

MINUTES OF THE HOUSE INSURANCE COMMITTEE

The meeting was called to order by Chairperson Patricia Barbieri-Lightner at 3:30 p.m. on February 3, 2004 in Room 527-S of the Capitol.

All members were present except:

Representative David Huff- excused
Representative Joe Humerickhouse- excused
Representative Scott Schwab- excused

Committee staff present:

Bill Wolff Legislative Research Department
Ken Wilke, Revisor of Statutes
Rena Hansen, Secretary

Conferees appearing before the committee:

Jarrod Forbes, Insurance Department Liaison
Larry Brunning, Insurance Department Actuary
Linda Shepard, Insurance Department, Assistant General Council
Jerry Slaughter, Kansas Medical Society
Tom Bell, Kansas Hospital Association
Chris Swickard, Security Benefit

Others attending:

Twenty, including but not limited to attached list.

Representative Bonnie Huy requested a bill to require a sticker of proof of insurance that would be replaced every 3 months.

The bill was introduced by consensus.

Questions were posed by: Representatives Bob Grant, Nancy Kirk, and Nile Dillmore.

Representative Nancy Kirk requested a bill that deals with colorectal screening and health insurance. The bill was introduced by consensus.

Representative Nile Dillmore requested a bill concerning automobile insurance relating to payment of certain claims.

The bill was introduced by consensus.

Hearing on:

HB 2545: Insurance; updating certain mortality tables used in valuation of life insurance policies.

Jarrod Forbes, Kansas Insurance Department, (Attachment # 1), gave testimony in support of this bill that changes the actuary table for credit life mortality tables. The bill also allows the Commissioner to adopt future tables by rules and regulations rather than amending the statute.

Fiscal Note for **HB 2545** was presented.

Hearing closed.

Hearing on:

HB 2546: Insurance; conversion plans, commissioner's authority.

Proponents.

CONTINUATION SHEET

MINUTES OF THE HOUSE INSURANCE COMMITTEE at 3:30 p.m. on February 3, 2004 in Room 527-S of the Capitol.

Jerrold Forbes, Kansas Insurance Department, (Attachment #2), presented testimony in support of this bill giving reasons to change the wording from the statute from "shall" to "may". The amendment is not intended to scare off any merger proposals, but rather make sure that all values of the statutory surplus are fair and equitable for all policy holders involved. Linda Shepard, Insurance Department, Assistant General Council, was also available for questioning.

Questions were posed by: Representatives Cindy Neighbor, Ray Cox, Nancy Kirk, and Nile Dillmore. Several representatives questioned the strength of the wording change and were concerned that changing the wording to "may" might in fact weaken the valuing of the company if the residing Insurance Commissioner chose to. They were assured that this would not be the case

Jerry Slaughter, Kansas Medical Society, Kansas Medical Mutual Insurance Company, (Attachment #3), appeared before the committee in favor of **HB 2546**. This bill is really about establishing the value of a company at conversion. They believe the current statute is weak. The true fair market value has the ability to be vastly understated under the current statute. This house bill would be very pro-policy holder as it seeks to give the commissioner the power to value the company at a fair price during the conversion process. This bill puts the Insurance Commissioner, a neutral party, in the best place possible to help determine a fair market value of a company that would be fairest to the policy holders.

Questions and comments were posed by: Representatives Stephanie Sharp, and Nancy Kirk.

Tom Bell, Kansas Hospital Association, (Attachment #4), in support of the bill, believes that **HB 2546** would be a helpful to clarify the statute and create a tool that would help make the valuing of a company more fair to the policy holder.

Opponent:

Chris Swickard, second Vice President and council for, Security Benefit Life Insurance Company, (Attachment #5), presented testimony in opposition to the bill. He stated that the consumer might possibly not be given even the value of the company because the word "may" gives the option for the commissioner to give a value even lower than the statutory surplus. **HB 2546** "(1) introduces unnecessary uncertainty in the demutualization process, (2) weakens the Kansas conversion statute, (3) makes Kansas based mutual organizations less competitive," and "(4) could be harmful to Security Benefit and its policyholders."

Questions were posed by : Representatives Nancy Kirk, Bob Grant, and Revisor Ken Wilke.

A question was posed to Natalie Hague by Representative Nancy Kirk that asked if there was a way to change the language to satisfy both proponents and opponents.

Fiscal note for **HB 2546** was presented.

Hearing closed.

Representative Barbieri-Lightner introduced her intern Bethany Kraus from Washburn University studying International Law.

Representative Nile Dillmore moved to accept the minutes presented for January 20, 22, 27, and 29, seconded by Representative Mike Burgess, passed unanimously.

Meeting adjourned.

HOUSE INSURANCE COMMITTEE GUEST LIST

DATE: February 3, 2004

NAME	REPRESENTING
John LAUNTER	KIDS
Jeff Botelho	AAHP - HFAA
Natalie Haag	Security Benefit
Janice	KID
Pamela Ann Lower	Security Benefit
Rebecca Wempe	KS Life Ass'n



Kansas Insurance Department

Sandy Praeger COMMISSIONER OF INSURANCE

COMMENTS
ON
HB 2545—PERTAINING TO THE USE OF MORTALITY TABLES
HOUSE COMMITTEE ON INSURANCE
February 3, 2004

Madam Chair and Members of the Committee:

Thank you for the opportunity to visit with you on behalf of the Kansas Insurance Department. House bill 2545 amends K.S.A. 40-409 so the credit life mortality tables are in concert with all other actuarial tables used by the insurance industry. In the early 1980's when this statute was amended to reflect the then current actuarial tables, the credit life tables were overlooked. It is the opinion of the Kansas Insurance Department that there was no reason other than human error why this area was not changed as well.

This bill will also allow the Commissioner to adopt future mortality tables by rules and regulations, as opposed to amending the statute. This too is in concert with the changes made in the early 1980's.

Along with me today is Larry Bruning the department's actuary, and we both are happy to answer any questions you may have.

Jarrold Forbes
Legislative Liaison

House Insurance
Date: 2/3/04
Attachment # 1



Kansas Insurance Department

Sandy Praeger COMMISSIONER OF INSURANCE

COMMENTS
ON
HB 2546—PERTAINING TO THE CONVERSIONS
OF MUTUAL COMPANIES TO STOCK COMPANIES
HOUSE COMMITTEE ON INSURANCE
February 3, 2004

Madam Chair and Members of the Committee:

Thank you for the opportunity to visit with you on behalf of the Kansas Insurance Department. House bill 2546 amends K.S.A. 40-4004 (b) by changing "shall" to "may". The department believes the effect of this change is to allow the Insurance Commissioner the authority to determine if the statutory surplus of an insurance company is an adequate value for conversion. Quite simply, the Commissioner believes this change is important for the protection of consumers during a conversion process.

Some may believe having a company's value set at the statutory surplus without further considerations by the Insurance Commissioner is preferred. However, I would submit that having the Kansas statutes guaranteeing a conversion might not be in the best interest of the Kansas Consumer. We believe it is the duty of the department to take a close look at these conversions and make an appropriate evaluation of the facts involved. This amendment is not intended to scare off conversion offers, rather to make sure the value placed on a company is fair and equitable to all policyholders involved.

Along with me today is Linda Sheppard, Assistant General Council for our department. She is our office expert with regard to these issues and was instrumental in the Anthem v Praeger case. We would be happy to stand for any questions the committee may have.

Jarrold Forbes
Legislative Liaison

House Insurance
Date: 2/3/04
Attachment # 2



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To: House Insurance Committee

From: Jerry Slaughter
Executive Director

Date: February 3, 2004

Subject: HB 2546; concerning the conversion of mutual companies to stock companies

The Kansas Medical Society appreciates the opportunity to appear today on HB 2546, which would amend the law governing the process by which mutual insurance companies convert to stock companies. This intent of this legislation appears to be very similar to that of HB 2337 from last session. We support this bill, and urge your favorable consideration of it.

I am also appearing on behalf of and expressing the support of the Kansas Medical Mutual Insurance Company (KaMMCO), which KMS formed in 1989 to provide professional liability insurance coverage for our member physicians. Today, fifteen years later, KaMMCO is the largest writer of medical malpractice insurance in our state, and as a mutual insurance company it remains true to its core mission of serving and protecting its policyholders. Both KMS and KaMMCO believe this legislation will allow the insurance commissioner to more effectively carry out her primary responsibility in these matters – protecting policyholders.

The need for this change became apparent when Anthem and Blue Cross Blue Shield of Kansas sought approval for a transaction that involved converting Blue Cross to a stock company which would then be acquired by Anthem. As you know, the transaction was denied by the Insurance Commissioner, and following an appeal, that decision was ultimately upheld by the Kansas Supreme Court on August 6, 2003. One of the areas of weakness in the conversion statute is addressed by this bill. The existing law, KSA 40-4004(b), *requires* the commissioner to find that the amount of consideration provided by the converting insurer to policyholders is “fair and equitable” so long as the consideration is at least equal to the statutory surplus attributable to contributions of policyholders. As a practical matter, this provision ties the insurance commissioner’s hands to approve an amount that may be considerably less than the fair market value of the converting insurer. What was undoubtedly intended as a floor in the statute, effectively became a ceiling. It could very well operate to understate the true value of the converting insurer, meaning policyholders would receive less at the conversion. This proposed change just gives the insurance commissioner some flexibility in determining whether the consideration is fair and equitable, and truly sets a floor, or minimum, on that valuation.

We support HB 2546, and urge you to report it favorably. Thank you for the opportunity to offer these comments.

House Insurance
Date: 2/3/04
Attachment # 13

Memorandum



Donald A. Wilson
President

To: House Insurance Committee

**From: Kansas Hospital Association
Thomas L. Bell, Executive Vice President**

**Re: House Bill 2546—Conversion of Mutual Companies to Stock
Companies**

Date: February 3, 2004

The Kansas Hospital Association appreciates the opportunity to provide comments in support of House Bill 2546. This bill amends the current law concerning conversions of mutual companies to stock companies by changing the word "shall" to "may" in K.S.A. 40-4004 (b). In short, it gives the Insurance Commissioner more flexibility to determine in a given case whether the statutory surplus of an insurance company is an adequate value for conversion. Current law does not give the Commissioner that authority. We believe this amendment is a positive step toward clarifying the law.

The job of the Insurance Commissioner during a conversion process is the protection of future policyholders and the public. It is our belief that HB 2546 gives the Commissioner another tool to help fulfill this obligation. The effect of the proposal will be to better allow the Commissioner to perform her oversight function. While the Supreme Court ruled in the Anthem case last year that the Commissioner does have some authority in this area, the provisions of HB 2546 would help to clarify the situation.

Thank you for your consideration of our comments.

House Insurance
Date: 2/3/05
Attachment # 4

Kansas Hospital Association

Testimony on House Bill No. 2546

Committee on Insurance

My name is Chris Swickard and I am Second Vice President and Counsel for Security Benefit Life Insurance Company ("Security Benefit"). I am here today to testify in opposition to House Bill No. 2546.

Background

HB 2546 would amend K.S.A. 40-4004(b) which is part of the Kansas statutes dealing with demutualization of mutual insurers and mutual holding companies. A mutual organization is a private company controlled by its members but which has no stockholders. When a Kansas domiciled mutual organization wishes to demutualize, it does so under a "Plan of Conversion" that must meet certain criteria under Kansas statutes. One of the criteria that must be met is that the amount of consideration paid to policyholders under the Plan of Conversion must be "fair and equitable." Currently 40-4004(b) provides that a plan of conversion providing for the payment to policyholders of an amount at least equal to the statutory surplus attributable to the contributions of policyholders *shall* be deemed to be fair and equitable. If HB 2546 becomes law, 40-4004(b) would be amended to provide that payment of statutory surplus to policyholders *may* be deemed to be fair and equitable.

Security Benefit's Opposition

Security Benefit opposes HB 2546 because (1) it introduces unnecessary uncertainty in the demutualization process, (2) it weakens the Kansas conversion statute, (3) it makes Kansas based mutual organizations less competitive, (4) it could be harmful to Security Benefit and its policyholders, and (5) the existing statute is fair.

Uncertainty – As noted previously, HB 2546 introduces unnecessary uncertainty to the demutualization process. Like each of you, Kansas based mutual organizations want to be able to plan their affairs in advance to the extent possible, especially with respect to matters of finance. If this Bill becomes law, Kansas based mutual organizations will not be able to determine in advance with reasonable certainty whether the consideration proposed to be paid to policyholders in a demutualization is adequate. They could thus spend a lot of time and resources exploring business opportunities without any certainty regarding whether the consideration to be paid to policyholders will be deemed to be fair by the Insurance Commissioner. (A valuation conducted by the Insurance Commissioner would not occur until the demutualization process is well under way.) In addition, there are numerous other safeguards set forth in the statutes to make certain that the public interest is served in a demutualization (e.g. the Plan of Conversion must be approved by the requisite number of policyholders, the Plan may not unjustly enrich officers, directors, or employees of the mutual organization and the operations of the new stock company must not be "hazardous" to existing or future policyholders or the public.) There are enough uncertainties in business acquisitions and enough discretion given to the Insurance Commissioner under 40-4004 as it currently exists. More does not need to be added.

Weakens existing statute – Security Benefit is also concerned that if HB 2546 becomes law, it will weaken Kansas' conversion statute thus making Insurance Commissioner orders under the statute more susceptible to challenge. Because HB 2546 introduces another permissive, discretionary judgment into the conversion process, it creates an additional point from which detractors could argue that reversible error has occurred. For example, a conversion plan that

House Insurance
Date: 2/3/04
Attachment # 5

provided for the payment of statutory surplus and is approved by the Insurance Commissioner could be challenged on the basis that it was reversible error for the Commissioner to not require a higher payout.

Kansas based mutual organizations less competitive – Because of the additional uncertainty introduced by the Bill, Kansas based mutual organizations would be less likely than similarly situated competitors (both stock competitors and mutual organizations located in other states) to attract desirable business partners. The financial services industry is rapidly changing, and while it is difficult to predict what will happen in the future, it is clear that competitive forces will bring increasing pressure on market participants. Kansas based businesses must have flexibility to respond to these events. To the extent that the probability of acquiring a mutual organization becomes less certain, as it would be if HB 2546 becomes law, and to the extent that Commissioner orders under the conversion statute are more prone to be challenged, Kansas based mutual companies will be less attractive to prospective business partners.

Harmful to Security Benefit – The Bill could be harmful to Security Benefit if it chose to demutualize its mutual holding company structure. In a typical demutualization (i.e. one that is not “sponsored” by an acquiring company) the policyholder’s membership interest is extinguished by the insurer by giving the policyholders stock of the demutualized insurer. However, due to restrictions under the tax code, policyholders who have tax-qualified contracts (e.g. TSA contracts under I.R.C. Section 403(b), IRA contracts under I.R.C. Section 408 etc.) can not receive stock as payment for their membership interest. Instead they receive “policy credits.” Policy credits are a mechanism whereby the insurer increases the cash value of the contracts receiving the credit. Policy credits reduce the insurer’s statutory surplus dollar for dollar. Insurers with a large book of qualified plan business, such as Security Benefit, can experience a strain on surplus by giving policy credits. By extension, a determination by the Insurance Commissioner that the consideration to be paid to policyholders must exceed statutory surplus would be harmful to Security Benefit (and ultimately to its policyholders) because it would increase the amount of policy credits paid to holders of tax-qualified contracts and would further reduce surplus.

Existing Statute Fair – Security Benefit’s final objection to the proposed Bill is that we believe the existing statute appropriately balances the needs of the insurance industry for a conversion statute that is reasonably certain against the Insurance Commissioner’s desire to have more flexibility and discretion in order to protect the interests of existing and future policyholders. We believe these competing interests were weighed by the Legislature and that it purposely arrived at the existing statutory language in 40-4004(b). The nature of a policyholder’s interest in a mutual organization is not the same as the interest of a stockholder in a stock company. A stockholder purchases the stock of a stock company with a single goal in mind, to make a return on the investment. A person purchasing an insurance policy from a mutual organization does not have that same profit goal in mind. What he or she wants is for the insurer to perform its obligation under the insurance contract in accordance with its terms. Any notion of profit from the membership interest acquired in connection with that policy is secondary at best. In fact, if the policy lapses or is surrendered before the organization demutualizes, no profit will ever be recognized from the membership interest that person held. In view of these differences, and for all of the other reasons mentioned previously, we believe it is appropriate for the Legislature to determine, as it did when it enacted the existing version of K.S.A. 40-4004(b), that payment of an amount at least equal to statutory surplus in a demutualization is fair to policyholders.