

Approved: 1/28/98
Date

MINUTES OF THE Senate Committee on Financial Institutions and Insurance.

The meeting was called to order by Chairperson Don Steffes at 9:00 a.m. on January 20, 1998 in Room 529-S of the Capitol.

All members were present except: Senator Corbin, Excused

Committee staff present: Dr. William Wolff, Legislative Research Department
Fred Carman, Revisor of Statutes
Nikki Feuerborn, Committee Secretary

Conferees appearing before the committee: Insurance Commissioner Kathleen Sebelius

Others attending: See attached list

Senator Steffes reported that the Attorney General's opinion on the release of names of state banks participating in the "wild card" provision offered by the State Bank Commissioner's office would probably be available today.

Kathleen Sebelius, Insurance Commissioner, and Chairman Steffes reviewed the report of the Task Force on the Kansas Insurance Industry which met during the interim (Attachment 1). The open dialogue and freedom of ideas expressed within the panel was reviewed. The general conclusion and recommendation was that education administration, the business community, and the economic development segment should work together for the future growth of the insurance industry in the state. Emporia State University is currently offering a business/insurance degree plan and Johnson County Community College continues to develop and offer continuing insurance education courses. Any request for the need to increase the currently available educational programs should be substantiated by the industry. The option of developing a complete educational program for the training of an actuary is an expensive process as six years is required for such training. Iowa began their program with Drake University more than 50 years ago.

Even though home offices rarely move, Kansas would be an ideal climate for regional and claims processing centers as many are already located near the I-435 corridor in Johnson County. The labor force is available in some of the metro areas as well as educational courses offering the basic insurance classes.

The problem of privilege taxes/retaliatory taxes required of non-domiciled Kansas insurance companies is sometimes considered double taxation. This problem was addressed in 1997 by lowering the premium tax to 1% and the balance is offset through tax credits. It is necessary to rid the industry of this secondary taxing situation before most foreign companies will be interested in future development of the insurance industry in Kansas. No rate filing fees are charged by the Kansas Insurance Department. By allowing "File and Use" to expand, competition in the insurance arena will increase and be viewed as more deregulation of the industry.

The meeting adjourned at 10:04 a.m. The next meeting will be held on January 21, 1998.

**SENATE FINANCIAL INSTITUTIONS & INSURANCE
COMMITTEE GUEST LIST**

DATE: 1-20-98

NAME	REPRESENTING
John Federico	Human
David Hanson	Ks Insur. Assns.
Susan Anderson	Hein + Weir
Ann Hornish	KS Insurance Dept.
Kevin Davis	Am Family Ins.
Richard Wilborn	Farmers Alliance
Bill Mitchell	" "
Chuck Stones	KBA
Mark Barcellona	Commerce & Housing
Janelle White	Div of Budget
Dawn Reid	KSNA
Teresa Sillman	HIAT
Tom Wilder	Kansas Insurance Dept.
Kathleen Sebelius	KANSAS Insurance Dept.
Callie Lee Denton	KS Association of Health Plans
Lathy Peterson	Prudential

FINAL REPORT

of the

TASK FORCE ON THE

KANSAS INSURANCE INDUSTRY

to the

1998 Kansas Legislature
and Governor Bill Graves



Kansas Legislative Research Department
December 1997

Senate F.R.D.
Attachment 1
Jan 20, 1998

TASK FORCE ON THE KANSAS INSURANCE INDUSTRY

MEMBERSHIP

<u>Legislative Members</u>	<u>Nonlegislative Members</u>
Senator Don Steffes, Chair	Kathleen Sebelius, Vice-Chair
Senator Paul Feleciano, Jr.	Mary Birch
Representative Tom Bradley	Kevin Davis
Representative Nancy Kirk	John Graham
	Ken I. Omura
	Senator Sandy Praeger*
	John Rolfe
	Gary Sollars
	Roger Viola

* Appointed by the Governor.

TASK FORCE ON THE KANSAS INSURANCE INDUSTRY

STUDY TOPIC*: S.C.R. 1601 established a Task Force to study the insurance industry in Kansas in order to identify programs and actions that can be undertaken to promote the growth of the existing industry, enhance its financial viability, and attract out-of-state insurance companies to Kansas.

BACKGROUND

The Special Committee on Insurance, which met during the 1996 interim, recommended a bill to the 1997 Legislature to repeal the premium tax on annuities. The rationale for the proposal was to relieve Kansas domestic insurers of the annuity premium tax and the retaliatory tax imposed by other states, and to provide foreign insurers an incentive to redomesticate their business operations in Kansas. Proponents of the tax repeal bill argued that current tax law represented both bad economic and social policy. The 1997 Legislature subsequently repealed the tax.

During debate over repeal of the tax, the Special Committee speculated that, in addition to tax law, other impediments might exist which have a negative affect on the vitality of the industry in Kansas. Additionally, the Special Committee was told that other states, particularly Iowa, had made growth of the insurance industry a focal point of state-assisted economic development initiatives. The Special Committee drafted and recommended passage of S.C.R. 1601 by the 1997 Legislature to provide a mechanism for discovering whether more changes in law and the insurance environment are needed to stimulate the development of the insurance industry in this state.

S.C.R. 1601 created a 13-member Task Force consisting of legislators, the Insurance Commissioner and her appointees representing the domestic and foreign life and property and casualty insurers and insurance agents, and persons representing the public and economic development interests appointed by the Governor. The Task Force was charged "to examine the current climate of the Kansas insurance industry, as well as other states which have a successful insurance industry, to determine whether actions can be taken to strengthen and improve the insurance industry in Kansas."

The first challenge for the Task Force was to identify the characteristics of the industry as it exists in 1997. Generally, the insurance industry in Kansas is stable and healthy. One thousand four hundred and fifty two companies compete across all lines for the \$6.0 billion Kansans spend annually for insurance products. The bulk of the business is carried on through foreign or nondomestic companies. The industry generates millions of dollars in tax and fee revenues to the State General Fund.

Despite these large figures the number of insurance companies domiciled in Kansas has changed very little over the last half century. In 1950, 46 domestic companies were selling their product in Kansas. In 1995, 51 domestic companies were providing insurance products. Focusing solely on numbers, however, gives too narrow a view of the industry. The products companies market have changed significantly over the years. Life companies are deeply involved in annuities and securities

* Topics referred by the Legislative Coordinating Council concerning TIAA-CREF, cancellation of property insurance policies, telephone solicitation by unlicensed personnel, and payment of consultants were not considered by the Task Force.

products, health and accident companies either are, or compete with, managed care entities, and small crop and hail companies have given way to larger, multi-lines property and casualty companies.

The second challenge for the Task Force was to expand on recent regulatory reform efforts in the state. The industry has been regulated by the Kansas Insurance Department since 1871. In 1997, based upon recommendations of the Insurance Commissioner, and on its own initiative, the Legislature enacted several important reforms with significant effects on the Department, consumers, and companies. Reforms consisted of converting to file and use of forms and rates for certain line of commercial property and casualty insurance, setting the premium tax at 2 percent for all companies, repealing the tax on annuities, abolishing the privilege tax on domestic companies, allowing certain tax credits for employment in Kansas, consolidating numerous statutes relating to fines and penalties, writing new law for redomestication, repealing outdated statutes, and revoking unnecessary rules and regulations. The overall insurance environment in Kansas is more positive for companies and Kansas consumers. Both entities seem best served in a competitive and active insurance market.

The third challenge to the Task Force was to recognize and support the evolutionary, if not revolutionary, changes under way within the industry and the marketplace and to discourage regulation that would interfere with the best attributes of the new order. The insurance marketplace in 1997 extends far beyond the geographical boundaries of the State of Kansas. Likewise, the competitors of traditional insurance companies no longer are solely other traditional insurers. Rather, competition now comes from securities companies and banking entities that seek to meet the financial services needs of their clients and customers. On the regulatory side, state and national regulators of these newly emerging financial organizations also are competing for authority over state, national, and global insurance marketplaces.

TASK FORCE ACTIVITIES

Conferees Appearing Before the Task Force

Conferees appearing before the Task Force represented a variety of interests with regard to the insurance industry and included some members of the Task Force. Kathleen Sebelius, Insurance Commissioner and Task Force Vice-Chairperson, and Catherine Weatherford, Executive Vice-President, National Association of Insurance Commissioners (NAIC), represented the views of regulators. The views of the regulated industry were presented by: Kevin Davis, American Family Insurance Company; John Graham, Kansas Farm Bureau; Ken Omura, Allstate Insurance Company; Gary Sollars, Charleton-Manley, Inc.; Roger Viola, Security Benefit Group, Inc.; David Hanson, Kansas Association of Property and Casualty Insurance Companies and the Kansas Life Association; John Knack, Blue Cross, Blue Shield of Kansas; Bill Sneed, American Investors Life Insurance Company; Lee Wright, Farmers Insurance Group; and Richard Wilborn, Alliance Insurance Companies. Other conferees included Mary Birch, President, Overland Park Chamber of Commerce, who presented Johnson County's experience with the growing insurance industry on College Boulevard. John Rolfe, Deputy Secretary, Department of Commerce and Housing, and Bob Marcusse, Kansas City Area Development Council, offered information on economic development strategies. Frank J. Ross, Jr., Polsinelli, White, Vardeman, & Shalton, P.C., presented information on Vermont's captive insurance industry, and finally Terri Vaughn, Commissioner, Iowa Division of Insurance, provided a detailed description of her state's insurance industry.

Barriers to Doing Business in Kansas

The Task Force engaged in lengthy discussions regarding the barriers to doing business in Kansas. Industry representatives pointed to five areas of concern: budgetary funding; retaliatory taxes; excess regulation; inadequate regulatory staff; and educational deficiencies.

First, the Task Force discussed funding of the Insurance Department's regulatory program. The program is funded through statutorily-authorized fees and a portion of the premium taxes collected from insurance companies, which together are subject to an annual limit of \$4.8 million. Any money over the \$4.8 million limit that is needed to operate the program must come from an additional assessment against insurers. From the industry perspective, the funding formula constitutes double taxation. Insurers first pay through fees and taxes, and second, through the yearly assessment.

Second, accompanying this complicated funding system is the issue of retaliatory taxes. Because of the special assessments levied against foreign companies doing business in Kansas, the home state of those companies imposes retaliatory taxes against Kansas' domiciled companies doing business in those states. Industry representatives explained that the retaliatory tax has financial implications for doing business in Kansas. In effect, the retaliatory tax amounts to a "third" tax to a Kansas insurance company and serves as a disincentive to an insurance company considering domicile in Kansas.

Third, the Task Force learned about the effect of excess regulation on the insurance industry. Regulatory excess operates as a disincentive to do business in any state. Industry representatives stated that even the perception of excess regulation could hinder the growth of the industry. The industry recognized that the Insurance Commissioner's initiatives addressing the procedures for approval of rates and forms have improved the insurance environment in Kansas; however, industry representatives noted that continuing the procedure of filing and waiting for approval of rates and forms was onerous and lengthy. Furthermore, representatives noted that historically the licensure of insurance agents in Kansas took longer than in other jurisdictions. While efforts have been made to reduce the time required for agent licensure, the time currently necessary to admit a company to do business in Kansas remains excessive.

To counter excess regulation, industry representatives recommended further reform of insurance laws relating to rates and forms which would lead to open competition and accelerate entry of new products into the Kansas market. The Commissioner expressed her philosophical support for such changes, but stressed the importance of a step-by-step approach to rating and filing issues. Nevertheless, representatives of the industry, appreciative of the changes made to date, urged the Task Force to recommend further reform in both commercial and personal lines of insurance.

The fourth issue raised as a barrier to doing business was inadequate staffing of the regulatory entity. Effective and efficient regulation depends on the Insurance Department's ability to maintain a professional staff and the appropriate technology. In particular, several Task Force members suggested that an actuary on the staff would greatly expedite the regulatory process.

The Insurance Commissioner did not disagree. She explained that the Insurance Department currently is not able to hire an actuary due to the provisions of K.S.A. 40-110. That statute provides that no employee of the Insurance Department may be paid a salary higher than the Commissioner. Her salary is set by K.S.A. 40-102 and current appropriations at \$66,211 (excluding fringe benefit costs). In contrast, a licensed actuary demands between \$80,000-\$100,000. Thus, these statutes prevent the Insurance Department from hiring an actuary or other professional staff that command high salaries.

The fifth and final barrier to doing business raised by the Task Force was inadequate education and training programs. An educated and technically trained work force is essential for the insurance

industry, and the availability of such a work force is a major criteria when an insurance company considers a new location for expansion. The Task Force noted Emporia State University's School of Business and its Center for Insurance Education, but wondered about its use by the insurance community and whether the industry's needs were being met.

Economic Development Issues

The conferees before the Task Force agreed that Kansas has many appealing features which can attract new industry. In support of such statements, conferees presented the Task Force with a regional insurance industry profile prepared by CERI Research Papers, and Best's Review of the ten best cities for insurance companies. Features of Kansas highlighted in the testimony were a ready work force and a high quality of life. Kansas can also boast significant employee productivity. Additionally, the state is located in the Central Standard Time zone which facilitates business conducted with persons on both coasts. Across the state, numerous cities and counties possess the potential for attracting regional and claims-paying offices. Johnson County has the added feature of being easily accessible by highways and an international airport. The county also has space for companies to lease or build. The Best's Report ranked Kansas City fifth of the top ten cities overall for insurance companies.

The conferees agreed that several areas should be examined when planning for future development of the insurance industry. With regard to domestic companies, the state must acknowledge that the retention of existing companies is of equal importance to attracting new companies. To that end, conferees suggested that Kansas' tax policy be examined to decrease the tax burden on existing companies. For example, growth in the current industry could be encouraged by a reduction in personal property taxes on machinery and equipment. Conferrees also suggested that tax policy which specifically targets the insurance industry would assist existing companies. For example, credits could be made available for insurance companies that invest in real property or state bonds, make charitable contributions, operate within an enterprise zone, or encourage employee development. Such credits would be similar to those allowed other basic Kansas employers in manufacturing and export office services.

With regard to attracting new companies to Kansas, conferees suggested that state and local economic development organizations cooperate to market the state and its assets nationally. Further, competitive tax laws, as discussed above with regard to domestic companies, are required if Kansas is to compete nationally for home and regional offices.

Insurance Initiatives in Other States

The Task Force was directed to collect information on other states' successful insurance initiatives and, thus, it heard testimony about Vermont and Iowa. Vermont is unique because it has limited its activities to attracting captive insurance companies to its state. A captive insurance company is one usually owned by a large corporate conglomerate for the purpose of insuring its own risks. Due to Vermont's initiative, its captive company market has grown more than 300 percent and has resulted in significant economic benefits statewide. Following Vermont's lead, Maine, Hawaii, and Colorado have actively pursued the captive insurance industry. Currently Kansas authorizes captive companies to be chartered in the state, but no special consideration has been extended to those few created here, and such companies have been restricted to limited bases of coverage.

Iowa has a successful, broad-based insurance industry which has long been a prominent feature of the state's economic landscape. Over time, the state has developed strong insurance education

programs, a reliable work force, and the reputation of stable regulation. Further, in response to the farm crisis in the mid 1980's, Iowa aggressively pursued growth by creating a special section in the Department of Economic Development to target insurance entities. The industry has recently grown at a rate significantly higher than the national average. In her personal remarks to the Task Force, Iowa's Insurance Commissioner described several economic development strategies that have been tried with varying degrees of success, and she noted that Iowa continues to focus on long term growth. The Commissioner closed her comments with her opinion that strong regulation is consistent with economic development.

CONCLUSIONS AND RECOMMENDATIONS

In exploring the charge assigned to it by the Legislature in S.C.R. 1601, the Task Force concludes that a primary objective of the state should be to take care of the existing domestic companies. The Task Force recognizes that Kansas can not replicate the history existing in Iowa; nevertheless, Kansas has geographical, environmental, and lifestyle qualities that can strengthen the existing industry and attract new insurance offices. Great strides have been made with regard to deregulation, and Task Force members acknowledge a new atmosphere has developed in Kansas which did not exist three years ago. Thus, the Task Force is encouraged that the potential for growth in the insurance industry exists. The Task Force emphasizes that a dynamic insurance industry ensures greater consumer choice and participation in the insurance marketplace and that the state, therefore, should facilitate the creation and maintenance of an environment in which a strong competitive market can thrive.

Based on these considerations, the Task Force makes the following specific recommendations.

- The Task Force recommends the formation of an informal insurance advisory board modeled after a similar group utilized in Iowa. The board should be made up of representatives from the Insurance Department, the industry, the Kansas Department of Commerce and Housing, and academia. The board should serve as a think tank on the economic development of the insurance industry and provide an on-going effort to advise regulators and legislators of ways to strengthen and develop the industry. As an informal volunteer organization, the board would function at no cost to state. The Task Force recommends that the board first examine Kansas' educational and training programs in insurance, assess the needs of the industry in that regard, and make recommendations for any change.
- The Task Force recommends a change to the method of funding the Insurance Department's regulatory program. The Task Force agrees the current system amounts to double taxation, is unwieldy, and creates a problem with retaliatory taxes. A change of this nature will assist both the industry and the Insurance Department, as the latter will be saved from the yearly administrative duty to calculate and bill assessments. The Task Force realizes that a change in funding will impact the State General Fund; however, this impact should not be used as an excuse to perpetuate the current funding formula.
- The Task Force recommends the repeal of provisions in K.S.A. 40-110 which cap all salaries in the Insurance Department at the level of the Commissioner's salary. The impact of the current law is that Commissioner is unable to hire an actuary or other necessary staff that demand a higher salary than the Department can statutorily pay.

The Task Force notes that this recommendation will simply allow the Commissioner more flexibility within her allocated budget and FTE's to make staffing decisions which will best serve the Department's purpose.

- The Task Force encourages the rapid implementation of "file and use" for form and rate approval into more lines of insurance than are currently permitted. The Task Force notes that this issue repeatedly arose as an industry priority, and it concludes that this process of deregulation should continue if Kansas is to remain competitive with other states. Additionally, the Task Force congratulates the Insurance Commissioner in her aggressive move towards deregulation and suggests that the Commissioner pursue dialogue with the insurance industry and consumer groups in order to accelerate general deregulation and the movement toward open competition. The Task Force asks the Commissioner to report to the standing insurance committees of the 1999 Legislature on the progress made in this area.
- The Task Force recommends that standing tax and economic development committees address areas of tax policy with regard to the insurance industry. Legislative committees should examine standing tax codes to determine whether tax policy may impede the growth of industry in general. For example, personal property taxes on equipment and machinery should be examined. Further, the committees should examine whether economic incentives, such as tax credits against premium taxes, can be put into place to encourage investment in and by insurance companies.

The Task Force concludes its activities with a feeling of success due to the unexpectedly candid dialogue that occurred between industry representatives, regulators, and private sector economic development groups. The Task Force is encouraged by this openness and convinced that opportunities exist in Kansas to strengthen and grow the insurance industry.