Approved: February 10, 1993
Date

MINUTES OF THE HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE.

The meeting was called to order by Chairperson William Bryant at 3:30 p.m. on February 9, 1993 in Room 527-S of the Capitol.

All members were present except:

Committee staff present: William Wolff, Legislative Research Department
Bruce Kinzie, Revisor of Statutes
Nikki Feuerborn, Committee Secretary

Conferees appearing before the committee:
Jerel Wright, Kansas Credit Union Association
Don Teasley, Clark-Bardes

Others attending: See attached list

Jerel Wright, representing the Kansas Credit Union Association, asked that legislation be introduced which would allow creditors to offer group credit life insurance with group life insurance (Attachment 1). It would raise the cap from $50,000 to $100,000 on group credit life. Representative Neufeld moved that the bill be introduced into legislation. Representative Weiland seconded the motion. The motion carried.

Hearing on HB 2083: Insurable interest of employers in their employees.

Don Teasley, representing Clark/Bardes, Inc. of Dallas, gave the history of this proposed legislation which deals with the funding of post-retirement health care liabilities (Attachment 2). Companies are now required to accrue for and report on their books the amounts of unfunded liability which those companies had promised their employees for post-retirement health care benefits. Employers have found that the use of life insurance products is one of the most effective ways of dealing with the funding of these long-term liabilities. There has been some difficulty in putting these products into place because of the lack of clarity or more frequently the lack of existence of state laws with respect to insurable interest. There are no guidelines in Kansas as to the amount of insurance than an employer may take out on non-management and retired employees. This bill specifically gives an employer an insurable interest and then provides a measuring devise as to the amount of insurance that can be purchased. The measurement is based upon the liability that the corporation has undertaken with respect to its employee welfare benefit plans. When this type of insurance is used, the employer is primarily after the tax benefits connected with loans of the cash value from the insurance policy. Another usage of an insurance policy is the purchase of such a product by a trust , which is the owner and beneficiary and invests in the insurance products as a means of sheltering the growth of the trust assets. The passage of the proposed statute would:

1. Add substance and clarity to the current law.
2. Create a better climate for employers to make decisions regarding financial impact.
3. Provide an understandable and measurable basis for the determination of an employers insurable interest.
4. Guarantee to employees the right to consent as to whether they wish to be insured by the employer or not.

Representative Helgerson moved that the minutes of February 8, 1993 be approved. Representative Correll seconded the motion. The motion carried.

The next meeting will be February 10, 1993.

GUEST LIST

COMMITTEE: F I & I.   DATE: 2-9-93

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATIO
DAVE MURRELL	1133 TOPEKA BLVD	KANSAS GROUP LIFE INS Co
Jennifer Rose	1133 Topeka Blvd.	Kansas Group Life
Bill Sneed	TOPEKA	Am Inv Life
J M Cornish	"	Ks Life Ins Assn
TERRY TIEDE	Topeka	Ks. Ins. Dept.
John Ensley	Topeka	Medco
Jerel Wright	Topeka	Ks Credit Union Assn
David A. Ross	TOPEKA	KS ASSN. OF LIFE UNDERWRITERS
Rick Friedstrom	Topeka	KALU
George Barbee	Topeka	Barbee & Assoc's
Chuck Stones	"	KBA
LARRY MAGILL	"	PIIAK
Cindy Tinsley	Paola	Ottawa U. Ruby Gibson
Chingpou Shih	"	"

AN ACT relating to insurance; concerning group life insurance policies and requirements; amending K.S.A. 1992 Supp. 40-433 and repealing the existing section.

Be it enacted by the Legislature of the State of Kansas:

Section 1. K.S.A. 1992 Supp. 40-433 is hereby amended to read as follows: 40-433. No policy of group life insurance shall be delivered in this state unless it conforms to one of the following descriptions:

(1) A policy issued by an insurance company organized under the laws of the state of Kansas on its employees and agents, which agents for the purpose of this act only shall be deemed employees, the beneficiaries under such policies to be persons designated by each insured, or a policy issued to an employer, or to the trustees of a fund established by an employer, which employer or trustees shall be deemed the policyholder, to insure employees of the employer for the benefit of persons other than the employer, both subject to the following requirements:

(a) The employees eligible for insurance under the policy shall be all of the employees of the employer, or all of any class or classes thereof determined by conditions pertaining to their employment. The policy may provide that the term " employees" shall include the employees of one or more subsidiary corporations, and the employees, individual proprietors, and partners of one or more affiliated corporations, proprietors or partnerships if the business of the employer and of such affiliated corporations, proprietors or partnerships is under common control through stock ownership, contract or otherwise. The policy may provide that the term "employees" shall include the individual proprietor or partners if the employer is an individual proprietor or a partnership. The policy may provide that the term " employees" shall include retired employees. No director of a corporate employer shall be eligible for insurance under the policy unless such person is otherwise eligible as a bona fide employee of the corporation by performing services other than the usual duties of a director. No individual proprietor or partner shall be eligible for insurance under the policy unless the proprietor or partner is actively engaged in and devotes a substantial part of their time to the conduct of the business of the proprietor or partnership. A policy issued to insure the employees of a public body may provide that the term "employees" shall include elected or appointed officials.

(b) The premium for the policy shall be paid by the policyholder, either wholly from the employer's funds or funds contributed by the employer, or partly from such funds and partly from funds contributed by the insured employees. No policy shall be

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issued on which the entire premium is to be derived from funds contributed by the insured employees. A policy on which part of the premium is to be derived from funds contributed by the insured employees may be placed in force only if at least 75% of the then eligible employees, excluding any as to whom evidence of individual insurability is not satisfactory to the insurer, elect to make the required contribution. A policy on which no part of the premium is to be derived from funds contributed by the insured employees shall insure all eligible employees, or all except any as to whom evidence of individual insurability is not satisfactory to the insurer.

(c) The policy shall cover at least five employees at date of issue.

(d) The amounts of insurance under the policy shall be based upon some plan, precluding individual selection either by the employees or by the employer or trustees.

(2) A policy issued to a creditor, who shall be deemed the policyholder, to insure debtors of the creditor, subject to the following requirements:

(a) The debtors eligible for insurance under the policy shall be all of the debtors of the creditor whose indebtedness is repayable in installments, or all of any class or classes thereof determined by conditions pertaining to the indebtedness or to the purchase giving rise to the indebtedness.

(b) The premium for the policy shall be paid by the policyholder, either from the creditor's funds or from charges collected from the insured debtors, or from both. A policy on which part or all of the premium is to be derived from the collection from the insured debtors of identifiable charges not required of uninsured debtors shall not include, in the class or classes of debtors eligible for insurance, debtors under obligations outstanding at its date of issue without evidence of individual insurability unless at least 75% of the then eligible debtors elect to pay the required charges. A policy on which no part of the premium is to be derived from the collection of such identifiable charges shall insure all eligible debtors, or all except any as to whom evidence of individual insurability is not satisfactory to the insurer.

(c) The policy may be issued only if the group of eligible debtors is then receiving new entrants at the rate of at least 100 persons yearly, or may reasonably be expected to receive at least 100 new entrants during the first policy year, and only if the policy reserves to the insurer the right to require evidence of individual insurability if less than 75% of the new entrants become insured.

(d) The amount of insurance on the life of any debtor shall at no time, under one or more policies, exceed the amount owed by that debtor which is repayable in installments to the creditor, or ~~$50,000~~ *$100,000*, whichever is less.

(e) The insurance shall be payable to the policyholder. Such payment shall reduce or extinguish the unpaid indebtedness of the debtor to the extent of such payment.

(3) A policy issued to a labor union, which shall be deemed the policyholder, to insure members of such union for the benefit of persons other than the union or any of its officials, representatives or agents, subject to the following requirements:

(a) The members eligible for insurance under the policy shall be all of the members of the union, or all of any class or classes thereof determined by conditions pertaining to their employment, or to membership in the union, or both.

(b) The premium for the policy shall be paid by the policyholder, either wholly from the union's funds, or partly from such funds and partly from funds contributed by the insured members specifically for their insurance. No policy shall be issued on which the entire premium is to be derived from funds contributed by the insured members specifically for their insurance. A policy on which part of the premium is to be derived from funds contributed by the insured members specifically for their insurance may be placed in force only if at least 75% of the then eligible members excluding any as to whom evidence of individual insurability is not satisfactory to the insurer, elect to make the required contributions. A policy on which no part of the premium is to be derived from funds contributed by the insured members specifically for their insurance shall insure all eligible members, or all except any as to whom evidence of individual insurability is not satisfactory to the insurer.

(c) The policy shall cover at least 25 members at date of issue.

(d) The amounts of insurance under the policy shall be based upon some plan precluding individual selection either by the members or by the union.

(4) A policy issued to the trustees of a fund established in this state by two or more employers if a majority of the employees to be insured of each employer are located within the state, or to the trustees of a fund established by one or more labor unions, or by one or more employers and one or more labor unions, which trustees shall be deemed the policyholder, to insure employees of the employers or members of the unions for the benefit of persons other than the employers or the unions, subject to the following requirements:

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(a) The persons eligible for insurance shall be all of the employees of the employers or all of the members of the unions, or all of any class or classes thereof determined by conditions pertaining to their employment, or to membership in the unions, or to both. The policy may provide that the term "employees" shall include retired employees and the individual proprietor or partners if any employer is an individual proprietor or a partnership. No director of a corporate employer shall be eligible for insurance under the policy unless such person is otherwise eligible as a bona fide employee of the corporation by performing services other than the usual duties of a director. No individual proprietor or partner shall be eligible for insurance under the policy unless the proprietor or partner is actively engaged in and devotes a substantial part of their time to the conduct of the business of the proprietor or partnership. The policy may provide that the term "employees" shall include the trustees or their employees, or both, if their duties are principally connected with such trusteeship.

(b) The premium for the policy shall be paid by the trustees either wholly from funds contributed by the employer or employers of the insured persons, or by the union or unions, or by both, or partly from such funds and party from funds contributed by the insured employees. No policy shall be issued on which the entire premium is to be derived from funds contributed by the insured persons. The policy shall insure all eligible persons, or all except any as to whom evidence of individual insurability is not satisfactory to the insurer.

(c) The policy shall cover at date of issue at least 100 persons and not less than an average of five persons per employer unit.

(d) The amounts of insurance under the policy shall be based upon some plan precluding individual selection either by the insured persons or by the policyholder, employers, or union.

(5) A policy issued to an association which has been organized and is maintained for purposes other than that of obtaining insurance, insuring at least 25 members, employees, or employees of members of the association for the benefit of persons other than the association or its officers. The term "employees" as used herein shall be deemed to include retired employees. The premiums for the policies shall be paid by the policyholder, either wholly from association funds, or funds contributed by the members of such association or by employees of such members or any combination thereof. The amounts of insurance under the policy shall be based upon some plan precluding individual selection either by the insured person or by the association or by the member.

(6) Any policy issued pursuant to this section may be extended to insure the employees against loss due to the death of their spouses or the employees' children under 21 years of age, or employees' children 21 years or older who are attending an educational institution and relying upon the insured employees for financial support, or any class or classes thereof, subject to the following requirements:

(a) The premium for the insurance shall be paid by the policyholder, either from the employer's funds or from funds contributed by the insured employees, or from both. If any part of the premium is to be derived from funds contributed by the insured employees, the insurance with respect to spouses and children may be placed in force only if at least 75% of the then eligible employees, excluding any as to whose family members' evidence of insurability is not satisfactory to the insurer, elect to make the required contribution. If no part of the premium is to be derived from funds contributed by the employees, all eligible employees, excluding any as to whose family members' evidence of insurability is not satisfactory to the insurer, shall be insured with respect to their spouses and children.

(b) The amounts of insurance shall be based upon some plan precluding individual selection either by the employees or by the policyholder, or employer and shall not exceed with respect to any spouse or child, 50% of the insurance on the life of such insured employee.

(c) Upon termination of the insurance with respect to the spouse of an employee by reason of the employee's termination of employment or death, the spouse insured pursuant to this section shall have the same conversion rights as to the insurance on such spouse's life as is provided for the employee under K.S.A. 40-434 and amendments thereto.

(d) Notwithstanding the provisions of K.S.A. 40-434 and amendments thereto only one certificate need be issued for delivery to an insured person if a statement concerning any dependent's coverage is included in such certificate.

(7) A policy may be issued to any other group which the commissioner of insurance finds is the proper subject of a group life insurance policy or contract. Any such group shall be subject to any appropriate conditions or provisions relating thereto which the commissioner may establish or require, consistent with the provisions of this act, and such conditions and provisions shall be included in the policy or contract.

Sec. 2. K.S.A. 1992 Supp. 40-433 is hereby repealed.

Sec. 3. This act shall take effect and be in force from and after its publication in the statute book.

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STATEMENT

To: House Financial Institutions and Insurance Committee

From: Don Teasley

Re: Insurable Interest

Date: February 9, 1993

My name is Don Teasley. I am a principal with the firm of Clark/Bardes, Inc., headquartered in Dallas, Texas. Since 1967 our firm has been involved in the business of helping corporations use specially designed life insurance products as a means of funding and financing long-term, benefit-related liabilities. Prior to 1986, almost all of our work was with the funding of supplemental executive compensation and supplemental benefit plans. However, beginning in 1986 companies began to seriously address the problem of funding post-retirement health care liabilities.

This interest in post-retirement health care costs and their impact on the company was brought about by the insistence of the Financial Accounting Standards Board that companies begin to accrue for and report on their books the amounts of unfunded liability which those companies had promised their employees for post-retirement health care benefits.

You may have read most recently of the $20+ billion hit to its 1993 financial statement that General Motors will take. This is a direct result of the application of what has now become the Financial Accounting Standards Board (FASB) statement 106. While most companies do not have liabilities of the magnitude posted by General Motors, nonetheless, it is common to experience currently undertaken liabilities in companies that range from $100 million to $1 billion of <u>present value</u> cost, with cash requirements in the multi-billion dollar range.

Companies have historically paid for post-retirement health care costs on a pay-as-you-go basis, expensing claims as they come due from year to year. Now, companies must accrue for the entire future value of the liability, and they are actively and vigorously investigating ways to pre-fund or finance these liabilities and not lay the burden on future

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flow subject to future increases in cost and cash and liability that might cause the benefits not to be paid or to be substantially reduced.

There is no special provision made in federal tax law for companies to obtain a tax deduction for pre-funding post-retirement health care, except in one instance, and the range of options available to employers for dealing with these huge unfunded liabilities are quite limited. Employers have found that the use of life insurance products is one of the most effective ways of dealing with the funding of these long-term liabilities. When a life insurance product is purchased on the life of an employee for the benefit of an entity other than insured himself, there must be an insurable interest that the employer has in the life of the employee. When Clark/Bardes began to explore the use of life insurance products as funding mechanisms for post-retirement health care liabilities, we very early encountered the difficulty of putting these products into place, because of the lack of clarity or, more frequently the lack of existence of state laws with respect to insurable interest. For example, Kansas, like many other states, does not have a state statute dealing with insurable interest. Gesiler v. Mutual Benefit Health and Accident Association, 183 P2d 854 (1943).

Our company determined several years ago that in many states, the only way that employers could effectively use life insurance products, where insurance was to be placed upon a broad cross section of their employees, rather than just a few executives, was for the legislature to either clarify the law or adopt statutes that would give employers the type of guidance they needed. Accordingly, we first approached the Virginia Legislature in 1989 and were successful in having a unanimous adoption of a new insurable interest law. That law provided employers with tests which they could understand and easily calculate to determine insurable interest and guide them in their ability to ask employees to allow their lives to be insured.

Since that time, Clark/Bardes, as well as other industry groups and associations, and in some cases bar associations, employer trade associations and other interested parties have promoted and seen the adoption of new insurable interest legislation passed in Maryland, Illinois, Michigan, Maine, Delaware, Georgia, Arkansas, Minnesota, California and Texas. Each of these pieces of legislation has had as its public policy basis the need to provide employers with both the ability and the guidance to insure their employees for the purpose of funding long-term employee-related liabilities.

The difficulty with the law in the past in other states and, currently, in Kansas has been that there are no guidelines provided as to the amount of insurance that an employer may take out on non-management and retired employees. What this bill does is specifically give an employer an insurable interest and then provide a measuring device as to the amount of insurance that can be purchased. This measurement is based upon the liability that the corporation has undertaken with respect to its employee welfare benefit plans, as defined under the federal Employee Retirement Income Security Act, known as ERISA. The amount of coverage that an employer can insure the life of an employee for, when it avails itself of this statute, is an amount commensurate with the liabilities that the employer has undertaken for those plans.

It is important to note that the employee must be notified that the employer wishes to insure his or her life and must be given the opportunity to decline having his or her life insured. Under current Kansas law there is no requirement that an employee consent to having his or her life insured. We are aware of a few brokerage groups which advise companies that they can insure employees for substantial amounts without the employees consent. This is, we believe, poor public policy, and it does not create a level business playing field for those of us who wish to engage in these transactions with prudence, care and certainty.

There are two types of insurance that are used in funding post-retirement health care. In the first type of insurance plan the corporation is the owner and beneficiary of the life insurance policies. When this type of insurance is used, the employer is primarily after the tax benefits connected with loans of the cash value from the insurance policy. There are substantial long-term tax benefits permitted in the Internal Revenue Code that an employer can derive from this policy loan transaction. In this manner, the federal government is providing indirect support to employers greatly assisting them in the financing of their post-retirement health care liabilities. Long term, the tax benefits connected with the policies are of greater value than the death benefits, but because these are life insurance policies the employer must still be concerned about the application of the insurable interest rules.

The second type of usage of an insurance policy involves the purchase of insurance products by a trust created under Section 501(c)(9) of the Internal Revenue Code, which allows employers a tax deduction for pre-funding post-retirement health care. The trust is the owner and beneficiary of the policies; it invests in insurance products as a means of sheltering the growth of the trust assets, which in this case are the cash values of the insurance policies.

The earnings on the cash values themselves provide the offset under FAS 106 which allows the corporation to reduce the liability on its books. Unlike pension plans, funds set aside in a 501(c)(9) trust are not blessed with tax free growth, and an insurance policy is the only means available to obtain tax free growth in trust assets, aside from investing in tax free municipal bonds.

Under current Kansas law, the closest that the statutes of Kansas come to addressing the issue of insurable interest is in Section 17-6102(16) of the Corporations Code where a domestic corporation is given the power to

> "provide insurance for its benefit on the life of any of its directors, officers or employees, or on the life of any stock holder for the purpose of acquiring at his death shares of its stock owned by such stock holder."

This provision clearly authorizes Kansas corporations to insure employees for their benefit, but it leaves the employers and those of us who try to counsel them with no guidance with respect to the amount of insurance which can be purchased. The only other guidance on this issue comes from a 1943 case titled Geisler v. Mutual Benefit Health and Accident Association. This case provides a test for insurable interest that requires a "reasonable pecuniary interest justifying the expectation of benefit or advantage from the continued life of the insured."

With neither of these tests, whether from the Corporations Code statute or the case law can employers or their consultants or advisers have a basis to know precisely what is expected, and so the tendency is to act with extreme or even undue caution or, more frequently, simply not to engage in the transaction because of a lack of certainty.

A suitable analogy might be based upon traffic speed laws. If a person were to enter Kansas and drive on its highways, that person could reasonably assume that driving was permitted if not invited and, further, that some speed limit was applicable. However, if Kansas posted no speed limits whatsoever, guidance would not be present for motorists to govern their driving behavior and some would drive exceptionally slow, others would apply the law of their own state, and still others would assume that there was some speed limit that applied, but they would go as fast as they could until they knew what it was.

The situation is roughly the same for employers and their advisers wishing to apply the very broad statements of insurable interest law currently on the books or decided in Kansas. There is no consistency of application and no standard by which companies can rationally make decisions, and as a result of this many employers, rather than even take conservative stances on this matter, are simply deciding that they will not look at these funding options for post-retirement health care until such time as the law is made clear. In other instances, we are aware of a few brokerage organizations that are viewing the current situation as an invitation to speed until caught which is not good for the citizens and employers of Kansas and likewise not beneficial for those of us who try to adviseour clients carefully and wish to do so on a level playing field.

The effect of passage of the statute we are offering would be: 1.) to add substance and clarity to the law that now exists; 2.) to create a better climate in which employers can make business decisions about a matter of significant financial impact on the companies; 3.) provide an understandable, measurable basis for the determination of an employers insurable interest, rationally related to a specific liability that the employer has already undertaken; 4.) guarantee to employees the right to consent as to whether they wish to be insured by the employer or not.