides for a stay of proceedings against an insolvent insurer in order to give the association time to exercise any rights it may have. All proceedings in which the insolvent insurer is a party in any court in this state shall be stayed 60 days from the date an order of liquidation, rehabilitation, or conservation is final to permit proper legal action by the association on any matters germane to its powers or duties. As to judgement under any decision, order, verdict, or finding based on default the association may apply to have such judgement set aside by the same court that made such judgement and shall be permitted to defend against such suit on the merits.

Section 15. Subsection (a) continues the prohibition of using the existence of the association in the inducement of sale of insurance. However, subsection (b) requires notification to new policyholders concerning the general parameters of the association article and responsibility thereunder.

Section 16. Repealer.

Section 17. Effective date.