

Approved

3/21/89  
Date

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS & INSURANCE

The meeting was called to order by SENATOR RICHARD L. BOND at  
Chairperson

9:00 a.m./~~p.m.~~<sup>XX</sup> on THURSDAY, MARCH 16, 1989 in room 529-S of the Capitol.

~~XX~~ members were present ~~except~~ Senators Bond, Salisbury, Strick, McClure, Anderson, Parrish, Karr, Reilly, Kerr, and Moran.

Committee staff present:

Bill Wolff, Legislative Research  
Bill Edds, Revisors Office  
Louise Bobo, Committee Secretary

Conferees appearing before the committee:

John Johnson, Kansas Trial Lawyers  
Terri Roberts, Kansas State Nurses' Association  
Ron Smith, Kansas Bar Association

Chairman Bond called the meeting to order at 9:15 a.m. Proponents for SB 282 appeared before the committee.

John Johnson, Kansas Trial Lawyers, appeared before the committee in support of this bill. Mr. Johnson said the main purpose of this bill was to make it illegal for insurance companies to work together to fix prices. It would eliminate cooperative actions among insurers in our state to establish uniform prices for insurance policies. This bill would make it clear that the Kansas anti-trust laws, and the remedies thereunder, apply to the insurance industry to the same extent that they apply to all other industries. According to Mr. Johnson, when the insurance carriers are forced to compete on price, they develop specific and effective competitive pricing tools that reduce rates. Mr. Johnson stated that SB 282, as proposed, would not prohibit the collection and dissemination by the Insurance Service Organization of information regarding past or historical cost data. It would prohibit the pooling of information on future pricing data. There would no longer be a common suggested price for all companies to adopt. (attachment 1)

Discussion followed. A committee member asked Mr. Johnson how this bill would affect out of state insurance companies. Mr. Johnson stated that it would force the insurance companies to set their own projections—even though the underwriter might have access to the information from other states that information would probably not apply in Kansas as all states have different criteria. Another committee member inquired how the insurance companies would be monitored to make sure they did not use the data they receive for price fixing and not just for guidelines. Mr. Johnson said that it was a matter of enforcing the law. Staff informed the committee there was nothing in this bill to prohibit any insurance company from using the ISO data to establish their rates. Conversely, there is nothing to make a company use the ISO data to establish their own rates but they do have to stay within the rate guidelines they file with the Commissioner.

Terri Roberts, Kansas State Nurses' Association, spoke before the committee in support of SB 282. Ms. Roberts stated that this bill would foster competition by insurance companies and thereby provide better priced insurance for the consumer. She continued that this bill would be one factor in curtailing the industries cycles of "writing away from risk" and increasing premiums to cover their losses in the cycle. Ms. Johnson said that the high interest rates in the '80's caused companies to write policies at prices in relation to expected losses. When interest rates dropped, affecting their investment income, that factor, along with greater losses than anticipated, caused the companies to raise their prices and write only the best risks. These factors affected the availability of malpractice insurance coverage to four groups of

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS & INSURANCE,  
room 529-S, Statehouse, at 9:00 a.m./~~p.m.~~ on THURSDAY, MARCH 16, 1989

Registered Nurses. Ms. Johnson said that KSNA supported this bill as being one way of gaining protection from the price setting game played by insurance companies when profits are down. (attachment 2)

Ron Smith, Kansas Bar Association, informed the committee that his organization had a limited interest in this bill. He provided written testimony of Robert Adrian, a Salina attorney and Chairman of the KBA Insurance Committee, who expressed concern over the deletion of section 14 in SB 282 dealing with rebate restrictions. His conclusion is that the anti-rebate statutes are outdated and serve no useful purpose. They deny the insurance agent the right to use his commission however he wants and the anti-rebate statutes also thwart competition among insurance agencies and companies. (attachment 3)

Mr. Smith concluded his remarks by stating that the KBA had no position on this bill.

Senator Reilly moved that the committee minutes of March 13 be approved. The motion was seconded by Senator Strick. The motion carried and the minutes approved as written.

Chairman Bond adjourned the meeting at 10:00 a.m.

GUEST LIST

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# KANSAS TRIAL LAWYERS ASSOCIATION

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## TESTIMONY OF THE KANSAS TRIAL LAWYERS ASSOCIATION IN SUPPORT OF SB 282 BEFORE THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE MARCH 16, 1989

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Mr. Chairman, ladies and gentlemen of the Committee, my name is John W. Johnson. I am a practicing attorney in Wichita, Kansas and I am currently serving as President-Elect of KTLA. We are here today urging your support for SB 282. This bill will make it illegal for insurance companies to work together to fix prices. It will force companies to determine their own independent rates and in doing so create greater price competition.

SB 282 has created some controversy, largely from the insurance community. This is understandable.

My intent is not to cast stones, but rather to make sure you focus upon the special immunity that exists for the benefit of the insurance industry. That's correct, these companies are able to collaborate, cooperate and agree on the price they charge us in the form of premiums. In any, and I repeat, in any other business or industry where competition is possible, this would be per se illegal.

There appears to be virtual universal agreement that a significant and continuing problem with the insurance delivery system in the State of Kansas exists. The problem has defied solutions to date, which have ranged from the creation of state administered insurance companies to

*Attachment 1  
 Sen FI + I  
 3/16/89*

substantial limitation of liability on the part of insureds, to outright granting of immunity to others from liability for negligent acts which result in injury to others.

Nationally, insurance as a business is a three hundred ninety-eight billion dollar industry. Here in Kansas, as in the rest of the country, we spend more for insurance than any other necessity besides food and shelter. In fact, it is said that most Americans spend all they earn from the first of the year until the 18th of February just to pay for their insurance coverage.

This huge industry, that we are so closely bound to and which consumes so much of our income, is unique in its ability to establish the price it charges for its product. Rates in the insurance industry are promulgated by rate bureaus, industry-sponsored organizations, which collect and disseminate cost and price information. The Insurance Service Office (ISO) collects data and promulgates rates for most lines of insurance. ISO rates these lines for the entire country and their established rates for these lines are strongly adhered to by the industry as a collective method of retaining an effective price control system for all companies. This rate making procedure not only stifles competition, but it discourages operating efficiencies, as the advisory rate establishes a price high enough to allow the least efficient company to earn a profit.

In the past several years it has become increasingly apparent that many of the price fixing practices of the insurance industry have not led to stability in the insurance market place. They have, instead, led to a serious aggravation of the problems in the industry brought on by the cyclical nature of the

insurance business. For decades observers have noted the industry has been rocked with one crisis after another. Usually the crisis is first one of availability of insurance and then one of affordability. Many times the availability and cost crisis run together as the insurance industry reels from its apparent boom and bust cycle.

Since 1945, the anti-competitive practices of the industry which allows price fixing have been protected by a federal law known as the McCarran-Ferguson Act. This Act allows the business of insurance to be conducted in violation of the Sherman and Clayton Anti-trust Acts, which are the federal laws that prohibit all other businesses from engaging in anti-competitive activities, such as price fixing.

By having the freedom to set prices, the industry has been able to engage in a practice known as "cash flow underwriting". Simply stated, this is a price fixing scheme which allow insurance companies to sell their product at less than profitable rates in order to get large market shares and to stimulate cash flow into the company investment portfolio. This is always done during times of high interest rates or times of rapidly expanding stock market prices. Losses suffered by selling the product too cheaply, and in some instances below cost, are covered by profits realized from investment earnings on the huge cash balances that are accumulated.

If there is a trend in the cost of liability insurance at this point in the insurance cycle, it is that rates are dropping. Insurance trade publications speak of "price wars" in the property/casualty marketplace, with average premiums falling in the last twelve months. Business Insurance magazine, in its

January 2, 1989 issue, stated, "These are the good old days for insurance buyers. Rates continue to drop, with insurers cutting property/casualty rates between 25% and 40% and general liability rates between 10% and 33%...."

However, when investment returns dwindle, due to lowering interest or market conditions, the industry only has to return to the protection of its price fixing privilege and initiate as many rounds of price increases as are necessary to bring the company back into a profitable pricing mode. Often times the company can get back in one year what it has given away during the previous five or six years when some of its lines of insurance were underpriced. Without the anti-trust exemption, this could not and would not occur.

The purpose of SB 282 is simply to eliminate cooperative actions among insurers in our state to establish uniform prices for insurance policies. Although Kansas does not expressly exempt the business of insurance from its anti-trust laws, the Kansas insurance rating law, K.S.A. 40-1111 et seq. expressly authorizes anti-competitive activity by insurers. Other sections of the insurance code must also be taken into consideration as well, but this bill is intended to make it clear the Kansas anti-trust laws, and the remedies thereunder, apply to the insurance industry to the same extent that they apply to all other industries. If adopted, the bill will eliminate all statutory exceptions to Kansas anti-trust law and would, thus, require Kansas insurance companies to stop collective price fixing.

We met with representatives of the Insurance Department and they identified several technical problems with SB 282. They include:

1. rebates and other inducements in title insurance,
2. developing assigned risk plan rates,
3. adding fire insurance to this Act,
4. the authority of the Commissioner to develop statistical rate plans with the help of rating organizations.

We completely agree with their concerns in these areas and would welcome the necessary corrections to SB 282.

The concept of competitive rating is not a new one. Legislatures in other states have initiated competitive rating in the workers' compensation area. For example, the states of Michigan, Illinois, Minnesota and Oregon have all implemented competitive rating statutes. In a report published by the Government Accounting Office in December, 1986, the GAO evaluated the initial experience with competitive rating. The report stated:

"Insurance regulators in states that instituted competitive rating laws for 1984 generally believe that competitive rating laws favorably effected the cost of workers' compensation insurance."

Four states reported lower premiums, including Michigan, where rates dropped 30.6%. When the carriers were forced to compete on price, they developed specific and effective competitive pricing tools that reduced rates. So, if you ask what benefits will SB 282 provide to consumers, here is your answer. There is every reason to create an environment in Kansas that enhances competition and lowers rates.



In addition to efforts at the federal level seeking a repeal of the McCarran-Ferguson exemption, which, incidentally, has been endorsed by the National Conference of State Legislatures and the National Association of Attorneys General, a trend is clearly developing in other states to eliminate protection for the insurance industry from anti-competitive conducts. Other states which are presently considering legislation to eliminate state anti-trust immunity for insurance companies are New Jersey, Indiana, Wyoming, New Mexico, Maryland and Michigan. Of course, you are all aware that California voters approved similar changes in a vote this past November.

SB 282, as proposed, will not prohibit the collection and dissemination by ISO of information regarding past or historical cost data. What will be prohibited, however, is the pooling of information on future pricing data. Companies often can and do benefit from knowledge of collective information on past insurance costs, but they do not need to compare notes on how to use that information to determine how much they are going to charge for their product in the future. Lost development factors such as future expenses, profits and inflation would only be computed by individual insurance companies using their best information. Collective future price trending would be prohibited as well. These computations should not be done and distributed by ISO based upon collective information supplied by all companies. There would no longer be a common suggested price for all companies to adopt.

In response to this proposed bill, we anticipate you will be told it will spark the ruination of small insurance companies in Kansas. It may be said these small competitors are not able to

effectively compete with larger companies and are totally dependent upon insurance rating bureaus to supply "trending" or "advisory rates." According to the information supplied by the National Insurance Consumers Organization, it is projected to cost a company approximately one-tenth of one percent of collected premiums to hire personnel trained and experienced in establishing competitive rates. Let us not forget, the anti-trust laws were enacted to protect competition, not individual competitors. Wouldn't the resources of these companies be better spent on assuring their ability to effectively compete in Kansas on the strength of their product, service and price, rather than spending literally thousands of dollars on trying to convince us as consumers that we are "in good hands" or that "we've got Kansas covered?"

We also believe you may be told by opponents of this bill that you should not tamper with an insurance system that is not broken, because it may create chaos. Clearly the insurance system is a component of the environmental climate confronting our state in certain lines of insurance, both in terms of availability and affordability. To vigorously pursue this bill will not create chaos. It will stimulate competition, which is one of the true long-term solutions to the so-called medical malpractice "crisis" being debated before this body. Insurance companies have nothing to fear from SB 282. We understand and share their concern that state regulation and joint historical data collection be maintained. We are willing to work with the industry to assure that outcome.

Elimination of the anti-trust exemption for insurance rate making will introduce a level of competition into the business that many believe is long overdue. It will suppress the tendency towards radical cycles of lack of availability of insurance, followed by devastating increases in price. One of the policy decisions you must make is whether the insurance industry should be permitted to continue with unfair protection or whether a meaningful step should be taken towards assuring an environment where rates will be more stable, and, we think, more competitively priced. In this time of ever-escalating premium costs, the later is obviously the better course of action. Wouldn't you rather tell your constituents at the end of this session that you cast your vote for free market competition, rather than a vote to retain the only mechanism in business today allowing for price maintenance? Let's help free market forces do what they have been proven to do best, make prices responsive to demand and not to artificial price restraints. You can take this step today by casting your vote in favor of SB 282.

Thank you.

# KSNA

the voice of Nursing in Kansas



FOR MORE INFORMATION CONTACT:

TERRI ROBERTS, J.D., R.N.  
EXECUTIVE DIRECTOR  
KANSAS STATE NURSES' ASSOCIATION  
820 QUINCY, SUITE 520  
TOPEKA, KANSAS 66612

March 16, 1989

S.B. 282

Senator Bond and members of the Committee on Financial Institutions and Insurance, my names is Terri Roberts R.N., and I am the Executive Director of the Kansas State Nurses' Association. The Kansas State Nurses' Association is the professional organization for Registered Nurses in the state of Kansas. KSNA is a member of the American Nurses' Association, which is our national organization.

The Kansas State Nurses' Association and the American Nurses' Association are concerned about insurance industry reforms, and have been since 1986 when several of our nursing specialty groups were excluded from malpractice coverage and the availability of coverage was either limited or non-existent.

KSNA supports S.B. 282 as one important step that the Kansas Legislature can take in insurance industry reform that would promote the availability of cost-effective insurance to nurses and others. S.B. 282 would foster competition by insurance companies and conceivably provide better priced insurance for the consumer. This bill would be one factor in curtailing the industries cycles of "writing away from risk" and increasing premiums to cover their losses in the cycle.

### The Current Crisis

What precipitated the current crisis is that the high interest rates of the early 80's with their promise of very high investment income caused companies to write policies at prices where they expected underwriting losses. Unfortunately (for the companies), interest rates dropped resulting in the companies making less investment income than anticipated. In addition, losses were greater than projected causing them to have to pay out more claims. The companies reaction was to raise their prices and to write only the best risks resulting in the crisis that affected the availability of malpractice insurance coverage to four groups of Registered Nurses in this country. The crisis was and has been exacerbated by the withdrawal of many reinsurers from the American market. Most primary carriers will not write a line of business unless they can get reinsurance so this withdrawal of reinsurers results in companies writing fewer policies. Although the current and ongoing crisis can be viewed as just another of the industry's cycles, it appears to be worse than any previously. The most recent previous crisis was in the mid-70's and was largely limited to medical malpractice.

KSNA supports legislation such as S.B. 282 that would offer some protection from the well recognized price-setting game played by the insurance industry when the profits in the industry are down.

*Attachment 2*  
*Jan FIF*  
*3/16/89*

S.B. 282  
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### Availability of Malpractice Insurance for Registered Nurses

In 1985 Nurse Midwives were dropped by the only remaining insurance company that was providing liability insurance to this group of nurses, and it took a national campaign to provide malpractice insurance to this group of nurses.

In 1986 Psychiatric and mental health nurses experienced problems in obtaining coverage. The situation was remedied, by the crisis may return.

Certified Registered Nurse Anesthetists also have seen their premiums go to \$3400 and their policy converted from an occurrence to a claims-made policy. There is currently only one carrier writing coverage for nurse anesthetists in this country.

In 1987 Nurse practitioners found themselves with no avenue for coverage for a 5 month length of time. It was this third and intolerable situation that has led the nursing profession as a whole to begin initiatives that would prevent being held "hostage" by the insurance industry to practice in our work settings without malpractice insurance coverage. KSNA and ANA have published numerous articles and brochures for our membership regarding the changes in the availability of insurance, the types of insurance and the problems in the industry that created this crisis for our profession. The ANA is now collecting data on nursing liability claims to more adequately police and safeguard the premiums being asked by the industry.

While we recognize that the issue of availability of malpractice insurance is one with many facets, we believe that S.B. 282 addresses a much needed aspect of insurance industry reform at the state level.

Thank you for the opportunity to speak.



Dale L. Pohl, President  
A.J. "Jack" Focht, President-elect  
Robert W. Wise, Vice President  
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Christel Marquardt, Past President

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Ronald Smith, Legislative Counsel  
Art Thompson, Legal Services Coordinator

The Hon. Richard Bond  
Chairman,  
Senate Financial Institutions and Insurance  
Statehouse  
Topeka, KS 66612

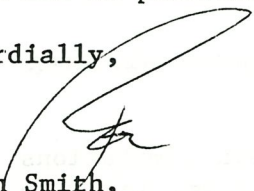
Dear Senator Bond,

Enclosed is a memorandum from Robert Adrian, a Salina attorney and Chairman of the KBA Insurance Committee. This committee reviews group policies that various companies sell to our 5,000 members, everything from liability insurance, health, life, disability and other sundry insurance policies. This memo was reproduced on our system from a Fax copy for easier reading.

The Insurance committee is interested in §14 of SB 282. They suggest repeal of the anti-rebate sections of the current insurance code because it would be good for insurance consumers such as KBA and its members. The reasons for Mr. Adrian's suggestion is outlined in the current memorandum, which includes his legal research.

KBA has no position on the other sections of the bill.

Cordially,

  
Ron Smith,  
Legislative Counsel

enc

cc: Members of the Committee

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Attachment 3  
Sen F. I + F  
3/16/89

MEMORANDUM

To: Senator Richard Bond, Members of the  
Senate Financial Institutions and Insurance Committee

From: Robert Adrian

Subj: Anti-rebate statutes

It has come to my attention that within the near future you will be considering the recommendations proposed in Senate Bill No. 282. In reviewing the Senate Bill and the proposed changes thereto, I note in §14, the proposed deletion of the rebate restrictions. It is my opinion you should give serious consideration to deletion of these sections. In an effort to help you evaluate whether or not these sections should be stricken, I am providing to you research on the specific issue of rebate statutes and their continued usefulness in today's business society.

Historically, the Anti-Rebate statutes were passed for the following reasons:

- (1) Agents were splitting their commissions with policyholders in an attempt to increase sales and profits;
- (2) Insurers then would offer increasing commissions to agents as an attempt to retain agents, thereby competing for agents instead of policyholders;
- (3) This led to some less financially affluent policyholders, in effect, funding the rebates of more affluent policyholders;
- (4) Insurer insolvencies occurred due to the cut throat competition; and
- (5) Fear that such competition would drive our companies allowing overall premiums to increase.

The result was the passage of anti-rebating statutes wherein limitations were placed on commission earnings, premium collection charges, loans to agents unless properly collateralized, and prohibited the giving and receiving of bonuses by agents for new business. [See John S. Coniff, "Anti-Rebate Statutes After the Florida Litigation: Alternative Controls for Pricing Abuses," Journal of Insurance Regulation, 109, 113-114 (1986); Also, James S. Brock, "Bates and Rebates, 376, 278 (1963).]

As an aid to legislatures, the National Association of Insurance Commissioners (NAIC) adopted the Model Unfair Trade Practices Act. As of the date of Mr. Coniff's article, every state had adopted a version of this Model Act.

Kansas, in particular, adopted the Model Act almost verbatim. The public policy expressed above is one of consumer protection so as to prevent secret rebate agreements which would give unfair preferential treatment of certain persons. [Brock at 383.]

From a policy standpoint, these anti-rebate statutes have come under a great deal of criticism lately because they destroy the ability of consumers freedom to contract. By restricting rebates, potential insureds (and agents for that matter) cannot enter into an agreement to decrease premium payments. This thwarts competition. As such, simple economics says that when competition decreases, prices increase. This is obviously bad for the potential policyholder. From an agent's point of view, the lack of ability to negotiate a commission rebate creates a disincentive to compete. [Coniff at 131-134.]

Another criticism of the anti-rebate statutes is that they are difficult to police. [Coniff at 128-131.] Because the penalties for violation of the anti-rebate laws can be severe, violators do not voluntarily admit their guilt.

Finally, these statutes, in particular the Model Act, were written in 1947, when the consumer protection movement was still in its formative stages. Today, with all of the regulatory procedures facing the insurance industry, the outright prohibition of rebating in all areas of the insurance business is simply unnecessary. [See Coniff at 141.]

Florida had a statute almost identical to K.S.A. 40-2404(8)(a). In 1986, this statute was challenged as unconstitutional based on the reasoning that it was a denial of property without due process. The Florida Supreme Court held the statute to be unconstitutional. [Department of Insurance v. Dade County Consumer Advocates Office, 492 So.2d 1032 (1986)] The Court reviewed the historical basis for the anti-rebate statutes and categorically rejected them. Using a substantive due process argument, the Court held denying the insurance agent the right to rebate a portion of his commission unnecessarily limits the bargaining power of the policyholder. [Id. at Syl. para. 2.] Moreover, the Court stated that there was no identifiable relationship between the anti-rebate statute and the public policies heretofore set forth which supposedly protect the public health, safety, and general welfare. [Id. at 1035.]

The are age-old reasons for supporting the anti-rebate statutes:

- (1) That, in the absence of these laws, similarly classified policyholders of the same insurer will pay different prices for the same policy;
- (2) That consumers' efforts to compare costs of similar policies will be thwarted;
- (3) That consumers will be more likely to focus on the size of the rebate than on the quality of the insurance;
- (4) That premiums will increase as a result of pressure by agents for larger commissions to enable them to offer larger rebates; and
- (5) That many policies will lapse because consumers will replace their policies each year with new policies sold by different agents who



can offer larger rebates as a result of the prevailing first year commission structures, resulting in higher administrative costs.

The Florida Supreme Court was unpersuaded by these arguments. Instead, the Court focused on the question of whether "a statute that prohibits an insurance agent from reducing the amount of the commission he or she will earn from selling the insurance is valid." [Id. at 1034.] In ruling the Florida statute invalid, the Court supported the Coniff rationale set out above.

In conclusion, it would appear that the anti-rebate statutes are outdated and serve no useful public policy purpose. Further, it would appear the anti-rebate statutes are a denial of the right of an insurance agent to use his property -- his commission -- however he wants and without the due process of law as guaranteed by the federal and state constitutions. As such, anti-rebate statutes thwart competition among insurance agencies and companies.

In reviewing Senate Bill No. 282, I would ask that you give serious consideration to repealing the rebate portions of K.S.A. 40-2404 as proposed in Senate Bill No. 282.