

MINUTES OF THE _____ House COMMITTEE ON _____ Insurance

The meeting was called to order by _____ Representative Turnquist _____ at
Chairperson

_____ 3:30 _____ a.m./p.m. on _____ February 26, _____, 1992 in room _____ 531 _____ of the Capitol.

All members were present except:

Representative Sebelius, Excused
Representative, Gilbert, Excused

Committee staff present:

Mr. Fred Carman, Revisor
Mrs. Emalen Correll, Research
Mr. Chris Courtwright, Research
Mrs. Nikki Feuerborn, Secretary

Conferees appearing before the committee:

Representative Kerry Patrick
Mr. Terry Tiede, Insurance Department
Mr. Bud Cornish, Kansas Life Insurance Companies and Kansas Association
of Property and Casualty Insurance Companies
Mr. Richard Wilborn, Alliance Insurance Companies of McPherson
Mr. Roger Viola, Security Benefit Life Insurance Company
Mr. Mark Heitz, American Investors Life Insurance Company
Mr. Bill Sneed, State Farm Insurance
Mr. Rick Liby, Health Insurance Association of America
Mrs. Lori Callahan, KaMMCO

Hearing on HB 2894 - Repeal of tax credit for contribution to guaranty fund

Representative Patrick appeared before the committee to explain his proposed legislation. This bill would abolish the credit provision of the Kansas guaranty fund. The law currently states that if claims are paid out of the fund then the insurance companies that pay into it get a dollar for dollar credit or offset on their future premium taxes due and owing the state. This fund was formed to guarantee insurance company policy payments and the ultimate cost is born not by the insurance companies or their policy holders but by the taxpayers of the State of Kansas. The taxpayers are acting as a sort of reinsurance company for all of the insurance companies doing business in the state. According to the Legislative Research Department, only 19 of the 52 states have a premium tax offset property/casualty guaranty fund, therefore, placing Kansas in the minority viewpoint. In the last 20 years, the State general fund has lost about \$24 million in revenue due to insurance company insolvencies. (See Attachment 1).

Mr. Terry Tiede, Assistant Commissioner of the Insurance Department, appeared to give information only to the Committee and to emphasize the role the two Kansas Insurance Guaranty Associations play in protecting the people of Kansas when an insurance company licensed in this state becomes insolvent. In the event a member insurer is declared insolvent, the Kansas Insurance Guaranty Association becomes obligated to the extent of the covered losses and premium refunds if they meet certain stipulations according to law. The purpose of the Kansas Life and Health Insurance Guaranty Association Act of 1972 is to provide protection, subject to certain limitations, to Kansas insureds by paying claims and continuing coverages under life, accident and health and annuity contracts when a member insurer is unable to perform its obligations due to its financial impairment. (See Attachment 2).

Mr. Bud Cornish, representing Kansas Life Insurance Companies and Kansas Association of Property and Casualty Insurance Companies appeared as an opponent. The result of the repeal will be:

1. There will be a reduction in foreign retaliatory taxes paid to the Kansas General Fund.
2. There will be a reduction in Kansas privilege tax paid to the Kansas General Fund by the domestic companies.

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 3:30 ~~xxx~~ p.m. on February 26, 1992

3. There will be an increase in retaliatory taxes paid by domestic companies to other states.
4. There will be an increase in premium tax paid to Kansas.

This issue is critical to the small single state mutual property and casualty companies which for the most part write rural fire and casualty business. Should the premium tax offset be repealed, the assessment can only be recouped through an increase in premium rate. The small company cannot remain competitive if it raises rates, particularly if the large companies do not increase rates. Recoupment by increasing premium rate is not a viable answer. (See Attachment 3).

Mr. Richard Wilborn, Vice President of Alliance Insurance Companies of McPherson, appeared as an opponent to the bill. The fund was set up to protect policyholders should a property and casualty insurance company become insolvent and fail. These dollars are assessed directly to the existing insurance companies in Kansas to pay for claims and expenses incurred by the insolvent company. Rate increases, assessed dollars removed from policyholders' equity, and other states imposing retaliatory taxes on insurance companies doing business in their states would be effects of the repeal of this bill. (See Attachment 4).

Mr. Roger K. Viola, Security Benefit Life Insurance Company, appeared as an opponent of the bill. Most state legislators recognize the soundness of allowing companies to offset assessments against premium taxes. The social burden of insolvencies is spread over the relatively large tax-paying population rather than the smaller insured population of each state. (See Attachment 5).

Mr. Mark Heitz representing American Investors Life Insurance Company, Inc., appeared as an opponent of the bill. If Kansas removes the offset, then the other 46 jurisdictions in which they do business would disallow the offset. The cost of this act is minimal compared to the millions of dollars annually paid to the general fund from insurance taxes and fees. (See Attachment 6).

Mr. Bill Sneed, State Farm Insurance Company, appeared as an opponent of the bill. It would be erroneous to make a change in Kansas based upon the fact that there are other states which, when their laws were enacted, did not include a premium tax offset. Those states that do not provide a premium tax offset have other mechanisms in place which can have a diminishing effect on the amount of assessments an insurer must incur. (See Attachment 7).

Mr. Rick Liby, Health Insurance Association of America, appeared as an opponent to the bill. There is legitimate concern regarding the premium tax offset and the fact that ultimately the state ends up paying for these guaranty fund assessments. It is equally important to point out that this mechanism requires the insurance companies to put the money up front first, and that they only receive the premium tax offset on a percentage basis over a five-year period. Although it ultimately requires the state to pay for the assessments, it does provide a savings to the state inasmuch as the present value of the dollar must be incorporated whenever a review such as this occurs. (See Attachment 8).

Mrs. Lori Callahan, KaMMCO, appeared as an opponent to the bill. The guaranty fund serves to allow immediate payment of claims for insolvent insurance companies, while allowing prorated future offsets for the assessments from the premium taxes which all insurance companies are required to pay to the state of Kansas. This fund provides a financial safety net to policyholders of companies that were not well managed, and participated in risky investments, underpricing or other unsound business practices. The guaranty fund system has worked well in Kansas to protect the insurance buying public as well as to ease the burden on the taxpayer through the spreading out of the reimbursement of the assessment over several years. (See Attachment 9).

CONTINUATION SHEET

MINUTES OF THE House COMMITTEE ON Insurance,
room 531 N, Statehouse, at 3:30 ~~xxx~~ p.m. on February 26, 1992, 19

Written testimony from Mr. Lee Wright, Farmers Insurance Group, and Mr. Brad Smoot, American Insurance Association, was presented to the committee. (See Attachments 10 and 11).

Hearing on HB 3040 - Mechanism to reimburse or to transfer funds from the Health Care Stabilization Fund

Mr. Chris Courtwright of Research prepared a legislative report which was read by Mrs. Emalene Correll. This bill would provide for an acceleration of reimbursements from the HCSF to the Health Care Provider Insurance Availability Plan. The bill was requested for introduction by KaMMCO, who is now the servicing carrier for the plan. Mrs. Callahan stated that the bill was needed for cash-flow reasons given some of the changes which have been occurring relative to the depopulation of the plan.

Mrs. Callahan appeared for KaMMCO as a proponents of the plan. This bill would facilitate reimbursements by allowing quarterly, as opposed to annual, reimbursements. (See Attachment 12). Technical amendment on Page 9 Line was requested.

Representative Cornfield moved to amend HB 3040 on Page 9 Line 19 by deleting "for the preceding fiscal year." Representative Flower seconded the motion. Motion carried.

Representative Campbell moved that the bill pass favorably from committee as amended. Representative Welshimer seconded the motion. Motion carried.

Representative Welshimer moved the minutes of February 19 and 20 be approved. Representative Cozine seconded the motion. Motion carried.

Meeting adjourned at 5:10 p.m.

House Insurance Committee
February 26, 1992
Re: House Bill 2894

I. Provisions of HB 2894

This bill would abolish the credit provision of the Kansas guarantee funds. The law currently states that if claims are paid out of the fund then the insurance companies that pay into it get a dollar for dollar credit or offset on their future premium taxes due and owing the state.

II. Analysis

The guarantee funds are the state equivalent to FDIC insurance for banks and savings and loans. Guarantee funds are used in the marketing approach of insurance companies as they sell their particular financial service products.

I have no problem with insurance companies coming together and forming guarantee funds on their own if they wish to assume the risk of one of their competitors from going under. **It is an entirely different matter, however, when a fund is formed to guarantee insurance company policy payments and when the ultimate cost is born not by the insurance companies or their policyholders but by the taxpayers of the State of Kansas.**

I received a letter from Mr. Dennis Roth of the Patrons Group of insurance companies in Johnson County On HB 2894. He said eliminating the premium offset was "unfair to tax insurance companies for the losses caused by the

indiscretions of their competitors through mismanagement, fraud, cutthroat pricing, etc."

The fundamental question raised by Mr. Roth's letter is this I believe: If his insurance company is unwilling to insure the success or failure of his competitors then why should the state of Kansas be willing to insure them??

For my colleagues this is precisely the situation which exists under current Kansas law. The Kansas taxpayers are acting as a sort of reinsurance company for all of the insurance companies doing business in the state of Kansas. For when an insurance company fails and claims must be paid, it is not the privately owned insurance companies or their policyholders who are making good those insurance contracts. It is the taxpayers of Kansas through dollar for dollar reductions in insurance company premium taxes into the state's general fund who make good those policies.

I know that I am being redundant but if the insurance companies are the entities who are benefitting from the existence of a guarantee fund, then they are ones who should pay for it. **This credit is a great deal for the insurance companies but is it a great deal for the taxpayers? Why should we, the taxpayers, insure privately owned insurance companies if other privately owned insurance companies are unwilling to do so??**

According to the Legislative Research Department only 19 of the 52 "states" have a premium tax offset Property/Casualty guarantee funds. Current Kansas Law on Property/Casualty guarantee funds is clearly the minority viewpoint.

In the last 20 years, the State general fund has lost about \$24 million in revenue due to insurance

company solvencies. This amount does not take into account the revenue losses to the State general fund that will result because of the collapse of Mutual Benefit.

Mr. Roth's letter also raises a red flag to me as to the adequacy of existing insurance regulation in the state of Kansas. Shouldn't our insurance department be capable enough to prevent insurance company fraud or mismanagement or cutthroat pricing? And if not, why should the taxpayers be required to pick up the insurance companies' tab if they are unwilling or unable to adequately police themselves.

We had a recent collapse in New Jersey of a major insurance company, Mutual Benefit life. Right up until the time of its collapse it was able to write insurance in Kansas. We don't know yet the cost to the state general fund due to the reduction of premium taxes paid but it will probably run into the millions of dollars.

I've attached a copy of a recent article from the Wall Street Journal that points up the financial difficulties of some of the largest insurance companies in the United States. Let me read a portion of it to you. If this article is correct, another large insurance company is on the brink of collapse and the state general fund will be the loser once again.

In this era of tight budgets, we need every dollar we can get if we are to fund social service and education budgets. The taxpayers of the State should not be asked to bear the burden of additional taxes until this credit is offset; the taxpayers of the state of Kansas should get out of the insurance business of insuring failed companies. It is not fair and we simply can no longer afford it.

Hidden Risks

Life Insurers' Loans On Real Estate Cause Ever-Rising Worries

Lax Accounting Rules Keep
Clients, Investors in Dark
About Souring Mortgages

Gradual Moves to Tighten Up

By NEIL BARSKY and SUSAN PULLIAM
Staff Reporters of THE WALL STREET JOURNAL

By any yardstick, Miami's Southeast Banking Tower is a troubled property. The principal tenant, the failed Southeast Banking Corp., plans to move out, leaving the building only half occupied. And with Miami's 25% office vacancy rate, one of the highest in the nation, finding new tenants won't be easy.

That could hurt Aetna Life & Casualty Co., which holds the building's \$222 million

Annuities Threat

The Bush administration has proposed stripping away tax benefits from some new annuities, a move insurance executives say would devastate the annuity business. Story on page C1.

mortgage, because the limited partnership that owns the building probably won't collect enough rent to meet the mortgage payments. But you would never learn that from Aetna's financial reports; company officials say the mortgage is listed as a performing loan.

"If that tower had been owned by a bank and there was such a huge question about the lessee's ability to pay, it would have been written down long ago," says Edward Furash, a Washington, D.C., consultant. "But because it's an insurance company, there's a different standard."

Greater Urgency

In strong real-estate markets, the differing accounting standards don't matter much. But with commercial real-estate values dropping in much of the nation, such accounting matters have taken on greater urgency. Recently, a string of surprises from life-insurance companies suggests that their bookkeeping allows them to hide real-estate problems from regulators, policyholders and investors. And the resulting doubts aren't limited to small, undercapitalized insurers. The credibility of such giants as the life-insurance units of Aetna and Travelers Corp. is being called into question.

The industry's lax accounting standards don't necessarily indicate that its problems will become as serious as those at banks and savings-and-loan institutions. While banks and S&Ls lend mostly to developers before any tenants have been signed up, life insurers have traditionally played it safer, lending long term on fully tenanted properties with cash flowing in.

But that difference no longer gives insurers the breathing room it once did. They are finding that troubled properties, which are growing in number, are luring away tenants by offering bargain-basement leases. Thus, a 90%-leased building can slide into a 10%-leased situation, resulting in "slow strangulation" for the insurer holding the mortgage, says John Klopp, a managing partner with Victor Capital Group, a real-estate finance company in New York.

Risks of a 'Run'

Another change has undermined insurers' traditional argument that they need less of a cushion for real-estate losses than do other financial companies because their liabilities are longer-term. In the 1980s, insurers began selling billions of dollars of investment products, such as guaranteed investment contracts, some of which can be withdrawn at a moment's notice. When insurers are hit by a "run" by policyholders cashing in their policies to get out their money, the companies may have to sell off real estate at a loss. They even may be unable to sell enough real estate to meet the withdrawal demands.

That was the case with Mutual Benefit Life Insurance Co., which was seized by regulators in July. Indeed, the New Jersey insurer's problems didn't surface until it told rating agencies of its real-estate woes, sparking a downgrading of its financial standing and panic among policyholders.

Now, rating agencies, after criticism that they have been too slow to downgrade insurers, are stepping up their surveillance of the industry. And over the past few months, insurance regulators, the Securities and Exchange Commission and the Financial Accounting Standards Board have been slowly implementing changes that should eventually help bring insurers' problems into clearer focus.

Accounting Advantages

But meanwhile, insurance companies, in contrast to banks, enjoy a slew of accounting advantages that tend to hide real-estate problems and raise the possibility that they are worse than they seem.

Insurers answer to often-overmatched state regulators, which review their portfolios as infrequently as every three years. Banks, by comparison, are monitored by federal regulators who send in examiners whenever they sense a problem.

The way banks and insurers account for delinquent loans is different as well. Under generally accepted accounting rules used by banks, a loan is considered delinquent if 60 days past due. Insurance accounting lets companies wait 90 days before the loan is considered delinquent.

Insurers have other ways of hiding problems. If they hold both equity and debt on a project, for example, they can keep the loan current by investing more money

Please Turn to Page A5, Column 1

Hidden Risks: Life Insurers' Real-Estate Loans Spur Rising Worry, Aggravated by Their Obscure Reports

Continued From First Page

without admitting the loan has gone sour. Even after a borrower is clearly about to default, as could well happen to Aetna's Southeast Banking tower loan, insurers can continue to carry the loan on their books at cost; banks can't.

Because of this, the reserves set aside by insurance companies as a percentage of problem real-estate loans are only a third of the comparable reserves at banks, according to one study. At mutual insurance companies, which escape SEC scrutiny because they are owned by policyholders instead of shareholders, the reserves are even lower. Only about 18 of the 100 largest life insurers had established any reserves for regulatory reporting purposes at the end of 1990, according to John Kleiman, a vice president of Conning & Co., a Hartford, Conn., insurance-research firm.

As a result, the financial community can only guess at the extent of the industry's real-estate problems, Mr. Kleiman says. Insurance filings don't "tell you what you need to know. Any honest observer will tell you that insurance companies' reporting pales in comparison to other financial-services companies," he says.

That is no small problem. Collectively, insurers hold \$250 billion in commercial real-estate mortgages. But up to the moment that New Jersey regulators seized Mutual Benefit Life last year, the company never had reserved for possibly bad real-estate investments.

Analysts warn that more failures or forced mergers may be looming. But if one relies solely on insurers' regulatory filings, it is next to impossible to figure out which portfolios are in the most trouble.

The insurance industry contends that the companies, on the whole, have been frank with the public about their real-estate problems and that insurers' problems aren't as serious as the banking industry's.

"Our delinquency rate was 5.61% in the third quarter of 1991," says a spokesman for the American Council of Life Insurance. "That is not a happy position for us to be in, but it's also not catastrophic." By comparison, he says, bank delinquencies are nearly 14% of commercial and residential mortgage loans.

Rising Standards

In recent months, the insurance industry has been moving toward stricter disclosure. The National Association of Insurance Commissioners has adopted a regulation that will be phased in starting this year and will force insurers, for the first time, to set aside reserves for expected real-estate losses. And, under a recently adopted accounting rule, publicly held insurers, along with other financial-services companies, will have to disclose the market value of their real-estate holdings.

But analysts say the changes may be too little, too late. For one thing, the NAIC reforms won't go into full effect until 1994. Under the new rules, moreover, reserves would be based on past default experience, not on the quality of individual loans. Under such a system, Aetna still might not be required to reserve against its loan on the Southeast Banking tower, for example.

The SEC has also got into the act. Last year, it assigned a task force to look into insurers' reporting and disclosure practices. The agency apparently wants to bring their practices more in line with those of banks, which have been moving toward marking their commercial real-estate portfolios to current market value.

The suspicions about insurers were fueled in the 1991 third quarter when Aetna, after the SEC requested information about the company's real-estate portfolio, disclosed that its problem loans could rise sharply. The announcement was particularly dispiriting to stockholders because on numerous occasions in 1990 and

1991, Aetna's management had reassured analysts and investors about its real-estate portfolio. During every quarter last year, however, Aetna set aside reserves for real estate, each time saying they were at "appropriate levels."

An Unpleasant Surprise

In November, however, Aetna raised questions among investors about how much worse its problems would become when it disclosed that as much as \$1.3 billion of its real-estate loans could go bad this year. That would increase its troubled real-estate loans to nearly \$4.5 billion, almost 20% of its \$23.5 billion property portfolio. Analysts now believe that Aetna may need to set aside additional reserves.

An Aetna spokesman says, however, that "substantially" less than \$1.3 billion will actually turn sour. And he notes that of the company's current \$533 million in real-estate reserves, \$300 million has been set aside to cover future problems that have not yet developed. "That is more than adequate for the \$1.3 billion of potential problem loans," he contends.

Also in November, Travelers disclosed a potentially more serious development: an SEC inquiry into its reporting and disclosure practices dating back to January 1988. Sources familiar with the SEC requests for information say the inquiry appears to focus on Travelers' disclosure of its real-estate problems in Texas.

The real-estate guessing game is even tougher with regard to mutual companies, which are highly secretive and operate under few public reporting requirements.

A typical case concerns Teachers Insurance & Annuity Association, which has a \$20 billion real-estate exposure—one of the largest of all insurers. The association, which runs a huge retirement fund mostly for college employees, has a top-notch credit rating and is considered one of the sturdiest insurers. But analysts following

its investments note some major problem loans. They cite, for example, a \$500 million loan to Mall of America, a Bloomington, Minn., project due to open in September in an area saturated with malls.

Real-estate analysts also are wondering about the insurer's investment in Seven World Trade Center, a two-million-square-foot New York tower housing Salomon Brothers' headquarters. The building started out with a mortgage slightly exceeding \$300 million, they say. When the developer, Larry Silverstein, needed money for improvements, he asked Teachers to lend it to him. Rather than foreclose on the property, Teachers twice increased its loans; today, its loans on Seven World Trade top \$400 million, and the insurer is supposed to receive a percentage of the building's profits above a certain amount. With the building only 80% occupied, however, it isn't believed to be generating any profit at all.

But although the value of the property is believed to be far less than \$400 million, Teachers is carrying the mortgage as a performing loan. In an identical situation, a bank would have to establish a reserve. A Teachers' spokesman says it reserved for bad real-estate mortgages in 1991 and 1990, but he declines to say how large the reserves were. A spokesman for Mr. Silverstein declines to comment.

The mortgage risks worry some observers. "One thing we should have learned is the lesson from Mutual Benefit," says Mr. Kleiman of Conning & Co. "They kept insisting their real-estate problems were under control, too." The uncertainty about insurers' investments is likely to hang over the industry as long as the real-estate slump drags on.

Canadian Steel Output Rises

OTTAWA — Canadian steel production totaled 256,007 metric tons last week, a 3% increase from 248,599 tons the previous week and a 4.5% increase from 244,919 tons a year earlier, Statistics Canada, a federal agency, said.

For the year through last week, production totaled 875,150 tons, a 1.2% decline from 885,480 tons a year earlier.

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Testimony by
Terry Tiede, Kansas Insurance Department
Before the House Committee on Insurance
House Bill No. 2894

House Bill No. 2894 proposes to repeal K.S.A. 40-2906a and K.S.A. 40-3016 which are the premium tax offset provisions of the Kansas Insurance Guaranty Association Act and the Kansas Life and Health Insurance Guaranty Association Act. The Kansas Insurance Department neither supports nor opposes House Bill No. 2894. We are simply testifying to provide information to the Committee and to emphasize the role the two Kansas Insurance Guaranty Associations play in protecting the people of Kansas when an insurance company licensed in this state becomes insolvent.

It is important to point out that the members of both the Kansas Insurance Guaranty Association and the Kansas Life and Health Insurance Guaranty Association consist of those companies that are authorized to transact in Kansas the lines of insurance covered by the respective Association. In fact, both Acts provide that all member insurers shall be and remain members of the Association as a condition of their authority to transact insurance in this state.

The Kansas Insurance Guaranty Association Act was enacted in 1970 by the Kansas legislature to provide Kansas consumers of property and casualty insurance with certain protection against financial loss due to the insolvency of a member insurer. The Association becomes fully operative and provides such protection when a member insurer is determined to be insolvent by a court of competent jurisdiction.

Inasmuch as the Act authorizing the Kansas Insurance Guaranty Association contains a number of exclusions and limitations, the following is a summary of the basic provisions of the Kansas Insurance Guaranty Association Act. It is only a summary, and does not provide an in-depth analysis of the Act.

In the event a member insurer is declared insolvent, the Kansas Insurance Guaranty Association becomes obligated to the extent of the covered losses and premium refunds existing prior to the date of

House Ins
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Attachment 2

insolvency and arising within 30 days after the determination of insolvency, or before the policy expiration date if less than 30 days after the determination, or before the insured replaces the policy or causes its cancellation, if such insured does so within 30 days of the determination of insolvency. This provides an opportunity for the policyholder to obtain coverage elsewhere but still provides them with protection in the interim. The protection provided by the Association is afforded to the claimants or insureds who are residents of this state at the time of the insured event. Protection is also afforded if the property from which the claim arises is permanently located in this state. The Association shall not, however, be subject to an amount due any reinsurer, insurer, insurance pool or underwriting association, as subrogation recoveries or otherwise.

The obligation of the Kansas Insurance Guaranty Association includes only the amount of each covered claim which is more than one hundred dollars (\$100) and less than three hundred thousand dollars (\$300,000), except that the Association shall pay the full amount of any covered claim arising out of a workers' compensation policy. However, in no event shall the Association be obligated to the policyholder or claimant in an amount in excess of the face amount of the policy from which the claim arises.

The Kansas Life and Health Insurance Guaranty Association Act was enacted in 1972 by the Kansas legislature. The purpose of the Act is to provide protection, subject to certain limitations, to Kansas insureds by paying claims and continuing coverages under life, accident and health and annuity contracts when a member insurer is unable to perform its obligations due to its financial impairment. The Kansas Life and Health Insurance Guaranty Association becomes fully operative when an authorized insurer is declared insolvent by a court of competent jurisdiction.

Inasmuch as the Act authorizing the Guaranty Association contains a number of exclusions and limitations, the following will summarize some of the more significant provisions of the Act.

With regard to an individual's right to recover under life, annuity or health policies protected by the Act, an individual is only provided protection when:

1. The individual, regardless of residency, except for nonresident certificate holders under group policies or contracts, is the beneficiary, assignee or payee of a covered policy or contract.
2. The individual policy or contractholder is a resident of the State of Kansas.
3. The individual is not a resident of the State of Kansas, but only with respect to an annuity contract which has been awarded pursuant to a judgement or settlement agreement in a medical malpractice liability action, as provided for in K.S.A. 40-3303.
4. The individual is not a resident of the State of Kansas, but only under all of the following conditions:
 - a. the impaired or insolvent insurer was a Kansas domestic insurer;
 - b. the insurer never had a license to do business in the state in which the individual resides;
 - c. the state in which the individual resides has an association similar to this state's; and
 - d. the individual is not eligible for coverage by the association of the state in which the individual resides.

For the purpose of this Act, a resident means any person who resides in this state at the time a member insurer is determined to be an impaired or insolvent insurer and to whom a contractual obligation is owed.

Additionally, the Association does not provide coverage for any portion of a policy where the individual has assumed the risk, for any policy of reinsurance, for interest rates that exceed a specified average rate, for employers' plans that are self funded, for parts of plans that provide dividends or credits in connection with the administration of the policy, for policies sold by companies not authorized to do business in Kansas, or for any unallocated annuity contract. Also, the Kansas Association will not provide coverage where any guaranty protection is provided to the individual under the laws of the insolvent or impaired insurer's state of domicile.

The benefits for which the Guaranty Association may become liable shall not exceed the lesser of; 1) The contractual obligations for which

the insurer is liable, or would have been liable had they not become impaired or insolvent; or 2) with respect to any one life, regardless of the number of policies or contracts: (A) \$100,000 in life insurance benefits including net cash surrenders and withdrawal values; or (B) \$100,000 in health insurance benefits including net cash surrender or withdrawal values; or (C) \$100,000 in the present value of annuity benefits, including net cash surrender and withdrawal values. The Act goes on to state that in no event shall the Association be liable to expend more than \$200,000 in the aggregate with respect to any one life as provided in A, B or C above.

The Associations obtain the funds necessary to provide the protection afforded under these two Acts by assessing their member insurers in accordance with the provisions contained in the Guaranty Association Acts. Currently when such assessments are paid, the member insurers receive from the Association a Certificate of Contribution equal to the amount of the assessment paid. For the calendar year of issuance, the insurer is allowed to consider 100% of the amount of the Certificate of Contribution as an asset of the insurer. For the first calendar year after the year of issuance the insurer is required to write off 20% of the original value of Certificate of Contribution and is only allowed to carry 80% of the value as an asset. It is the 20% amount that is written off that K.S.A. 40-2906a and K.S.A 40-3016 allows the insurer to offset against its premium tax liability to this state with respect to business transacted in that year. This same procedure is followed for the five consecutive years following the year of issuance at which time the carrying value of the Certificate of Contribution is reduced to zero and the insurer has in effect been given the opportunity to recoup through the premium tax offset provision 100% of the original assessment.

Attached as Exhibits 1 through 4 are copies of several documents we felt the Committee might find of interest.

Exhibit 1 was an exhibit to a recent report we understand was prepared by the National Conference of State Legislatures. As you can see, this

exhibit shows which states have Guaranty Associations and which Guaranty Associations provide for a premium tax offset.

Exhibit 2 shows the dates and amounts of all the assessments that have been made by the Kansas Insurance Guaranty Association since its inception in 1970.

Exhibit 3 shows the dates and amounts of all the assessments that have been made by the Kansas Life and Health Insurance Guaranty Association since its inception in 1972. On this exhibit the footnotes are extremely important because even though the Association has assessed over \$9 million to date, over \$5.2 million was either not subject to premium tax offset or was returned to the state general fund. Which leaves a net amount of approximately \$3.8 million that was or will be subject to premium tax offset.

Exhibit 4 shows in the first column the total amount of premium taxes collected and deposited into the state general fund since inception of the Guaranty Associations in 1970 and in the second column we included both taxes and fees collected and deposited into the state general fund since inception of the Guaranty Associations in 1970.

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PREMIUM TAX OFFSETS FOR GUARANTY FUND ASSESSMENTS

	<u>LIFE/HEALTH</u>	<u>PROPERTY/CASUALTY</u>
Alabama	YES	YES
Alaska	NO	YES
Arizona	YES	YES
Arkansas	YES	YES
California	NO	NO
Colorado	YES	NO
Connecticut	YES	NO
Delaware	YES	YES
Florida	YES	YES
Georgia	YES	NO
Hawaii	YES	NO
Idaho	YES	NO
Illinois	YES	NO
Indiana	YES	YES
Iowa	YES	NO
Kansas	YES	YES
Kentucky	YES	NO
Louisiana	YES	YES
Maine	NO	NO
Maryland	NO	NO
Massachusetts	YES	NO
Michigan	YES*	NO
Minnesota	NO	NO
Mississippi	YES	NO
Missouri	YES	YES
Montana	YES	NO
Nebraska	YES	YES
Nevada	YES	YES
New Hampshire	NO	NO
New Jersey	YES	NO
New Mexico	NO	NO
New York	YES	NO
North Carolina	NO	NO
North Dakota	YES	NO
Ohio	YES	NO
Oklahoma	YES	NO
Oregon	YES	YES
Pennsylvania	YES	NO
Rhode Island	YES	NO
South Carolina	YES	NO
South Dakota	YES	NO
Tennessee	YES	YES
Texas	YES	YES
Utah	YES	YES
Vermont	YES	NO
Virginia	YES	YES
Washington	YES	YES
West Virginia	NO	NO
Wisconsin	YES	YES
Wyoming	YES	NO
District of Columbia	No Guaranty Fund	NO
Puerto Rico	NO	NO
Total	41	19

* varies according to formula in single business tax

Sources: National Association of Insurance Commissioners; Southern Finance Project; National Organization of Life and Health Insurance Guaranty Associations; National Conference of Insurance Guaranty Associations

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Kansas Insurance Guaranty Association Assessments

DATE OF ASSESSMENT	COMPANY NAME	AMOUNT OF ASSESSMENT
05/17/71	Homeowners Ins. Co.	\$ 50,000.00
12/31/71	Trans Plains Casualty Co.	\$ 50,000.00
06/08/76	Missouri General Ins. Co.	\$ 50,000.00
01/01/80	Reserve Ins. Co.	\$ 199,797.20
01/25/82	Proprietors Ins. Co.	\$ 998,954.00
12/05/85	Excalibur Ins. Co.	\$ 700,000.00
12/05/85	Ideal Mutual Ins. Co.	\$ 4,000,000.00
12/05/85	Iowa National Mutual Ins. Co.	\$ 3,800,000.00
12/04/87	Allied Fidelity	\$ 950,000.00
12/04/87	Mission Insurance	\$ 2,200,000.00
12/04/87	Mission National	\$ 950,000.00
12/04/87	Integrity Insurance	\$ 1,700,000.00
11/15/88	Ideal Mutual Ins. Co.	\$ 3,000,000.00
12/00/90	Ideal Mutual Ins. Co.	\$ 1,000,000.00
12/00/90	Intercontinental Ins. Co.	\$ 200,000.00
Total		\$19,848,751.20

NOTE: This does not include Accident & Health Assessments (A&H) because they are made through the "Kansas Life & Health Insurance Guaranty Association."

FSAE0100

Kansas Life and Health Insurance Guaranty Association Assessments

DATE OF ASSESSMENT	COMPANY NAME	AMOUNT OF ASSESSMENT
01/25/77	Underwriters National Assur. Co.	\$ 74,670.27
05/15/78	Underwriters National Assur. Co.	\$ 73,732.32
01/31/80	Underwriters National Assur. Co.	\$ 123,394.62
01/02/82	Underwriters National Assur. Co.	\$ 168,130.89
12/15/86	Underwriters National Assur. Co.	\$ 155,000.00
05/10/78	Old Security Life Ins. Co.	\$ 246,509.51*
05/10/78	Old Security Life Ins. Co.	\$ 499,990.45*
02/20/79	Old Security Life Ins. Co.	\$ 249,994.68*
02/20/79	Old Security Life Ins. Co.	\$ 499,991.47*
10/03/83	Iowa State Travelers Mutual Assur. Co.	\$ 699,317.00
12/19/84	National Investors Life Ins. Co.	\$3,645,000.00**
08/08/88	Farm & Ranch Life Ins. Co.	\$ 250,000.00
11/15/88	Baldwin United Companies	\$ 398,000.00
08/10/89	Underwriters National Assur. Co.	\$ 30,000.00
01/15/90	American Mutual Ins. Co. of Boston and American Mutual Liability Ins. Co. (Joint Assessment)	\$ 195,000.00
11/01/90	Amalgamated Labor Life Ins. Co.	\$ 655,000.00
11/01/90	Life of Indiana	\$ 170,000.00
11/01/90	Missouri National Life	\$ 620,000.00
11/01/90	Underwriters National Assur. Co.	\$ 240,000.00
Total		\$9,043,731.21

*Liquidator distribution of \$1,557,688.06 was deposited in general fund and only \$1,496,484 was assessed and subject to premium tax offset. Therefore, the Old Security insolvency actually resulted in a net addition to general fund.

**National Investors Life Insurance Company. These assessments were part of the "Baldwin-United" insolvency which was ultimately resolved by a global enhancement plan developed by the National Association of Insurance Commissioners. Consequently, almost if not all of these assessments were returned to the companies and no premium tax offset resulted.

FSLB0161

KANSAS INSURANCE DEPARTMENT
SUMMARY OF DEPOSITS INTO STATE GENERAL FUND
1970 - 1991

	<u>Total Premium Taxes Collected and Deposited Into the State General Fund</u>	<u>Total Taxes and Fees Collected and Deposited Into the State General Fund</u>
CY 1970	\$ 9,930,236.71	\$10,701,526.74
CY 1971	10,460,142.12	11,260,687.16
CY 1972	12,089,331.16	13,020,118.34
CY 1973	12,915,003.60	13,946,760.00
CY 1974	16,018,149.20	17,104,601.28
CY 1975	15,312,192.90	16,400,786.13
FY 1976	19,565,901.08	20,800,762.43
FY 1977	22,631,895.28	24,055,919.25
FY 1978	26,019,086.79	27,717,228.36
FY 1979	28,678,795.93	31,618,616.93
FY 1980	31,049,766.98	34,103,196.52
FY 1981	33,561,535.51	36,909,120.03
FY 1982	35,555,848.37	39,124,734.68
FY 1983	38,064,532.49	44,485,341.10
FY 1984	41,121,227.53	46,620,572.74
FY 1985	65,937,687.48	72,710,683.37
FY 1986	53,660,642.56	62,919,149.30
FY 1987	56,088,006.75	63,695,143.25
FY 1988	60,693,267.60	68,059,363.09
FY 1989	61,865,559.63	69,773,100.73
FY 1990	62,154,919.09	70,876,279.63
FY 1991	<u>69,331,758.59</u>	<u>78,716,704.92</u>
Total	<u>\$782,705,487.35</u>	<u>\$874,620,395.98</u>

ASRN8/FMS

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Before the Kansas House Insurance Committee
February 26, 1992
TESTIMONY OF L. M. CORNISH
on behalf of
THE KANSAS LIFE INSURANCE COMPANIES
and
THE KANSAS ASSOCIATION OF PROPERTY AND CASUALTY INSURANCE COS.
in opposition to HB 2894

Mr. Chairman, and Members of the Committee:

Thank you for this opportunity to discuss HB 2894, which, if enacted, would repeal the "premium tax offset" provisions contained in the Kansas Guaranty Fund Acts. There are two acts - one covering property/casualty companies, the other covering life/health companies.

The purpose of both Acts is to pay, subject to certain limitations, the financial loss of Kansas claimants and policyholders, caused by the insolvency of an insurance company doing business in Kansas. The funding to pay such losses is raised by assessing solvent insurance companies doing business in the state.

The Kansas Association of Property and Casualty Insurance Companies is composed of seventeen (17) Kansas domestic property and casualty companies as named on the attached letterhead. These companies are mostly small, single state mutuals and are writers of fire and casualty insurance in the rural areas of Kansas.

House Insurance

2-26-92

Attachment 3

The Kansas Life Insurance Association is composed of the eleven (11) Kansas domestic life and health companies as hereafter named on the attached letterhead.

The Kansas legislature enacted the life/health act in 1972, and it amended the property/casualty act in 1976. At those times it determined that it was unfair as a matter of public policy to tax solvent insurance companies for the losses incurred by the indiscretions of their competitors through mis-management, fraud, cut-throat pricing, etc. Those indiscretions were and are totally beyond the control of the competing solvent companies and their policyholders. Both Acts provide that the solvent insurance companies may offset these assessments against their Kansas premium tax, over a period of five years. However, the companies lose investment income on this money.

This public policy has worked well over the years. During good years and bad, Kansas policyholders and claimants have been compensated promptly and fairly. Hardships created by insurance policies written by insolvent insurers can fall on anyone and everyone. The public at large is vulnerable to being victimized by insurance coverage which does not deliver on its promises. The cost of protecting those at risk - which is the entire public - should be distributed through the

broadest base available - the entire public. This public policy is achieved by absorbing the costs of insurer insolvencies throughout the state's taxing base. To do otherwise is to provide the public at large with a benefit that is funded by only a segment of the public - a truly unfair result.

Guaranty funds were designed to protect the general public - not just those who buy insurance protection. As examples: an uninsured pedestrian injured by an automobile insured by an insolvent insurer may apply to the guaranty fund. The worker injured on the job covered by an insolvent workers' compensation insurer may apply to the guaranty fund. A person injured by a mechanical defect with product liability coverage by an insolvent insurer may apply to the guaranty fund. The Kansas guaranty fund is for the protection of the general public. The public policy enacted by this legislature in the 1970's is still valid and still necessary.

The public, through the Kansas Insurance Department, polices the solvency of insurance companies doing business in this state. A repeal of the present premium tax offset will cause additional expense which will cause a reduction of the policy holders' surplus of solvent companies. This places the cost of insurance insolvencies on those least able to control the conduct of the insolvent insurer.

CURRENT TAXATION OF THE KANSAS LIFE INSURANCE INDUSTRY

The insurance industry is already heavily taxed in Kansas. In fiscal 1991, insurance companies paid approximately \$78,716,704.12 in taxes and fees into the Kansas General Fund. These include privilege taxes, premium taxes, fire marshal taxes and retaliatory taxes. In addition, Kansas companies pay real estate taxes, federal income taxes, retaliatory taxes to other states, contributions to the Workers' Compensation Fund and payments to the Firefighters Relief Tax. In addition, this legislature is currently considering a further tax which will assess fees to insurance companies for funding the insurance department. Total taxes and fees paid in fiscal 1991 totalled \$98 million dollars.

Needless to say, the effect of the enactment of HB 2894 will be to increase the cost of doing the business of insurance in Kansas and this expense will necessarily "pass through" and impact the insurance premiums of every Kansas insurance buyer - life, fire, auto, and health. The insurance companies doing business in Kansas have struggled to hold down insurance premium rates. Kansas ranks 45th in auto premiums. We are proud of this mark. It is no secret that the property insurance companies, particularly our small domestic rural

writing companies, have had a serious depletion of surplus caused by storm losses during the past two years. Adding an additional expense at this time will be a heavy blow.

The use of the premium tax offset to fund guaranty fund assessments is well accepted by other states. Most states have a life/health premium tax offset and sixteen (16) states have such an offset for property/casualty companies.

RETALIATORY TAX IMPACT

The enactment of HB 2894 would cause a serious adverse retaliatory tax impact upon Kansas in two ways. First, it will cause the domestic insurance companies to pay additional retaliatory taxes to other states. Second, it will reduce the amount of retaliatory taxes currently being paid to the Kansas General Fund by foreign insurance companies doing business in Kansas.

The retaliatory tax paid to the General Fund by foreign insurance companies in FY 1991 was \$3,403,856.15. Clearly an enactment of HB 2894 will cause a reduction in the retaliatory tax paid by foreign companies to Kansas. How much will be determined by whether there are further insolvencies and the amount of assessments which are necessary. We do know

that the result will be that the premium tax paid by domestic insurance companies to Kansas will increase and the amount paid by foreign companies as retaliatory tax to Kansas will diminish.

In addition, the enactment of HB 2894 will cause a tax retaliation by other states against Kansas domestic insurance companies doing business in those states. The retaliation tax is peculiar to the insurance industry and not generally understood. All states, except three, have enacted retaliatory laws. Essentially, these retaliatory laws provide that, if Kansas taxes companies from other states doing business in Kansas more than those states tax Kansas companies doing business in those other states, then Kansas companies will be charged the higher tax by those other states as a retaliation. For example, if a Missouri company writing business in Kansas is taxed a total of \$50,000 by Kansas, and a Kansas company writing the same amount of business in Missouri is taxed only \$40,000 by Missouri, the Kansas company will be assessed an additional \$10,000 in retaliatory tax by the State of Missouri. This type of tax is multiplied by other states in which the Kansas company does business. Needless to say, this tax inhibits the growth and development of Kansas insurance companies.

If the Kansas premium tax offset should be repealed, the net premium tax of all companies - foreign and domestic -

obviously will be increased. The retaliatory equation then comes into play with Kansas companies paying more retaliatory tax to the other states in which they do business and the foreign insurance companies paying less retaliatory tax to Kansas.

SPIRALING INSURANCE PREMIUM RATES

The insurance industry and its policyholder/consumers are concerned with increasing premium rates. The insurance industry is doing everything possible to keep coverages both available and affordable. However, this additional tax expense will be yet another overhead factor which will impact premium rates.

CURRENT FIXED RATE CONTRACTS

Kansas companies have issued life insurance contracts to many policyholders. Most of those are fixed premium and cannot be re-opened to allow a "pass-through" of this additional tax even though unreimbursed premium tax will be paid. Rates for newly issued policies may be raised to accommodate this additional charge.

SUMMARY

It is impossible to predict the amount of guaranty fund assessments which will be levied in coming years. This depends upon insolvencies, if any, and the amount of assessments which are presently in the five year pipeline.

The result of the repeal will be:

1. There will be a reduction in foreign retaliatory taxes paid to the Kansas General Fund.
2. There will be a reduction in Kansas privilege tax paid to the Kansas General Fund by the domestic companies.
3. There will be an increase in retaliatory taxes paid by domestic companies to other states.
4. There will be an increase in premium tax paid to Kansas.

This issue is critical to the small single state mutual property and casualty companies which, for the most part, write rural fire and casualty business.

Should the premium tax offset be repealed, the assessment can only be recouped through an increase in premium rate. However, the small company cannot remain competitive if it raises rates - particularly if the large companies do not increase rates. Recoupment by increasing premium rate is not a viable answer.

We urge this Committee to keep in place the public policy which has worked well.

Respectfully submitted,

L. M. CORNISH
General Counsel
Kansas Life Insurance Association
Kansas Association of Property
Casualty Insurance Companies

Kansas Association of

PROPERTY & CASUALTY
INSURANCE COMPANIES, INC.

L. M. Cornish
Legislative Chairman
Merchants National Tower
P. O. Box 1280
Topeka, Kansas 66601

MEMBER COMPANIES

Armed Forces Ins. Exchange
Fl. Leavenworth

Bremen Farmers Mutual Ins. Co.
Bremen

Consolidated Farmers Mutual Ins. Co., Inc.
Colwich

Farm Bureau Mutual Ins. Co., Inc.
Manhattan

Farmers Alliance Mutual Ins. Co.
McPherson

Farmers Mutual Insurance Co.
Ellinwood

Great Plains Mutual Ins. Co., Inc.
Salina

Kansas Fire & Casualty Co.
Topeka

Kansas Mutual Insurance Co.
Topeka

Marysville Mutual Insurance Co., Inc.
Marysville

McPherson Hall Insurance Co.
Cimarron

Mutual Aid Assn. of the Church
of the Brethren
Abilene

Swedish American Mutual Insurance Co., Inc.
Lindsborg

Town and Country Fire and Casualty Ins. Co., Inc.
Hutchinson

Upland Mutual Insurance, Inc.
Chapman

Wheat Growers Mutual Hail Ins. Co.
Cimarron

Patrons Mutual Insurance Co.
Olathe

Kansas Life Association

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L. M. Cornish

General Counsel

900 Merchants Natl. Bank Bldg.

Topeka, Kansas 66612

The American Home Life Insurance Co. Employers Reassurance Corp.
Topeka Overland Park

American Investors Life Insurance Co. The Great American Life Ins. Co.
Topeka Hutchinson

The Centennial Life Insurance Co. Great-West Life & Annuity Ins. Co.
Mission Wichita

Kansas Farm Bureau Insurance Co.
Manhattan

Kansas Group Life Insurance Co.
Topeka

The Pyramid Life Insurance Co.
Shawnee Mission

Security Benefit Life Insurance Co.
Topeka

The Victory Life Insurance Co.
Topeka

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February 25, 1992

To: House Insurance Committee

Subject: House Bill 2894, Concerning Repeal of the Kansas Premium Tax Offset
for Guaranty Fund Assessment

Mr. Chairman, members of the Insurance Committee. Thank you for the opportunity to speak before you today. I am Richard Wilborn, Vice President of Alliance Insurance Companies, McPherson, Kansas. The Alliance Companies are members of the Kansas Association of Property and Casualty Companies which represents the domestic property and casualty companies in the state.

I would like to address my remarks today to an issue that could have a far-reaching economic effect on all insureds in the State of Kansas; repeal of the insurance industry premium tax offset for Guaranty Fund assessments.

First, I would like to explain the necessity of the offset tax and how it has helped Kansans since its inception in 1971. Since 1971, Property & Casualty insurance companies writing business in the State of Kansas through the Guaranty Fund, which was set up to protect policyholders should a property and casualty insurance company become insolvent and fail, has paid out approximately \$19 million dollars. These dollars are assessed directly to the existing insurance companies in Kansas to pay for claims and expenses incurred by the insolvent company. Thus, insureds with claims are protected, even though their insurance company has failed.

The companies who are assessed are then able to take a 1/5th premium tax deduction of the assessed dollars each year over a five year period. Under this law, which has worked well for over 2 decades, companies who have had to pay assessments have not dipped into vital policyholders' equity to pay the assessments of insolvent companies because of the allowed tax offset. Companies are more than glad to provide an interest free loan to the state to keep a strong insurance environment in our state to benefit all consumers.

The insurance industry doing business in Kansas today annually pays more than \$75 million in taxes and fees to the state. In 1991 alone, the property and casualty insurance industry paid more than \$400 million in storm-related claims to Kansans following the devastating tornadoes that struck throughout the spring and summer. These dollars were paid out of policyholders' equity of each company.

(continued)

House Insurance
2-26-92
Attachment 4

IF THE PREMIUM TAX OFFSET IS REPEALED:

-- The companies paying the assessments would no longer have tax offset capabilities and would have to pass the total payment on to policyholders in the form of a rate increase. The premium tax offset is designed to keep rates stabilized...and not...I repeat...not...raise insurance rates in the state of Kansas. The Alliance Insurance Companies have more than 55,000 policyholders in the state of Kansas alone who would be affected by a possible rate increase should the offset be eliminated. Presently, assessments are not part of rate considerations in Kansas.

---Small insurance companies in Kansas, because of their stature, may not be able to pass the assessment along because of the competitive atmosphere existing in the insurance markets today throughout the state. Not being able to take an offset, or being able to pass the assessment along could put the small companies at risk.

--Medium size companies, and larger companies, may be forced to take the assessed dollars from their policyholders' equity and pass the assessment along in the form of higher rates.

The present system does not place a direct hit on policyholders' equity; instead payment is made and then a receivable is entered for the tax offset maintaining capital in the marketplace, therefore, companies such as the Alliance Insurance Companies, maintain a strong equity position for policyholder protection.

-- The A.M. Best Company, the financial watchdog of our industry, has noted that the Kansas domestic companies provide insurance products and services to approximately 70 percent of the rural insurance market in Kansas. Many rural residents are insured with small mutual companies. If these small companies dip into their policyholders' equity for assessments, it could have a detrimental effect on their operating ability, especially in rural areas.

--Multi-State insurance Companies, such as the Alliance Insurance Companies, will not only lose the tax off-set, but may also find that other states may impose retaliatory taxes.

We know there would be some retaliatory impact but it is very difficult to determine. First, it varies by states. Secondly, the assessments are periodical and therefore would not be an annual impact. Thirdly, it would depend on the amount of assessment being made in the other states as to whether or not a retaliatory impact would occur. We do know that when a foreign insurer is charged a fee in Kansas and the same is not charged a Kansas company in the foreign insurer's state of domicile, then retaliation may occur.

(continued)

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In closing, I urge you not to repeal the premium offset tax in our state. It will do harm to the existing insurance environment for the reasons stated. It will also be imposed at a time when our federal government is studying the possibility of taking regulation of the insurance industry from the states and placing it in a centralized federal bureaucracy. This would have a perilous affect on Kansas by eliminating from the state of Kansas the \$75 million collected in taxes and fees from the insurance industry. If the federal government prevails, it would also take all of the powers of the state away in many other regulatory areas of insurance. Kansans need legislative fiscal responsibility in the economic climate that prevails today. Keeping the premium tax offset will provide that responsibility by helping to hold insurance rates down and keep a strong insurance environment in the state. I respectfully request your positive consideration of the above stated concerns.

Thank you.

A handwritten signature in black ink, appearing to be "B. G. C.", written in a cursive style.



The Security Benefit
Group of Companies

Security Benefit Life Insurance Company
Security Benefit Group, Inc.
Security Distributors, Inc.
Security Management Company

700 Harrison St.
Topeka, Kansas 66636-0001
(913) 295-3000

February 26, 1992

Subj: House Bill No. 2894
Repeal of Premium Tax Offset

Dear Chairman and Committee Members:

The Security Benefit Group, Inc. ("SBG") is a diversified financial services organization. It is a Kansas company that offers life insurance, mutual funds, annuities and retirement plans. Its parent company, Security Benefit Life Insurance Company ("SBL") has been in business for 100 years. SBG has nearly \$4 billion in assets under management and employs 570 Kansans.

I have reviewed the above-referenced House Bill which would repeal the statute that affords insurers a premium tax offset for guaranty fund assessments. SBL opposes this Bill.

State guaranty associations have been legislatively created in every state and Puerto Rico to assure that claims of insolvent insurers' policyholders are paid subject to certain limits. All insurers authorized to write life insurance or annuities in Kansas are required, as a condition of doing business, to be a member of the state's guaranty association.

As you are aware, after an insurer fails, if funds are needed to meet the claims of policyholders and annuitants, the guaranty association is activated. All healthy insurers doing business in Kansas are assessed a proportionate share of the amount required to meet outstanding claims of policyholders, subject to state law. Under this system, well-managed companies have to contribute funds to bail out a poorly-managed competitor, even when that competitor's insolvency may have been caused by an inadequate price structure which drew business away from the solvent companies.

Forty-two of the 51 jurisdictions with life-health insurance guaranty associations allow insurers to offset, against their premium or other tax liability to the state, the amount paid as assessments to the state guaranty association. These numbers illustrate the recognition by most state legislators of the soundness of allowing companies to offset assessments against premium taxes. In this manner, the social burden of insolvencies is spread over the relatively large tax-paying population rather than the smaller insured population of each state.

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Page two

The premium tax offset is particularly important for the life and health insurance industry since their policies are issued for substantially long periods of time with premiums guaranteed. Assessments against a life insurer cannot be passed on to current policyholders through the rate structure. While it is true that premium rates on future life insurance policyholders can be increased, assuming that reasonably accurate estimates can be made as to future insolvencies and consequent assessments, such future policyholders would also have to bear the cost of present insolvencies and consequent assessments.

The problem of insurance company insolvency is a social problem, not simply an industry problem. The solvent companies and their policyholders may be concerned about the competitive practices of others in the industry but they have no regulatory authority over those companies. State regulators play an important role in policing the solvency of the industry to prevent loss to consumers. When the system fails, the cost should be spread as broadly as possible, not borne entirely by the insured population of the state.

It is patently unfair to require the solvent, well-managed life insurance companies to bear the entire financial burden of an insolvency over which they had no control. In effect, insurers are being asked to pay twice--once when business is lost to a competitor that underpriced the product, and again when they have to pay the competitor's policyholder claims because the underpricing resulted in insolvency. Without a premium tax offset, consumers who choose to pay the actuarially sound premium rates charged by the well-managed companies are penalized as their premium levels are increased to reflect their company's cost of paying the losses for an insolvent competitor.

Some people might mistakenly believe that if a full premium tax offset is allowed, the industry would not be contributing to the guaranty association process at all. This is not true. Insurers contribute the use of their money for a period of five years, the recoupment period. Given the size of assessments annually incurred by solvent companies, this amounts to significant loss of investment income. If no assessments were made, those funds would go into a company's surplus account and be available for investments which would earn interest. It has been estimated that, with a 5-year recoupment period, companies recover 70 cents for every \$1 paid in guaranty association assessments. It is obvious that, even with tax credits, insurers make significant interest-free loans to state guaranty associations to address the insolvency problem.

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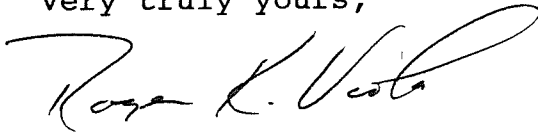
February 26, 1992
Page three

Insurance companies also contribute to the cost of insolvencies by running state guaranty associations. The Kansas guaranty association board is comprised of representatives of solvent insurance companies who take time from their jobs to serve as directors.

Lastly, the repeal of Kansas' premium tax offset would have a retaliatory impact on domestic companies. Not only would the repeal of the offset lead to Kansas companies paying higher taxes in Kansas, but it would also affect their ability to benefit from the use of such offsets in other jurisdictions, further increasing their tax liability. If another state has a retaliatory law, that state may not allow Kansas companies to use its offset if companies domiciled in such state are not afforded a similar offset in Kansas. Depending on states' retaliatory rules and the amount of guaranty fund assessments in retaliatory states, Kansas companies could be significantly affected.

Thank you for your time and consideration. I would be happy to address any questions you may have.

Very truly yours,



ROGER K. VIOLA
Senior Vice President
General Counsel and Secretary
Security Benefit Life Insurance Company

State of Kansas
House of Representatives
Insurance Committee
February 26, 1992
House Bill 2894

Statement of Mark V. Heitz
Chairman and General Counsel
American Investors Life Insurance Company, Inc.
Topeka, Kansas

The proposal to remove the premium tax offset from the Kansas Life and Health Insurance Guaranty Association (K.S.A. 40-3016) would be extremely burdensome on American Investors Life, primarily due to the retaliatory tax that would potentially be paid to other states.

If Kansas removes the offset, then the other 46 jurisdictions in which we do business would disallow our offset. For example, if every state levied a \$1 million assessment, we would currently pay Kansas \$35,000 and the other 46 jurisdictions \$314,500. Since the annual savings to the general fund of Kansas would only be \$200,000, the \$314,500 additional tax burden on one Kansas company is not justified.

The Guaranty Fund has filled its purpose - protecting Kansas insurance consumers. The cost is minimal compared to the millions of dollars annually paid to the general fund from insurance taxes and fees.

Your rejection of this proposal is requested.

James Sw.
Attachment 6
2-26-92

MEMORANDUM

TO: Representative Larry Turnquist
Chairman, House Insurance Committee

FROM: William W. Sneed
Legislative Counsel
The State Farm Insurance Companies

DATE: February 26, 1992

RE: House Bill 2894

Mr. Chairman, Members of the Committee: My name is Bill Sneed and I represent the State Farm Insurance Companies. Please accept this memorandum as our testimony on opposition to H.B. 2894. As I am sure the proponent of the bill will indicate, this bill attempts to delete the premium tax offset for contributions to either the property and casualty guaranty fund or the life guaranty fund.

When insurance guaranty funds were first proposed in the 1960's, the insurance industry was solidly opposed on the grounds that such funds would reduce the incentive of regulators to regulate for insolvency and on the grounds that it would be manifestly unfair to require the policyholders of well-managed companies to pay for losses traceable to mismanagement and/or corrupt management of other insurers. The NAIC also rejected the idea by asserting, "It is intended to deal with a problem that has been magnified out of reasonable proportion and the severity of the solution proposed is disproportionate to the problem." (II Proceedings of the NAIC 588 (1967)).

This uniform opposition to insurance guaranty funds by the insurance industry and the NAIC continued until, in 1969, Senators Dodd and Magnuson proposed a federal pre-assessment insurance guaranty fund modelled after the Federal Deposit

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Attachment 7

Insurance Corporation. When the insurance industry and the NAIC realized that Congress was serious, they agreed that the best way to demonstrate that federal legislation was unnecessary was to enact insurance guaranty funds in every state. This prompted the development of a "model" state bill and led to the enactment of some versions of that bill in 46 states within a period of three years. In the space of a few months, the insurance industry had moved from vigorous opposition to insurance guaranty funds to aggressive support of insurance guaranty funds.


Kansas law, similar to the NAIC model, provides that insurers may recoup assessments paid for guaranty fund obligations by taking such assessments and providing an offset against the taxes that an insurer would pay within the state pro-rated over a five-year period. As stated earlier, we do not agree that our policyholders should be taxed for the incompetent management of an insolvent competitor or the inability to sufficiently regulate a particular company within a particular state, and thus, we maintain our position that a premium tax deduction for these assessments is essential.

In regard to a review by this Committee relative to those states that provide a premium tax offset versus states that do not, we believe it is important to point out a particular issue when you are undertaking such a review. Those states that provided for the premium tax offset did so when the legislation was enacted. We are not stating this fact as an attempt to argue that whatever the 1971 legislature did binds the 1992 legislature, but we believe this to be an important point inasmuch as we do believe it would be erroneous to make a change in Kansas based upon the fact that there are other states which, when their laws were enacted, did not include a premium tax offset. Further, those states that do not provide a premium tax offset have other mechanisms in place

which can have a diminishing effect on the amount of assessments an insurer must incur. Finally, this issue is extremely important in the life insurance arena. Although it is extremely cumbersome to pro-rate assessments back through rates in the property and casualty area, it is virtually impossible to do so for life insurance. Those contracts and rates are set well in advance, and as such, an insurer would have no way to even attempt to recover the assessments that were generated for the incompetent management of an insolvent competitor, and in fact, this may create a vicious circle in that smaller companies may be faced with their own insolvency with this type of financial hit. We would also like to point out that, as the Chairman is aware, the current budget for the Insurance Department is taking great steps to expand the Insurance Department's division of financial surveillance. We believe that these types of steps are more appropriate in dealing with potential insolvencies of insurance companies, and we commend the Chairman and the subcommittee for taking these initial steps. We believe that it is only through effective regulation of these companies that the potential for premium tax offsets can be diminished vis-a-vis the attempt to prevent companies from going insolvent.

I appreciate the opportunity to present this testimony, and if you have any questions, either now or in the future, I will be happy to discuss this bill with you.

Respectfully submitted,



William W. Sneed
Legislative Counsel
The State Farm Insurance Companies

MEMORANDUM

TO: Representative Larry Turnquist
Chairman, House Insurance Committee

FROM: Rick Liby
Health Insurance Association of America

DATE: February 26, 1992

RE: House Bill 2894

Mr. Chairman, Members of the Committee: My name is Rick Liby and I work with the law firm of Gehrt & Roberts, Chartered, who act as Legislative Counsel for the Health Insurance Association of America ("HIAA"). HIAA is a health insurance trade association consisting of over 325 insurance companies that write over 85% of the health insurance in the United States today. Please accept this memorandum as our testimony in opposition to H.B. 2894.

I am aware that there's several other opponents of this bill, and I will not reiterate their comments, but only state for the record that we incorporate by reference their testimony that demonstrates why H.B. 2894 should not be passed. Further, there is an additional item that we believe it is important for the Committee to review.

We acknowledge that there is a legitimate concern regarding the premium tax offset and the fact that ultimately the State of Kansas ends up paying for these guaranty fund assessments. However, it is equally important to point out that this mechanism requires the insurance companies to put the money up front first, and that they only receive the premium tax offset on a percentage basis over a five-year period. Thus,

*House Insurance
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this mechanism, although it ultimately requires the state to pay for the assessments, does provide a savings to the state inasmuch as the present value of the dollar must be incorporated whenever a review such as this occurs. Thus, the state does realize a savings in this statutory mechanism, therefore providing an overall saving to all citizens of the state of Kansas for the potential mismanagement of other insurers.

Accordingly, based upon the comments of the other opponents and my material, we respectfully request that this Committee act unfavorably on H.B. 2894. I am available for additional comments or questions at your convenience.

Respectfully submitted,

Rick Liby

KaMMCO

KANSAS MEDICAL MUTUAL INSURANCE COMPANY

AND

KANSAS MEDICAL INSURANCE SERVICES CORPORATION

TO: House Insurance Committee
FROM: Lori Callahan, General Counsel
RE: H.B. 2894
DATE: February 26, 1992

The Kansas Medical Mutual Insurance Company, KaMMCO, is a Kansas Domestic, physician-owned, professional liability insurance company formed by the Kansas Medical Society pursuant to legislation enacted by the Kansas Legislature. KaMMCO currently insures over 800 Kansas physicians.

KaMMCO opposes H.B. 2894. Currently, 40 states, including Missouri and Kansas, have Guaranty Funds and permit the Guaranty Fund assessments to be deducted from the insureds premium taxes. The Guaranty Fund serves to allow immediate payment of claims for insolvent insurance companies, while allowing prorated future offsets for the assessment from the premium taxes which all insurance companies are required to pay to the state of Kansas. The offset is allowed since it is not the responsibility of solvent insurance companies to pay the claims of insolvent insurance companies, but the Guaranty Fund does allow for prompt payment of unpaid claims in the case of insolvencies. The premium tax offset, while not providing an immediate reimbursement to insurance companies since the offset only allows 20% of the assessment to be deducted from the premium taxes each year, does allow for reimbursement to the solvent insurance companies and thereby spreads the cost to the general taxpaying public over the next five years.

While many insurance companies initially resisted the establishment of the Guaranty Fund because it was felt it provided a financial safety net to policyholders of companies that were not well managed, and participated in risky investments, underpricing or other unsound business practices, the Guaranty Fund system has worked well in Kansas to protect the insurance buying public as well as to ease the burden on the taxpayer through the spreading out of the reimbursement of the assessment over several years. For these reasons, KaMMCO opposes H.B. 2894.

*House Insurance
Attachment 9*

2-26-92



FARMERS INSURANCE GROUP OF COMPANIES

10850 LOWELL AVENUE
SHAWNEE MISSION, KANSAS 66210-1613
Mailing Address: P.O. BOX 387
SHAWNEE MISSION, KANSAS 66201-0387

February 25, 1992

MEMORANDUM

To: Chairman and Members of House Insurance Committee
From: Lee Wright - Leg. Rep. - Farmers Ins. Group
Re: HB2894 - Guaranty Funds

Farmers Insurance Group position: **OPPOSE**

The property and casualty guaranty association and the life and health guaranty association were both designed to provide for the payment of losses suffered by policyholders or claimants of insolvent insurers.

By picking up the tab for its insolvent members, solvent insurers continue to protect innocent consumers from the mismanagement of its own competitors.

The law also provides solvent insurers some recoupment for guaranty fund assessments through a premium tax offset provision. This concept

- 1) makes it easier for insurers to meet guaranty fund obligations without raising prices or cutting back services for its own policyholders and
- 2) avoids a "domino affect" whereby significant bankruptcies could cause other insurance companies to also go bankrupt.

Farmers Insurance Group believes our current guaranty association laws are working well. Farmers opposes the removal of the premium tax offset as provided in HB2894.

*House Insurance
Attachment 10*

2-26-92

BRAD SMOOT
ATTORNEY AT LAW

1200 WEST TENTH STREET
TOPEKA, KANSAS 66604-1291
(913) 233-0016
FAX (913) 233-3518
PLEASE REPLY TO TOPEKA OFFICE

10200 STATE LINE, SUITE 230
LEAWOOD, KANSAS 66206
(913) 649-6836
FAX (913) 381-6965

February 25, 1992

The Honorable Larry Turnquist
Chairman
House Insurance Committee
State Capitol, Room 115-s
Topeka, KS 66612

Dear Chairman Turnquist and Members:

On behalf of the American Insurance Association, a trade association of more than two hundred property and casualty insurers providing insurance for Kansas consumers, I am writing to express our opposition to HB 2894.

HB 2894, as introduced, would eliminate the premium tax offset currently permitted for insurance company contributions to the state guaranty fund. That fund is created to protect insureds in the event of the financial failure of an insurance company. Currently, insurance companies would be assessed by the Insurance Department to make up for a default should a company fail. Then, over a five year period, the assessment is offset against the premium taxes insurance companies otherwise pay.

Currently, insurance companies doing business in Kansas are heavily taxed by the State. Depending on whether you include various fees, the amount approaches \$98 million per year. The insurance industry is certainly one of the most heavily taxed industry in state. Insurance company dollars provide the quick and sure source of funds to protect the insured, and even with the offset, there is no adjustment made for lost interest on moneys paid into the fund. In other words, the offset does not provide full reimbursement for the guaranty fund assessments.

HB 2894 would simply add to the potential insurance premiums to be paid by Kansas insureds. This comes at a time when numerous other legislative proposals may also be pushing insurance costs and premiums higher.

The philosophy of the guaranty fund and its funding arrangements were appropriate and sound when they were adopted. They have worked well over the years. Kansans have been protected by a quick and sure source of capital should any carrier fail in its obligations. The American Insurance Association sees no reason to change a successful system.

Thank you for your attention and interest in this matter of mutual concern.

Sincerely,



Brad Smoot
Legislative Counsel
American Insurance Association

House Insurance
2-26-92
Attachment 11

KaMMCO

KANSAS MEDICAL MUTUAL INSURANCE COMPANY
ON BEHALF OF
KANSAS HEALTH CARE PROVIDER INSURANCE AVAILABILITY PLAN

TO: House Insurance Committee
FROM: Lori Callahan, General Counsel
RE: H.B. 3040
DATE: February 26, 1992

The Kansas Medical Mutual Insurance Company, KaMMCO, is a Kansas domestic, physician-owned, professional liability insurance company formed by the Kansas Medical Society pursuant to legislation enacted by the Kansas Legislature. KaMMCO currently insures over 800 Kansas physicians.

On July 1, 1990, KaMMCO became the servicing carrier for the Kansas Health Care Provider Insurance Availability Plan. The Plan is a joint underwriting association for health care providers who cannot obtain medical malpractice insurance in the private market. Since July 1, 1990, the Plan has been greatly depopulated due to the increase in competition in the medical malpractice insurance market in the state of Kansas. The Plan is funded through premiums paid by its insureds and then is supplemented by the Health Care Stabilization Fund.

When KaMMCO became the servicing carrier for the Plan it applied its aggressive claims management procedure to the Plan claims. This procedure results in the moving of claims more quickly through the system, which results in a reduction of transaction costs. As a result, the numerous claims which occurred during the time when the Plan had a higher population have been settled or resolved in annual numbers greater than that resolved annually prior to July 1, 1990. This has occurred during a time when the depopulation in the Plan has resulted in lower premiums being collected by the Plan.

In order to make up this deficit, K.S.A. 40-3403 and K.S.A. 40-3413 provide for an annual comparison of the Plan to the Fund for Fund reimbursement purposes. Due to the new lower amounts of money in the Plan, due to depopulation, a mechanism is needed within the law to allow for more frequent reimbursement from the Health Care Stabilization Fund to the Kansas Health Care Provider Insurance Availability Plan, in order to continue the aggressive claims

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management of the Plan. H.B. 3040 would facilitate such reimbursements by allowing quarterly, as opposed to annual, reimbursements. KaMMCO, therefore, as the servicing carrier for the Kansas Health Care Provider Insurance Availability Plan supports H.B. 3040 and urges this Committee to report it favor for passage.

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1 as follows: 40-3413. (a) Every insurer and every rating organization
2 shall cooperate in the preparation of a plan or plans for the equitable
3 apportionment among such insurers of applicants for professional
4 liability insurance and such other liability insurance as may be in-
5 cluded in or added to the plan, who are in good faith entitled to
6 such insurance but are unable to procure the same through ordinary
7 methods. Such plan or plans shall be prepared and filed with the
8 commissioner within a reasonable time but not exceeding 60 calendar
9 days from the effective date of this act. Such plan or plans shall
10 provide:

11 (1) Reasonable rules governing the equitable distribution of risks
12 by direct insurance, reinsurance or otherwise including the authority
13 to make assessments against the insurers participating in the plan
14 or plans;

15 (2) rates and rate modifications applicable to such risks which
16 shall be reasonable, adequate and not unfairly discriminatory;

17 (3) a method whereby ~~annually~~ *periodically* the plan shall com-
18 pare the premiums earned to the losses and expenses sustained by
19 the plan ~~for the preceding fiscal year~~. If there is any surplus of
20 premiums over losses and expenses received for that year such sur-
21 plus shall be transferred to the fund. If there is any excess of losses
22 and expenses over premiums earned such losses shall be transferred
23 from the fund, *however such transfers shall not occur more often*
24 *than once each three months*;

25 (4) the limits of liability which the plan shall be required to
26 provide, but in no event shall such limits be less than those limits
27 provided for in subsection (a) of K.S.A. 40-3402 and amendments
28 thereto;

29 (5) a method whereby applicants for insurance, insureds and in-
30 surers may have a hearing on grievances and the right of appeal to
31 the commissioner.

32 (b) The commissioner shall review the plan as soon as reasonably
33 possible after filing in order to determine whether it meets the
34 requirements set forth in subsection (a). As soon as reasonably pos-
35 sible after the plan has been filed the commissioner shall in writing
36 approve or disapprove the plan. Any plan shall be deemed approved
37 unless disapproved within 30 days. Subsequent to the waiting period
38 the commissioner may disapprove any plan on the ground that it
39 does not meet the requirements set forth in subsection (a), but only
40 after a hearing held upon not less than 10 days' written notice to
41 every insurer and rating organization affected specifying in what
42 respect the commissioner finds that such plan fails to meet such
43 requirements, and stating when within a reasonable period thereafter