

SESSION OF 2005

SUPPLEMENTAL NOTE ON HOUSE BILL NO. 2326

As Amended by Senate Committee on
Financial Institutions and Insurance

Brief*

HB 2326 would amend existing law related to the Kansas Insurance Guaranty Association to clarify covered claims and the extent the claims are payable; to set a bar date for the filing of claims; to clarify the provisions for the exhaustion and offset requirements for claims; and to reclassify priority for claims filed.

The bill would become effective on publication in the *Kansas Register*.

Covered Claims

Specifically, the bill would provide that the individual claimant for a covered claim be a resident of the state at the time of the insured event and that the residence for claimant entities other than the individual is the state in which the principal place of business is located at the time of the insured event. The claim would be considered as a first party claim for damage to property that is permanently located in Kansas. Covered claims would not include:

- any amount due any reinsurer, insurer, insurance pool, or underwriting association, as subrogation recoveries or otherwise;
- any amount awarded as punitive or exemplary damages, unless such damages were covered under the policy of the insolvent insurer; or
- any claim by an affiliate of the insolvent insurer.

*Supplemental notes are prepared by the Legislative Research Department and do not express legislative intent. The supplemental note and fiscal note for this bill may be accessed on the Internet at <http://www.kslegislature.org>

The qualifications for covered claims in existing law, KSA 40-2906, would be amended further to clarify when coverage under the Association would be triggered. Covered claims would not include a claim filed with the Association after the earlier of, 18 months after the date of the liquidation order or the final date set by the court for the filing of claims against the liquidator or receiver of an insolvent insurer. A covered claim also would not include any claim filed with the Association or a liquidator for protection afforded under the policy of the insured for incurred, but not reported losses. Any obligation of the Association to defend an insured on a covered claim would cease upon either the payment by settlement or on a judgment, of an amount equal to the lesser of the covered claim obligation limit of the Association or the applicable policy limit or tender of such amount.

The bill also would expand the definition of "insolvent insurer" to include a licensed insurer determined to be insolvent by a court and against whom a final order of liquidation has been entered by a court in the home state of the insured. The obligation of the Association on the covered claims would be limited to the amount of each covered claim which does not exceed the first \$300,000 of any claim.

Recovery of Expenses and Insurance Policy Offset

The bill also would allow for expenses for the investigation or defense of claims against insureds under policies with an insolvent insurer to be considered expenses of the Association or similar organization handling claims. The Association would be given the right to recover from any person who serves as an affiliate of the insurer and whose liability obligations to other persons are satisfied in whole or in part by payments made under this Act. The bill also would clarify the provision for the exhaustion of an individual's right under the insurance policy, for policies of those other than insolvent insurers. A claim under an insurance policy is defined to include a claim under any kind of insurance, whether it is first party or third party, including accident and health insurance, workers' compensation, Blue Cross and Blue Shield and all other coverages except for the policies of an insolvent insurer. The provisions of the exhaustion and offset of the individual's insurance would be applied to all claims which have not been paid prior to the effective date of this act.

Classification for Priority Distribution of Claims

The bill also would amend the provisions for the priority of distribution of claims of the estate of an insolvent insurer to allow that:

- Class 1 would include administrative expenses;
- Class 2 would include all claims under policies, including those of the federal government;
- Class 3 would include all other claims of the federal government that are not policy related and addressed by Class 2;
- Class 4 would include compensation to employees for services performed that do not exceed two months of monetary compensation;
- Class 5 would include claims of general creditors;
- Class 6 would include claims of any state or local government except those under Class 2;
- Class 7 would include claims filed late or any other claims, other than those under classes 8 and 9;
- Class 8 would include surplus or contribution notes, or similar obligations, and premium refunds on assessable policies; and
- Class 9 would include claims of stakeholders or other owners in their capacity as shareholders.

The provisions of priority levels for the claims would be applicable to all claims which have not been paid prior to the effective date of this act.

Background

The bill was requested by the Insurance Commissioner whose representative indicated the Commissioner supported the proposed changes to the Guaranty Association law. The Kansas Insurance

Guaranty Association presented testimony about the necessity for changes in the Association law to address changes in commercial insurance policies and current insolvencies. The revisions proposed include setting a claim bar date to help reduce the financial and administrative burden of the Association and the potential for long-term liability. According to the Association, the amended provisions related to the classifications of claims were necessitated by a Supreme Court decision, *U.S. Department of Treasury v. Fabe*, 508 U.S. 491. The Association further indicated that 40 states have adopted such provisions.

The Kansas Association of Insurance Agents opposed the introduced version of the bill and suggested amendments be considered to reinstate Guaranty Fund coverage for large insureds and first party coverage for an affiliate of an insolvent insurance company, and the provision addressing a \$10,000 limitation on the unearned premium.

The House Committee on Insurance amendments remove the provisions relating to the exclusion of first party claims by an insured whose net worth exceeds \$25 million or who is an affiliate of an insolvent insurer. The Committee also amended the payment limit of covered claims to not exceed the first \$300,000 of any claim. The Committee also removed provisions related to the obligation on a covered claim by first deleting the provision of releasing the insured from settlement and limiting the covered unearned premium claims to \$10,000. The Committee also inserted a provision that the provisions of sections 4 and 5, separately, would be applicable to all claims, whether currently pending or brought after July 1, 2005.

The Senate Committee on Financial Institutions and Insurance further amended the language applicable to all claims addressed in sections 4 and 5 by removing "whether currently pending or brought after July 1, 2005" and inserting "which have not been paid prior to the effective date of this act." The Senate Committee also amended the effective date of the act.

The fiscal note prepared by the Division of the Budget on the introduced version of the bill indicates that passage of the bill would have no fiscal effect on the operations of the Insurance Department. The fiscal note also indicates that the fiscal effect on member companies of the Kansas Insurance Guaranty Association cannot be estimated.