Approved February 13, 1992
Date

MINUTES OF THE House COMMITTEE ON Insurance.

The meeting was called to order by Representative Turnquist at
Chairperson

3:45 xxx./p.m. on Tuesday, February 11, 1992 in room 531 N of the Capitol.

All members were present except: Representative Sebelius, Excused
Representative Cornfield, Excused
Representative Ensminger, Excused

Committee staff present: Mr. Fred Carman, Revisor
Mr. Chris Courtwright, Research
Mrs. Nikki Feuerborn, Secretary

Conferees appearing before the committee:
Mr. Dick Brock, Insurance Department
Mr. David Hanson, KAPCI
Mr. Bill Sneed, State Farm

The meeting was called to order at 3:45 p.m. by Chairman Turnquist.

Lori Callahan, representing KaMMCO, requested the introduction of legislation which would provide a mechanism to allow for more request reimbursement from the Health Care Stabilization Fund to the Kansas Health Care Provider Insurance Availability Plan. (See Attachment 1).

Representative Helgerson moved for the introduction of this request into legislation. Representative Neufeld seconded the motion. Motion carried.

Hearing on HB 2755 - UI/UIM coverage in auto liability policies
Chris Courtwright gave a staff review of the bill. This would amend KSA 1991 Supp 40-284 to change the language regarding two of the allowable exclusions or limitations from the uninsured and underinsured provisions in Kansas' mandatory motor vehicle liability insurance law. The bill would allow exclusions or limitations only to the extent that duplicative workers compensation and duplicative personal injury protection benefits apply. The bill was requested for introduction by the Insurance Department.

Mr. Dick Brock, Insurance Department, presented testimony indicating the need for such legislation. He described the bill as codification of the recent Supreme Court decision which interpreted the current law to be in agreement with the Insurance Department. (See Attachment 2).

Mr. David Hanson of the Kansas Association of P & C Insurance, proposed the "duplicative" be struck from the bill. Mr. Bill Sneed, State Farm, explained the meaning of "duplicative" in this sense. So long as companies offered an offset, one would not be able to collect twice - once from workers compensation and once from an insurance company.

It was suggested that the conferees collaborate with the committee members and Mr. Brock regarding the proposed language.

Hearing on HB 2787 - Activities of insurance holding companies
Mr. Chris Courtwright gave the staff review of this bill. This will would make a number of amendments in the insurance holding company statutes more closely conform the Kansas act with the NAIC model act and to correct two provisions in our existing law which were found to be somewhat "deficient" by a recent NAIC accreditation review. The Insurance Department thinks that future accreditation could be jeopardized if we do not correct these so-called deficiencies.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

CONTINUATION SHEET

MINUTES OF THE House COMMITTEE ON Insurance,

room 531-N Statehouse, at 3:45 a.m./p.m. on Tuesday, February 11, 1992.

Mr. Dick Brock, Insurance Department, spoke as a proponent of the bill. This bill would be an update to the Holding Company Act because: (1) the current holding company act includes an exemption that is simply not appropriate or acceptable in today's environment; (2) the definition of an extraordinary dividend in the current Kansas law is very substantially different than that contained in the current NAIC model; and (3) because of the need to propose amendments in these areas, the department believes it is appropriate to bring other provision of the Holding Company Act up-to-date so it will be comparable to the current NAIC model and, therefore, more comparable to the holding company acts in effect or which will be in effect in other states. (See Attachment 3).

The committee requested the amendments for **HB 2787** be put in balloon form.

Hearing on HB 2797 - Regulation of reinsurance intermediaries
Mr. Christ Courtwright gave the staff review of the bill. This bill would enact the Reinsurance Intermediary Act, which is legislation based upon another NAIC model act. The bill would bring reinsurance intermediary brokers and managers under the regulatory oversight of the Insurance Commissioner. The types of liability transfers which such persons engage in include both ceded reinsurance and retrocession. Among other requirements, reinsurance brokers and managers would be required to maintain detailed records for at least 10 years after the expiration of reinsurance contracts. Insurers also would be prohibited from engaging the reinsurance services of any persons or entities not licensed pursuant to the act. All of the reinsurance intermediaries would be subject to examination by the Commissioner. Violations of any provision of the law could result in fines of up to $5,000 per violation as well as license suspension or revocation. Reinsurance intermediary licenses would cost an initial $250, and the annual continuation fee would be $100. The act would not take effect until December 31, 1992, and contracts in effect prior to that date would remain in force until June 30, 1993.

Mr. Dick Brock, Insurance Department, appeared before the committee as a proponent of the bill. This is another solvency regulation that is necessary if the Kansas Insurance Department is to maintain its NAIC accreditation. He explained the purpose, problems, and necessity of the reinsurance in the ten different sections affected. (See Attachment 4).

Representative Neufeld moved for favorable passage of **HB 2797.** Representative Campbell seconded the motion. Motion carried.

A discussion of the proposed insurance plan for the state self-insuring state-owned buildings will be discussed at the Monday, February 17, 1992, insurance meeting. Representatives from the state architect and regents offices will be in attendance.

The meeting adjourned at 4:40 p.m.

GUEST LIST

COMMITTEE: Ins. Dept. DATE: 2-11-92

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATION
Dave Hanson	Topeka	Ks Assoc P&C
Dick Brock	"	Ins Dept
Lori Callahan	Topeka	KAMMCO
Bill Sneed	Topeka	State Farm
[illegible]	McPherson	Alliance Ins
LAURIE HARTMAN	TOPEKA	KBA
William L. Mitchell	~~Topeka~~ Hutchinson	Alliance Ins
Lee WRIGHT	Overland Park	F.I.G.

KaMMCO

KANSAS MEDICAL MUTUAL INSURANCE COMPANY

AND

KANSAS MEDICAL INSURANCE SERVICES CORPORATION

TO : House Insurance Committee

FROM: Lori Callahan, General Counsel

RE : Bill Request

On July 1, 1990, KaMMCO became the servicing carrier for the Kansas Health Care Provider Insurance Availability Plan, the Joint Underwriting Association for health care providers who cannot obtain medical malpractice insurance in the private market. Since July 1, 1990, there has been a substantial reduction in the number of claims and in addition the Plan has been greatly depopulated. As a result, revenue in the Plan, which is partially funded by the Health Care Stabilization Fund, has been reduced. Accordingly, a mechanism is needed within the law to allow for more frequent reimbursement from the Fund to the Plan. This proposed bill fulfills that need.

Insurance Committee

Attachment 1

2-11-92

P.O. BOX 2307 • TOPEKA, KANSAS 66601-2307
913-232-2224 / 800-232-2259

Section 1. K.S.A. 40-3403(c)(8) is hereby amended to read as follows: ~~Annually~~ Periodically to the Plan or Plans, any amount due pursuant to subsection(a)(3) of K.S.A. 40-3414 and amendments thereto.

Section 2. K.S.A. 1991 Supp. 40-3413(a)(3) is hereby amended to read as follows: A method whereby ~~annually~~ periodically the Plan shall compare the premiums earned to the losses and expenses sustained by the Plan for the proceeding fiscal year. If there is any surplus of premiums over losses and expenses received for that year, such surplus shall be transferred to the Fund. If there is any excess of losses and expenses over premiums earned, such losses shall be transferred from the Fund~~;~~. Provided that such transfers shall not occur more than each quarter;

Section 3. K.S.A. 1991 Supp. 40-3403 and K.S.A. 1991 Supp. 40-3413 are hereby repealed.

Section 4. This Act shall take effect and be enforced from and after its publication in the Kansas Register.

Testimony by

Dick Brock, Kansas Insurance Department

Before the House Committee on Insurance

House Bill No. 2755

House Bill No. 2755 amends the law relating to uninsured/underinsured motorist coverage included in automobile liability policies. The same amendment is included in 1991 House Bill No. 2126 which passed the House and is now in the Senate committee. This bill would simply clarify the language of the statute to remove or alleviate disputes regarding what we believe was the original legislative intent by adding the word "duplicative" to the exclusion language which attempts to prioritize the payment of benefits when UM/UIM, personal injury protection and/or workers compensation benefits apply to the injuries sustained in an accident. It should be noted that this is only one of several amendments proposed by the 1991 bill and is, in fact, a very simple change in comparison to the other components of that bill.

As some of you will recall, 1991 House Bill 2126 was sponsored by the Kansas Trial Lawyers Association who correctly pointed out that the amendment proposed by House Bill No. 2755 was consistent with the Department's interpretation of the statute as articulated in various letters relating to specific claims situations.

The problem with the existing language arose because some insurers were using the exclusions permitted by subparagraphs (4) and (6) of K.S.A. 1991 Supp. 40-284(e) to deny or reduce claims under underinsured motorists coverage by amounts the insured received from workers compensation or personal injury protection benefits even though payment would clearly not result in a double recovery (being paid twice) for the same injury. For example, assume an insured has purchased uninsured/underinsured (UM/UIM) coverage of $100,000, and receives $60,000 in personal injury protection benefits (PIP) but suffers injuries requiring $110,000 in medical expenses, some companies were or are

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Attachment 2

deducting the $60,000 PIP from the $100,000 UM/UIM coverage and claiming only $40,000 remained in UM/UIM benefits even though the insured had purchased $100,000 limits and still owed $50,000 for medical expenses. The only way these permissible exclusions make sense is if they prevent a double recovery. They don't make sense if the insured has UIM coverage remaining and covered medical bills to pay but the exclusion prevents him or her from receiving the benefits.

This argument has now, we hope, been settled by the Kansas Supreme Court whose decision agrees with the Department's interpretation. As a result, House Bill No. 2755 can now be described as a codification of the court's opinion, a copy of which is attached to my testimony.

IN THE SUPREME COURT OF THE STATE OF KANSAS

No. 66,319

FRANCES JEAN RICH, EXECUTOR OF THE ESTATE OF
JOHN E. LAVIN, DECEASED,
Appellant,

v.

FARM BUREAU MUTUAL INSURANCE COMPANY, INC.,
AND KFB INSURANCE COMPANY, INC.,
Appellees.

SYLLABUS BY THE COURT

1.

The purpose of legislation mandating the offer of uninsured and underinsured motorist coverage is to fill the gap inherent in motor vehicle financial responsibility and compulsory insurance legislation. This coverage is intended to provide recompense to innocent persons who are damaged through the wrongful conduct of motorists who, because they are

uninsured or underinsured and not financially responsible, cannot be made to respond in damages.

2.

The uninsured and underinsured motorist statutes are remedial in nature. They should be liberally construed to provide a broad protection to the insured against all damages resulting from bodily injuries sustained by the insured that are caused by an automobile accident and arise out of the ownership, maintenance, or use of the insured motor vehicle, where those damages are caused by the acts of an uninsured or underinsured motorist.

3.

The purpose of K.S.A. 40-284 is to provide the individual who is covered by the standard automobile liability policy with a right against his own insurer equal to that the insured would have against the uninsured or underinsured tortfeasor.

4.

K.S.A. 40-284(e)(6) allows an insurer to exclude or limit its uninsured and underinsured motorist coverage to the

extent that duplicative personal injury protection benefits apply. The legislature intended K.S.A. 40-284(e)(6) to permit an insured to recover underinsured motorist benefits which are not duplicative of PIP benefits. Any other result negates the legislature's intent to require underinsured motorist coverage protection.

Appeal from Shawnee district court; E. NEWTON VICKERS, judge. Opinion filed January 17, 1992. Reversed and remanded.

Jeffrey W. Jones, of Sloan, Listrom, Eisenbarth, Sloan & Glassman, of Topeka, argued the cause, and *Gary E. Laughlin*, of the same firm, was with him on the briefs for appellant.

M. Larry Bork, of Goodell, Stratton, Edmonds & Palmer, of Topeka, argued the cause, and *Wayne T. Stratton*, of the same firm, was with him on the brief for appellee.

The opinion of the court was delivered by

LOCKETT, J.: This is an action for the recovery of underinsured motorist benefits. John E. Lavin was a passenger injured in a one-vehicle accident. Both the driver and the owner of the vehicle paid the liability limits of their policies in settlement with Lavin. Because Lavin's

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underinsured motorist coverage limits exceeded the combined coverage of the two tortfeasors, Lavin made claim for underinsured motorist benefits against his own automobile liability insurance carrier, KFB Insurance Company, Inc. (KFB). That claim was denied by KFB on grounds the PIP benefits Lavin had collected from KFB exceeded his claim for underinsured motorist benefits. Lavin died three weeks before the trial court decision in favor of KFB. Lavin's executor now appeals the trial court ruling that, pursuant to K.S.A. 40-284(e)(6), the insurer was entitled to set off the underinsured motorist benefits it owed against the nonduplicative PIP benefits it previously paid.

Lavin was a passenger in a car driven by Jimmy Roberts, which was involved in a single-car accident. The owner of the vehicle was insured by State Farm Insurance Company, with liability limits of $50,000. Roberts was insured by Farm & City Insurance Company through Mid-States Adjustment, Inc., with $25,000 liability limits. Each of those insurers paid the limits of its policy to plaintiff in settlement of its insured's liability to Lavin.

Lavin was insured under four policies of automobile liability insurance, two with Farm Bureau Mutual Insurance Company, Inc., and two with KFB. Farm Bureau Mutual Insurance Company is not involved in this appeal.

Lavin received $31,167.52 of PIP wage loss benefits and $9,500 PIP medical benefits through KFB policy #FA65134, which had the highest PIP coverage. Lavin's KFB policy #BC41159 had the highest underinsured motorist coverage with a limit of $100,000. Lavin's underinsured motorist coverage exceeded the combined $75,000 liability coverages of the owner and driver of the vehicle ($50,000 + $25,000) by $25,000. The parties agree that the maximum liability coverage and PIP benefits plaintiff is entitled to receive is $177,000.

KFB denied the estate's claim for $25,000 on grounds the $40,667.52 in PIP benefits it paid Lavin exceeded his $25,000 claim for underinsured motorist benefits; therefore, the $25,000 claim can be offset against the PIP benefits already paid. K.S.A. 40-284(e)(6).

Lavin's insurance benefits were calculated as follows:

Liability	$100,000	
Lost Earnings	63,000	($1,750 x 36 months)
Medical	9,500	
Rehabilitation	4,500	
	$177,000	

The parties stipulated that a court or jury would probably find Lavin's actual damages exceeded $177,000. The parties also

stipulated that none of the damages plaintiff claims under the underinsured motorist coverage are damages to which PIP benefits "apply." Thus, the issue is whether Lavin's estate is entitled to the $25,000 of underinsured motorist benefits or whether KFB is entitled to offset the $25,000 of underinsured motorist coverage against the nonduplicative PIP benefits it paid.

The trial court, relying on a literal reading of K.S.A. 40-284(e)(6), ruled the statute allows the insurer to reduce the underinsurance coverage by payments it already made for personal injury protection. The trial court held the $25,000 of underinsurance coverage could be set off against the PIP payments and, thus, KFB had no further liability to its insured. Lavin's estate appealed, claiming K.S.A. 40-284(e)(6) allows setoff of the underinsured benefits only if the benefits are duplicative of the PIP benefits KFB previously paid.

In 1968, the Kansas Legislature enacted the uninsured motorist statute, K.S.A. 1968 Supp. 40-284. This statute allowed motorists who incurred damages in an automobile accident with an individual who had no automobile insurance to recover benefits for those damages from their own insurance company, up to the limits of their coverage. In 1981, the legislature amended the law to include within the uninsured motorist statute provisions for coverage for underinsured

motorists. This section of the statute, K.S.A. 40-284(b), provides:

> "Any uninsured motorist coverage shall include an underinsured motorist provision which enables the insured or the insured's legal representative to recover from the insurer the amount of damages for bodily injury or death to which the insured is legally entitled from the owner or operator of another motor vehicle with coverage limits equal to the limits of liability provided by such uninsured motorist coverage to the extent such coverage exceeds the limits of the bodily injury coverage carried by the owner or operator of the other motor vehicle."

The insurer charges a premium for uninsured motorist coverage and a separate premium for underinsured motorist coverage.

Other pertinent language of K.S.A. 40-284 allows an insurer to exclude or limit its uninsured and underinsured motorist coverage "to the extent that personal injury protection benefits apply." KFB's insurance policies incorporate the statute's language and state that coverage is not provided for bodily injury sustained by any person to the extent personal injury protection coverage applies.

PIP benefits apply to amounts for disability; funeral, medical, and rehabilitation expenses; substitution benefits; and survivor benefits. Intangible elements of damage, such as pain and suffering, disfigurement, and emotional distress are not covered by PIP benefits, but an injured person can recover such damages from the tortfeasor or, if the tortfeasor is underinsured, from the injured person's underinsured motorist insurance carrier. K.S.A. 40-3103(q).

Plaintiff contends the trial court erroneously construed the plain language of K.S.A. 40-284(e)(6) to allow KFB to offset the underinsured motorist coverage benefits against nonduplicative PIP benefits previously paid. Plaintiff further claims Lavin's estate is entitled to the $25,000 underinsured motorist benefits from the insurer because Lavin paid a separate premium for the coverage and the underinsured motorist benefits are not duplicative of the PIP benefits and, therefore, K.S.A. 40-284(e)(6) does not allow a setoff.

Plaintiff maintains that if the underinsured motorist coverage benefits claimed are for those intangible elements of damage not covered by PIP, *i.e*, damages to which PIP benefits do not "apply," there is no double recovery. Plaintiff asserts if the legislature intended the limiting phrase "to the extent that [PIP] benefits apply" to mean "in an amount equal to the PIP benefits which the insured has received or is entitled to

receive" the legislature could, should, and would have used a more specific phrase.

Plaintiff argues the trial court's construction of the statute leaves persons who purchase the highest level of PIP coverage, coupled with a medium to low level of liability coverage, no uninsured/underinsured motorist coverage in spite of having paid a premium for the coverage. In such a situation, the insured obtains no uninsured/underinsured motorist coverage because the insurer can set off its entire limit of uninsured/underinsured motorist coverage against PIP coverage. Here, for example, Lavin's potential PIP coverage was $77,000, but his underinsured motorist coverage after his recovery from the driver and the owner of the vehicle was only $25,000. Thus, the trial court's ruling allows KFB to disclaim all responsibility for underinsured motorist coverage despite the fact that Lavin paid an additional premium to KFB for that $100,000 of coverage.

Plaintiff contends it was not the intent of the legislature to enact remedial legislation requiring insurers to extend both PIP and uninsured/underinsured motorist coverage to Kansas drivers, for which those insurers collect additional premiums, and at the same time permit those same insurers to deny nonduplicative coverage of their injured insureds.

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KFB asserts the legislative history of the statute does not reflect an intention of the legislature to limit the effect of the statute to duplicative benefits and that recent attempts to amend the statute to include the word "duplicative" indicate that the current version of the statute allows exclusion of both nonduplicative and duplicative PIP benefits. KFB argues there is no ambiguity in the statute, which plainly states that both duplicative and nonduplicative PIP benefits the insurer has previously paid to its insured may be excluded from the underinsured motorist coverage. KFB's argument that legislative history reflects an intention to allow exclusion of duplicative and nonduplicative PIP benefits is not persuasive. The legislative history is of no benefit in determining the scope and meaning of 40-284(e)(6). Since the enactment of K.S.A. 40-284(e)(6), the Kansas Insurance Department has consistently taken the position that the legislative intent behind that statute was merely to prevent double recoveries by insureds and not to authorize a first-dollar setoff in cases where no duplication of recoveries would occur.

KFB contends two Kansas cases, *Hetzel v. Clarkin*, 244 Kan. 698, 772 P.2d 300 (1989), and *Bardwell v. Kester*, 15 Kan. App. 2d 679, 815 P.2d 120 (1991), are relevant and support its position that both duplicative and nonduplicative PIP benefits may be excluded from coverage. We disagree. KFB cites language on page 708 of *Hetzel* that "K.S.A. 1988 Supp.

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40-284(e)(6) allows insurers to limit the coverage under the uninsured motorist provision to the extent that PIP benefits have been paid," and concludes that language indicates that, in a case where damages were claimed to far exceed coverage, the court believed PIP benefits paid to plaintiff would be subject to setoff. KFB notes there is no indication in the court's discussion that a "duplicative" threshold is to be considered prior to the limitation.

KFB's conclusion as to what the court believed is unsupported by the language of the opinion. The statement in *Hetzel* referred to whether Hetzel had exhausted her remedies and could proceed under the Kansas Guaranty Act, K.S.A. 40-2905 *et seq.*

In *Bardwell v. Kester*, 15 Kan. App. 2d 679, Bardwell, a minor, was a passenger in an automobile driven by Gatlin. Gatlin's automobile was struck by an automobile driven by Kester. Bardwell was hospitalized with injuries he received in the collision. Farmers paid him $8,213.37 in PIP benefits as a covered family member under a Farmers policy issued to his father. In a friendly suit, Bardwell agreed to settle with Gatlin for $5,000, with Kester for $25,000, and with Farmers for $8,213.37. Farmers refused to pay the judgment under a setoff provision of its endorsement, authorized by K.S.A. 1990 Supp. 40-284(e)(6), which stated: "Any amount payable under

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the coverage shall be reduced by all sums payable for the same damages under any Personal Injury Protection." The trial court ruled that Farmers was not required to pay the judgment entered against it. Bardwell appealed, contending that the setoff provision of the insurance contract did not apply. He maintained the specific language of the Farmers policy only allowed for a setoff of PIP benefits which are "payable," not benefits already paid.

The Court of Appeals, after applying the rules for construction of an insurance contract, found that the only reasonable construction of the language was that the parties intended to reduce underinsured motorist coverage benefits by the amount of all benefits that eventually became payable prior to judgment. The Court of Appeals concluded that reading the contract otherwise would allow a duplicative payment. The application of K.S.A. 40-284(e)(6) to the PIP benefits paid by the insurer for the insured was not discussed in *Bardwell*.

The purpose of the legislation mandating the offer of uninsured and underinsured motorist coverage is to fill the gap inherent in motor vehicle financial responsibility and compulsory insurance legislation. This coverage is intended to provide recompense to innocent persons who are damaged through the wrongful conduct of motorists who, because they are uninsured or underinsured and not financially responsible,

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cannot be made to respond in damages. See *Winner v. Ratzlaff,* 211 Kan. 59, Syl. ¶ 1, 505 P.2d 606 (1973).

The uninsured and underinsured motorist statutes are remedial in nature. They should be liberally construed to provide a broad protection to the insured against all damages resulting from bodily injuries sustained by the insured that are caused by an automobile accident and arise out of the ownership, maintenance, or use of the insured motor vehicle, where those damages are caused by the acts of an uninsured or underinsured motorist. See *Simpson v. Farmers Ins. Co.,* 225 Kan. 508, 512, 592 P.2d 445 (1979). Other states have similarly found their uninsured and underinsured motorist statutes are remedial in nature and should be liberally construed to provide broad protection. See *American Service Mutual Insurance Co. v. Wilson,* 323 So. 2d 645 (Fla. Dist. App. 1975); and *Sinicropi v. State Farm Insurance Co.,* 55 App. Div. 2d 957, 391 N.Y.S.2d 444 (1977).

Uninsured and underinsured motorist coverage was developed by the Kansas Legislature as a means of protecting individuals from negligent uninsured or underinsured motorists. The purpose of K.S.A. 40-284 is to provide the individual who is covered by the standard automobile liability policy with a right against his or her own insurer equal to that the insured would have against the uninsured or

underinsured tortfeasor. *Van Hoozer v. Farmers Insurance Exchange*, 219 Kan. 595, 600, 549 P.2d 1354 (1976). We hold the legislature intended K.S.A. 40-284(e)(6) to permit an insured to recover underinsured motorist benefits which are not duplicative of PIP benefits. Any other result negates the legislature's intent to require underinsured motorist coverage protection.

Reversed and remanded for further proceedings.

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Testimony by
Dick Brock, Kansas Insurance Department
Before the House Committee on Insurance
House Bill No. 2787

In the late 1960s and early '70s, the American business community discovered the advantages of diversification. Some observers at the time were suspicious of the motives of those seeking to acquire ownership and control of insurance companies believing that the primary purpose of such activity was to circumvent many of the statutes that regulate the formation, management, investments and other operations of insurance companies. Others were less suspicious in that the acquisition of insurance companies by non-insurance interests would produce more access to capital markets, enhance profitability through new lines of business, and better serve expanding public needs through a more comprehensive range of financial services.

Regardless of which view was correct, it became evident that the interests of policyholders could be adversely affected if control of an insurer was sought for nefarious reasons, such acquisition would substantially lessen competition and/or, more important, the assets of the insurer were depleted or its financial condition otherwise jeopardized by transactions or relationships over which there was inadequate or no regulatory oversight or control.

Therefore, to meet the regulatory needs revealed by the acquisition and merger of insurance companies, the National Association of Insurance Commissioners developed and adopted the Insurance Holding Company System Regulatory Act.

With the exception of a section relating to permissible investments, Kansas enacted this basic act in 1974. The original and continuing purpose of the Holding Company Act is to protect the interests of the policyholders insured by a domestic insurance company if a controlling interest in such company is acquired by a new person or entity. Aside from some fairly technical amendments such as removing the act's

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application to securityholders, removal of some notification requirements and assigning responsibility for the payment of some of the costs incurred when formal hearings are conducted, the Kansas law relating to holding company systems had not been materially changed since its inception until 1991. As many of you will recall, we proposed and you enacted Senate Bill No. 67 last year which amended various provisions of the Holding Company Act.

House Bill No. 2787 is another update because: (1) our current holding company act includes an exemption that is simply not appropriate or acceptable in today's environment; (2) the definition of an extraordinary dividend in the current Kansas law is very substantially different than that contained in the current NAIC model; and (3) because of the need to propose amendments in these areas, we believe it appropriate to simply bring other provisions of our Holding Company Act up-to-date so it will be comparable to the current NAIC model and therefore more comparable to the holding company acts in effect or which will be in effect in the other states.

Many of the amendments are editorial in nature or are self-explanatory but the more substantive amendments will:

(1) Page 3, lines 6 through 15 -- Clarify that non-insurance entities must file the required preacquisition notification even though the transaction may ultimately not be subject to the Commissioner's approval. The preacquisition notice will permit him or her to be satisfied that the holding company to be acquired is not primarily engaged in the business of insurance.

(2) Page 6, lines 13 through 23 -- These provisions relate to the merger and acquisition provisions added by 1991 Senate Bill 67 regarding acquisitions of non-domestic insurers. In effect, this additional language will make acquisitions of domestic insurers subject to the

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same competitive standards as were applied to non-domestic insurers last year.

(3) Page 6, lines 36 and 37 -- Adds consideration of whether an acquisition of a domestic insurer is likely to be hazardous or prejudicial to the insuring public as a reason the Commissioner may disapprove the transaction.

(4) Page 7, lines 23 through 28 -- The language deleted in these lines is one of the most important amendments proposed by House Bill 2787. Specifically, control of a domestic insurance company can currently be acquired without approval or oversight if accomplished through the purchase of unissued stock.

At the time the Holding Company Act was first developed by the NAIC, it was designed to address the problems created by "hostile takeovers" where current owners and management interests and those seeking control often ignored the policyholder's welfare. Unissued stock was not involved because such securities are obviously under the control of management and therefore protected from unwanted or unwelcome purchase. However, it has become clear that any acquisition of a domestic insurer must be subject to scrutiny and meet certain tests regardless of the reason for or manner in which the change in control occurs.

Therefore, deletion of the exemption is essential to prevent injury to policyholders by the acquisition of a domestic insurer through a "friendly" purchase of unissued stock by undesirable interests.

(5) Pages 11 and 12, lines 17 through 43 and 1 and 2 respectively -- These provisions have been deleted but reinserted on pages 14 and 15, lines 27 through 43 and lines 1 through 9 respectively.

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(6) Page 13, lines 2 through 18 -- This is actually a correction of 1991 Senate Bill 67. For some reason, they were unintentionally omitted from our 1991 proposal and therefore were not included in the 1991 legislation. They are, however, a significant part of the requirements added in 1991 which requires domestic insurers to notify the Commissioner of certain transactions.

In lines 10 through 14 there are, however, some erroneous references. Specifically, in lines 10 and 11, the words "paragraph (2) of" should be deleted. Also, in line 11, the reference to subsection "(a)" should be deleted and reference to subsection "(b)" substituted therefore. On line 12, the reference to "paragraph (1)" should be deleted.

(7) The second really important amendment proposed by House Bill No. 2787 should appear on page 13, line 31 but was inadvertently omitted when the bill was printed. Therefore, on line 31, page 13, the word "greater" should be deleted and the word "lesser" substituted.

Obviously, when we make this change of one word it has a profound effect on the definition of extraordinary dividend. Consequently, the ability of insurers to pay a dividend to shareholders without the approval of the Commissioner is more limited. For example, under the current definition a life insurer with a surplus of $4 million and a net gain from operations of $500,000 as of December 31 would be able to make a dividend distribution of $500,000 to shareholders without the Commissioner's approval. Under the language proposed by House Bill 2787, the insurer's unfettered dividend authority would be $400,000 because 10% of $4 million is less than the net gain from operations. This doesn't at all mean the insurer is prevented from distributing a larger dividend but it would change the level at which the Commissioner's approval is needed. This difference, of course,

would be much greater for life insurers with a huge surplus but a minimal gain from operations.

It is important to note that we are talking only about dividends to shareholders. This provision doesn't have anything to do with policyholder dividends. Thus, the purpose of this amendment is simply to add a further safeguard against a distribution of dividends to a parent or other shareholders of such magnitude that the solvency of the insurer and therefore the welfare of policyholders might be endangered.

The changes proposed by House Bill 2787 regarding elimination of the exemption for unissued stock and the change in the definition of extraordinary dividends is necessary for Kansas to maintain its NAIC accreditation as one of the nine states that meets the national financial regulation standards. However, the much more important reason the bill was proposed is because the changes are needed.

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Testimony by

Dick Brock, Kansas Insurance Department

Before the House Committee on Insurance

House Bill No. 2797

House Bill No. 2797 is another solvency regulation tool that is necessary if the Kansas Insurance Department is to maintain its NAIC accreditation. Obviously, the accreditation in and of itself is a nice tribute to the legislature, Governor and Insurance Department that jointly made receipt of such distinction possible. However, a far more important part of the accreditation process is the much stronger state insurance solvency regulation system that will result. This objective is the purpose of House Bill 2797 which provides for the licensing and regulation of reinsurance intermediaries.

Needless to say, reinsurance is by its nature a vital component of insurance company solvency. For various reasons, the insurance mechanism performs better if the risk of a particular consumer is covered by a single insurer. There is only one insurer for the policyholder to deal with in the event of a claim, only one contract covering the risk, only one company's premium or rates and rating plans involved, and the company itself does not have to coordinate inspection services, safety initiatives, audits or other servicing responsibilities. However, by assuming all the liability under an insurance contract, the primary insurer may expose itself to excessive losses as a result of a single event, simultaneous losses under multiple policies resulting from the same event or some other unanticipated adversity. Therefore, insurers attempt to protect themselves from this result by transferring a part of the risk they have assumed to other insurers. The insurers to whom the primary liability or some of the primary liability is transferred may in turn transfer all or part of what they have assumed to still other insurers and this can continue until the risk originally written by the primary insurer is spread among a multitude of companies both in this country and abroad. This whole process of assuming and transferring or ceding risk is, of course, reinsurance and, as I said, it plays a very large role in a primary insurer's ability to remain solvent because no

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matter how much liability is spread throughout the insurance industry, the primary insurer remains solely responsible to its policyholders for any and all covered losses. This is an extremely complicated mechanism which, for a number of reasons, does not lend itself to direct regulation of reinsurance contracts, rates, placements and so forth. One of these reasons is that the system works very well the vast majority of the time because reinsurance transactions almost always involve knowledgeable and experienced "buyers and sellers". Nevertheless, more than a few well-managed, well-established insurance companies have found themselves incurring very significant, unanticipated losses even to the point of causing insolvency because the reinsurance they thought they had was not collectible when it was needed.

Because direct regulation of reinsurance transactions is virtually impossible and if attempted would unquestionably be counterproductive, House Bill No. 2797 imposes licensing requirements and performance responsibilities on the persons who solicit or negotiate reinsurance contracts with insurance companies. House Bill 2797 refers to these individuals and firms as reinsurance intermediaries and requires them to be licensed either as an agent or broker; or, be specifically licensed as a reinsurance intermediary. A licensed agent or broker does not have to be separately licensed as a reinsurance intermediary but, if he or she, transacts business as a reinsurance broker or reinsurance manager, compliance with the provisions relating to reinsurance intermediaries is required. The license for a reinsurance intermediary is a new provision and is basically a registration requirement. However, under the act there are two kinds of reinsurance intermediaries. The first is a reinsurance broker who would find other insurers willing to accept or assume risk from an insurer the broker represents and perhaps negotiate the terms of the contract but not be authorized to bind the reinsurance. The other reinsurance intermediary established by House Bill 2797 is a reinsurance manager who would be authorized to bind or manage risk assumed from another insurer. Because of this binding authority the

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Commissioner can require reinsurance managers to file a bond and maintain errors and omissions coverage but otherwise the licensing requirements are the same for reinsurance brokers and managers.

Beyond the licensing requirement, Sections 4 and 5 of House Bill 2797 establish the basic responsibilities of a reinsurance broker. The foundation of these responsibilities is included in Section 4 which includes a requirement that transactions between the reinsurance broker and any insurer it represents must be governed by a written authorization that delineates the rights and responsibilities of both parties. Section 5 sets forth a list of the records a reinsurance broker must maintain for a period of at least 10 years on each transaction.

Section 6 prohibits an insurer from using a reinsurance broker unless such person or firm is properly licensed.

Section 7 relates to reinsurance managers and imposes requirements quite similar to those applicable to reinsurance brokers; however, because a reinsurance manager can actually bind coverage, the contract between a reinsurance manager and reinsurer must be approved by the reinsurer's board of directors and a copy of such contract must be filed with the Commissioner. Also, reinsurance managers are subject to some specific prohibitions as listed in Section 8.

Section 9 prohibits insurers from using a reinsurance manager that is not properly licensed.

Section 10 authorizes the Commissioner to examine reinsurance intermediaries the same as insurance companies; Section 11 establishes the penalties for violation of the act; Section 12 authorizes the Commissioner to adopt regulations; Section 13 permits existing contracts with reinsurance intermediaries to continue in effect until June 30,

1993; and, Section 14 would make House Bill 2797 effective December 31, 1992.