INTERIM JOINT COMMITTEE ON BANKING AND INSURANCE

Minutes of the 2nd Meeting of the 2018 Interim

September 25, 2018

Call to Order and Roll Call

The 2nd meeting of the Interim Joint Committee on Banking and Insurance was held on Tuesday, September 25, 2018, at 10:00 AM, in Room 149 of the Capitol Annex. Senator Tom Buford, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Tom Buford, Co-Chair; Senators Rick Girdler, Morgan McGarvey, Dennis Parrett, Albert Robinson, John Schickel, and Dan "Malano" Seum; Representatives Joseph M. Fischer, Adam Koenig, Stan Lee, Michael Meredith, Steve Riggs, Dean Schamore, Wilson Stone, and Addia Wuchner.

Guests: Ballard Cassady, President and Chief Executive Officer, Debra Stamper, Executive Vice President and General Counsel, and John Cooper, Governmental Affairs Consultant, Kentucky Bankers Association; Patrick O'Connor, Deputy Commissioner, Kentucky Department of Insurance; David Dillon, Senior Vice President and Principal, Lewis & Ellis; Tom Peterson, Executive Director, and Kevin Griffith, General Counsel, Kentucky Life and Health Insurance Guaranty Association; Lawrence Ford, Senior Director of Government Relations, Anthem Blue Cross and Blue Shield; and Rob Hardy, Executive Vice President and General Counsel, Investors Heritage Life Insurance Company.

LRC Staff: Sean Donaldson, Jessica Sharpe, and Dawn Johnson.

Approval of Minutes

A motion by Senator Schickel and second by Senator Robinson to approve the minutes of the August 28, 2018, meeting carried by voice vote.

Bank Franchise Tax

Ballard Cassady, Kentucky Bankers Association (KBA), explained that Kentucky's bank franchise tax rate is on average 92 percent higher than any other corporate tax rate in the state. Corporate tax reforms enacted by the 2018 General Assembly increased the taxation gap. Mr. Cassady provided a historical overview of the state's bank taxation disparity and noted the effects of excessive taxation on local banks and their communities. Kentucky banks have an average effective tax rate of 13.3 percent, the highest rate nationally and is of five states that still has the bank franchise tax. Data provided by three

CPA firms comparing effective bank tax rates for Kentucky and nearby states reflected Kentucky's much higher rate and taxes collected. The bank franchise tax calculation used for Kentucky-based banks as compared to multi-state banks. While the taxation formula for multi-state banks is apportioned, those based solely in Kentucky are calculated on 100 percent of payroll, property, and revenue. Surrounding states no longer use the franchise tax and use the corporate tax instead. Companies based in other states can buy Kentucky based banks and fund the purchase with tax savings. Once a Kentucky-based bank is acquired, approximately 35 percent of employees are lost and bank branches are closed resulting in payroll and property tax decreases. Multi-state banks will take advantage of the ability to transfer lending activity to the state with the most advantageous tax requirements. Acquisition of Kentucky banks is accelerating resulting in reduced franchise taxes collected along with other tax receipts. Kentucky has lost approximately $665 million in capital over the past five years.

Responding to Senator Seum's questions, General Counsel Debra Stamper, KBA, said "franchise tax" is an antiquated term that is still used. Banks are not franchised but are instead chartered. Banks pay the franchise tax, not the corporate tax.

Senator Schickel said he has received much feedback from locally owned banks. In response to his question, Mr. Cassady said the KBA will lobby the 2019 General Assembly to convert to the corporate tax rate and will present this request at the upcoming legislative Appropriations and Revenue Committee meeting.

In response to Senator McGarvey's question, Mr. Cassady explained that the franchise tax affects locally owned banks. The smaller the bank the heavier the burden.

Responding to Representative Koenig's question, John Cooper, Governmental Affairs Consultant, KBA, said taxing net profits at corporate rate would incentivize from moving capital base offshore. Some areas are falling through the cracks and need further examination, such as internet based lending. Most constituents would rather have a community bank.

In response to Representative Rigg's question Mr. Cassady said the original intent of the franchise tax in 1995 was to apportion revenue of multi-state banks. At that time, most states had the franchise tax. Ms. Stamper explained that financial institutions were more limited so the taxation structure was different. This is the reason most states have switched to a corporate tax. Representative Riggs suggested the legislature will want to know more about tax deductions and tax credits compared to other corporations.

Long-Term Care Insurance in Kentucky

Patrick O'Connor, Deputy Commissioner, Kentucky Department of Insurance explained the purpose of long-term care insurance (LTCI) insurance is to fund LTCI costs and to protect assets an individual wants to bequeath to family. LTCI provisions and types

of plans available. As of 2017, average nursing home costs were $97,500 and assisted living facilities average $49,000. As premiums escalate, the potential value of LTCI exceeds premiums paid. The number of LTCI carriers has decreased drastically. The Department of Insurance is required to review and approve rate increases to protect consumers. The department provides a long term care insurance consumer guide.

David Dillon, Lewis & Ellis said LTCI is relatively new. Early actuarial cost analyses were wrong for reasons including low interest rates, regulatory limitations on needed rate increases, decreasing mortality rates, and under estimation of lapse rates and care costs. Corrections can be difficult to overcome. Mr. Dillon reviewed financial data for the 15 LTCI insurance providers.

Mr. Dillon noted that changes in the Life and Health Guaranty Act caused a major impact to the health insurance industry. The Penn Treaty liquidation made health insurers liable, even those not in the LTCI market. Kentucky's share of the liability is approximately $30 million. Because of the LTCI issues with first generation policies, 85 percent of new policy sales are life and annuity hybrids. Mr. Dillon reviewed rate increase data for Kentucky and comparable states. Regardless of the rate increase request by carriers, the average approval amount is 25 percent. Mr. Dillon discussed regulatory, pricing, and review approaches to rate increases. To achieve more consistency within the National Association of Insurance Commissioners (NAIC), the long-term pricing subgroup was created. Actuaries from all 50 states are currently developing a framework to achieve greater transparency and predictability in the review and approval of rate increase rates.

Tom Peterson, Executive Director of Kentucky Life and Health Insurance Guaranty Association (KLHIGA), gave an overview of the agency. It was created by the legislature in 1978 and has been amended several times to be more aligned with the NAIC Life and Health Guarantee Association Model Act (Model Act). Since the early 1990s, KLHIGA has participated in approximately 50, primarily multi-state, insolvencies that have affected more than 90,000 Kentucky residents. Kentucky liabilities have been approximately $400 million. The overall net cost was approximately $94 million. When a multi-state insolvency occurs KLHIGA works through the National Organization of Life and Health Insurance Guaranty Association (NOLHGA). NOLHGA helps guaranty associations fulfill their statutory obligations to provide continued protection for respective policy holders. When an insolvency occurs, a task force of representative guaranty associations of states most affected is established. Accountants, attorneys, and actuaries advise the task force throughout the liquidation process. The KLHIGA is not in a position to make a recommendation or express an opinion on matters associated with the NAIC's recent Health Maintenance Organization amendments to the Model Act. It can only observe that Kentucky has traditionally sought to keep the statutes in line with the Model Act which provides uniformity of consumer protection among states.

Kevin Griffith, General Counsel, KLHIGA, said insurance companies are excluded from the federal bankruptcy code. When an insurance company gets into financial difficulty it is the charge of the insurance commissioner where the insurance company is incorporated to take action. Penn Treaty Network America got into financial difficulties in the 1990s and a corrective action plan was implemented in the early 2000s. It was permitted to continue business and sell under this plan until January 2009 when the company went into receivership. Stakeholders fought liquidation and the Pennsylvania Commonwealth Court denied the petition and directed the establishment of a functional rehabilitation plan. By July 2016, Penn Treaty failed and a liquidation petition was approved March 1, 2017. Penn Treaty reflects all of the problems with long-term care insurance industry from an actuarial perspective. As a mono-line company, it had no profitable business to offset losses incurred under long term care only. It was ultimately underfunded by $2.7 billion. The risk profiles were misunderstood and shifted so much the only option was to increase premiums. Action should have been taken much earlier. The KLHIGA was called upon to protect 840 Kentucky residents. The present liability is $30.6 million.

Lawrence Ford, Senior Director of Government Relations, Anthem Blue Cross and Blue Shield, reviewed the guaranty process when a company is liquidated. Long term care insurance is defined as health insurance although very few health insurers write long term care insurance policies. However, when a long term care insurance insolvency occurs, 80 percent of the liability falls to health insurers. This resulted in the NAIC developing a compromise among major life insurers, health insurers, and NAIC. Anthem did not have any liability when Penn Treaty was addressed. The agreement adopted by the NAIC included a provision requiring HMOs be added to the Guaranty Association fund, and long term care insolvencies being equally addressed by health and life insurers. Anthem supports the recommended amendments to the Model Act. It is fair, sustainable and offers consumers greater protections and will result in greater confidence in insurance matters.

In response to Representative Meredith's question, Mr. Griffith said that while damage has been done with the first long term care policies, the market has done much to respond to the liabilities. It has moved to more hybrid products and standalone policies have become better rated. It would be difficult to segment types of insurance policies without compromising consumer protection. Representative Meredith expressed concern about ever increasing insurance rates and health insurers subsidizing a product that most consumers do not use. Mr. Dillon said that long term care has a mix of health and life insurance elements. The new hybrid model is a more stable. There are good reasons to keep a private market.

Rob Hardy, Executive Vice President and General Counsel, Investors Heritage Life Insurance Company, provided background on the company. As numerous other financial segments have experienced difficulties under federal regulation, the insurance industry has remained solid because of the state regulatory process along with the support of the guaranty associations. Potentially, small insurance companies face significant impact by

the changes in the guaranty fund assessments. Long term care was originally categorized as a health insurance product and the guaranty association system was based on that. Small companies, none of whom write long term care insurance, face a major impact. Given the potential impact it would be appropriate to provide an exemption for the small life insurance company segment. This would avoid a disproportionate effect on small life insurance companies. The exemption would have minimal impact to the guaranty assessment process.

There being no further business, the meeting adjourned at 11:55 AM.