STATE OF KANSAS

OFFICE OF THE ATTORNEY GENERAL

2ND FLOOR, KANSAS JUDICIAL CENTER, TOPEKA 66612-1597

ROBERT T. STEPHAN
ATTORNEY GENERAL

MAIN PHONE: (913) 296-2215
CONSUMER PROTECTION: 296-3751
TELECOPIER: 296-6296

December 28, 1990

ATTORNEY GENERAL OPINION NO. 90- 138

The Honorable Dale M. Sprague
State Representative, Seventy-Third District
P.O. Box 119
McPherson, Kansas 67460

Steven R. Wiechman
Legal Counsel
Kansas Association of Counties
212 S.W. 7th St.
Topeka, Kansas 66603

Re: Cities and Municipalities--Insurance; Group-Funded Liability Pools--Use of Claims Fund Account to Pay for Specific and Aggregate Excess Insurance

Synopsis: The Kansas insurance department has authority to review the proposed use of moneys in a claims fund established pursuant to K.S.A. 1989 Supp. 12-2616 et seq. The interpretation of the statute by the insurance department (allowing moneys deposited and maintained in the claims fund to be used to purchase specific and aggregate excess insurance) is not clearly erroneous. Cited herein: K.S.A. 1989 Supp. 12-2616; 12-2617, as amended by L. 1990, ch. 76, § 1; 12-2618, as amended by L. 1990, ch. 76, § 2; 12-2620; 12-2621, as amended by L. 1990, ch. 76, § 3; K.S.A. 1989 Supp. 12-2624; 12-2626; 12-2627; 12-2629; K.S.A. 44-581; 44-585.

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Dear Representative Sprague and Mr. Wiechman:

You request our examination of the interpretation by the Kansas insurance department (department) of K.S.A. 1989 Supp. 12-2621(b), as amended by L. 1990, ch. 76, § 3. Specifically, the issue raised is whether claims account moneys of a group-funded liability pool may be used to purchase aggregate and specific excess insurance, or whether such purchase may only be made from the administrative account. A February 15, 1990 letter from the department to the Kansas Association of Counties (KAC) sets forth the position of the department with regard to the issue we have been asked to review:

> "We have now completed a review of our position regarding the requirements of K.S.A. 12-2621(b). Based on our review of this matter, Ron Todd, Assistant Commissioner of Insurance, has advised us that *it would be permissible for the cost of aggregate and specific excess insurance to be paid from the claims fund account* of your proposed municipal group-funded general liability pool.
>
> "We do, however, reserve the right to review the premium and policy provisions of the excess coverage to assure that they would not adversely impact the claims fund account. In addition, the insurer providing excess coverage must be authorized to transact business in the state of Kansas.
>
> "We would also request an estimate of the balance of the claims fund account after payment of the cost of excess insurance to assure adequate funds to meet the expected losses of the pool. Expected losses should be based on the historical losses of the pool's members." (Emphasis added).

K.S.A. 1989 Supp. 12-2621(b) states:

> "(b) *An amount equal to at least 70% of the annual premium shall be maintained in a designated depository for the purpose of paying claims in a claims funds account.* The remaining annual premium shall be

> placed into a designated depository for the payment of taxes, fees and administrative and other operational costs in an administrative account." (Emphasis added).

It is a well established rule of construction that an administrative agency's interpretation of a statute is given deference, especially when the statute is enforced by the agency. K.S.A. 1989 Supp. 12-2618, as amended by L. 1990, ch. 76, § 2, empowers the department to issue certificates of authority to pools created pursuant to K.S.A. 1989 Supp. 12-2616 et seq. These certificates allow the group funded pools to operate. There is specific authority permitting the department to request and review information concerning specific and aggregate excess insurance. See K.S.A. 1989 Supp. 12-2618, as amended. In addition, in determining the fiscal coverage required, use of funds may impact upon matters which the department is required to review [specifically, the authority to review the financial condition of a pool. See e.g. K.S.A. 1989 Supp. 12-2620 and 12-2626(d)]. K.S.A. 1989 Supp. 12-2629 states that the "commissioner of insurance shall make recommendations as deemed advisable to assist Kansas local governments in the effective, efficient and fiscally sound operation of any proposed group-funded pool." (Emphasis added). It is therefore our opinion that the Kansas insurance department has the authority to determine whether portions of premiums paid into the claims fund may be properly expended to purchase specific and aggregate excess insurance coverage and such determination must be upheld unless incorrect as a matter of law.

Neither the legislative history surrounding this act nor the language of the statutes themselves specifically or clearly address whether the moneys in the claims fund may be permissibly used to purchase excess insurance coverage. We must therefore look to the act as a whole and the legislative history and intent surrounding its enactment. Counsel for the independent insurance agents has profered several arguments opposing the department's current interpretation of K.S.A. 1989 Supp. 12-2616 et seq. and K.S.A. 1989 Supp. 12-2621(b), as amended. Counsel believes the use of moneys in the claims fund for purchase of excess coverage violates the provisions of K.S.A. 1998 Supp. 12-2616 et seq. for the following generally stated reasons:

(1) The language of K.S.A. 1989 Supp. 12-2621(b) uses the words "for the purpose of paying claims", which does not leave

room for discretion or allow payment of premiums from the claims fund.

However, the term "for the purpose of paying claims" is not defined in the act nor was it discussed by the legislature. While it is true that the purchase of insurance is not directly a payment of claims, premiums for excess coverage ultimately are used for the payment of claims. The statute does not limit use of the claims fund _to pay_ claims. _Compare_ K.S.A. 44-585(b), workers compensation pool "at least 70% of the renewal premium shall be placed into a designated depository _for the sole purpose_ of paying claims. This shall be called the claims fund account. . . ." (Emphasis added). Rather, a claims fund account established pursuant to K.S.A. 12-2616 _et seq_. should be used "_for the purpose_ of paying claims." (Emphasis added). Excess coverage assists the pool in paying claims. Purchase of such coverage helps to pay for claims that exceed the policy limits. Thus, it is a defensible position that funds expended to purchase excess coverage are indeed used for the purpose of paying claims.

(2) The administrative fund established by K.S.A. 1989 Supp. 12-2621(b) contains much less restrictive language than the language of the previous sentence concerning the claims fund.

However, the administrative fund language does not specifically mentioned excess insurance premium payments. Rather, it appears to be a "catch all" fund intended to provide for all expenditures not associated with funding claims. As much as 30% of premiums paid by pool members are placed in the administrative fund "for the payment of taxes, fees and administrative and other operational costs." This broad language does not necessarily negate the use of claims funds for "the purpose of paying claims" if purchasing excess insurance fulfills such a purpose.

(3) The purpose of the act is to allow a pool for self-insurance purposes. The legislature determined that at least 70% of premiums paid by pool members should be used for self-insurance. To allow excess insurance to be purchased using moneys deposited in the claims fund, rather than the administrative fund moneys, could allow all claim obligations to be purchased. This could eliminate the pool nature of the group and essentially create a group fire and casualty insurance policy.

However, the purpose of K.S.A. 12-2616 *et seq.*, as evidenced by legislative history and as interpreted by the department, was to allow municipalities to join together and provide insurance as an alternative to traditional coverage. This was regarded as a positive attempt to provide municipalities with alternatives to and potential decreases in the cost of traditional insurance coverage. The legislature clearly wanted the pool to have and maintain sufficient funds on deposit in order to cover claims made. To require excess coverage premium payments to be made from the 30 percent of funds set aside for administrative purposes will not automatically result in sufficient claims coverage or adequate funds remaining in the claims fund. Moreover, requiring the purchase of excess coverage from the administrative fund could substantially increase the amount of premiums that must be paid by pool participants. Such an increase in premiums could make pools non-competitive with traditional insurance. The legislature did not intend that pools cost municipalities more than traditional insurance coverage. The legislature intended these pools to be financially responsible and economically sound, not cost prohibitive. Group purchasing can accomplish these purposes and is not prohibited by the act. Moreover, the facts in this situation do not indicate an attempt to purchase all coverage. Rather a pool does in fact exist, with only the excess coverage being purchased. If at least 70% of premiums paid are maintained for the purpose of paying claims, we must rely on the expertise of the insurance department in determining the sufficiency of claims coverage.

(4) K.S.A. 1989 Supp. 12-2618(h), as amended, permits either the purchase of excess insurance coverage or, alternatively, the maintenance of surplus funds. Counsel believes that these alternatives evidence legislative intent that the excess coverage be purchased from the administrative funds or that the surplus funds be in excess of the minimum 70% claims fund level. Counsel argues that the choice permitted by K.S.A. 1989 Supp. 12-2618(h), as amended, evidences a difference between the claims fund and purchase of excess coverage or maintenance of surplus funds.

K.S.A. 1989 Supp. 12-2621(c), as amended, discusses surplus funds; however, this discussion refers to permissible use of any surplus moneys "in excess of the amount necessary to fulfill <u>all the obligations</u> of the pool. . . ." (Emphasis added). Payment of claims, purchase of excess coverage or funding claims in excess of policy limits all represent potential obligations of the pool. All premiums paid by pool participants are split and deposited in one of two funds;

claims or administration. Expenditures from those fund do not negate the split, nor may the pool underfund coverage. Payments for excess coverage or maintenance of surplus funds both attempt to cover unforeseen losses.

K.S.A. 1989 Supp. 12-2618(h), as amended, requires <u>confirmation</u> of excess coverage purchase or, alternatively, maintenance of sufficient surplus funds. The act does not discuss or address whether surplus funds or excess insurance costs should be accounted for as part of the claims fund or the administrative fund. What is ultimately required is the maintenance of adequate funds sufficient to cover losses. However, the amounts necessary to fund losses cannot be absolutely predicted. Thus, the legislature made the decision that at least 70% of premiums paid should be set aside for the purpose of paying claims and required the pools to either purchase excess coverage or maintain sufficient surplus funds. The legislature also granted the department review authority concerning the fiscal reliability of such pools. The amount of premiums paid will ultimately determine the funding available for loss coverage. Adequacy of coverage will be based upon dollar amounts available and losses predicted or actually occurring. The fact that the legislature required either purchase of excess coverage or, alternatively, the maintenance of sufficient surplus funds does not, in our minds, negate the possibility that excess coverage may be provided for from funds maintained in the 70% of premiums paid which must be set aside for the purpose of paying claims if the department determines that such an accounting method maintains adequate funding for the purpose of paying claims. The requirement of excess coverage or maintenance of surplus funds speaks to adequacy of funding, not what may be permissibly paid from the claims fund. As evidenced by the February 15, 1990 letter to KAC, the department intends to review funds and excess coverage payments to assure that they do not adversely impact the claims fund account. Thus, the legislative mandate requiring adequate funding continues to be overseen by the department.

(5) K.S.A. 1989 Supp. 12-2624 permits a deduction from the premium tax on the portion of premium used to purchase excess insurance; "In the computation of tax, all pools shall be entitled to deduct any annual Kansas gross premiums returned on account of cancellation or dividends returned to members of such pools or expenditures used for the purchase of specific and aggregate excess insurance, as provided in subsection (h). . . ." K.S.A. 1989 Supp. 12-2621(b), as amended, states that taxes should be paid from the administrative fund. Counsel

therefore argues that if the claims fund is used to purchase excess coverage, the premium tax paid by the excess insurance carrier will be paid from funds that originated out of the claims fund.

However, K.S.A. 1989 Supp. 12-2621(b), as amended, refers to taxes paid by the pool, and not taxes paid by third parties. K.S.A. 1989 Supp. 12-2624 permits a deduction on tax paid by pools. Premiums paid are not taxes. Thus, K.S.A. 1989 Supp. 12-2624 and 12-2621(b), as amended, do not clearly evidence legislative intent prohibiting the payment of excess coverage from the claims fund.

Thus, while every legal argument offered by counsel for the independent insurance agent's may have merit, the decision of the department is not clearly contrary to the statutory language set forth at K.S.A. 1989 Supp. 12-2616 et seq. Based upon a review of the act as a whole, we believe the department's position is consistent with the legislative intent.

The insurance department and legislative history indicate that K.S.A. 1989 Supp. 12-2616 et seq. was in part modeled after the Kansas group-funded workers' compensation pool law, K.S.A. 44-581 et seq. Pools currently authorized to operate under this enactment have purchased specific and aggregate excess insurance and we have been informed by the department that, in each case, these pools have paid the cost of the premium for such coverage as an expense from the pool's administrative fund accounts. In addition, the normal insurance regulatory standard applicable to insurance companies operating in Kansas requires the cost of specific and aggregate excess insurance to be an administrative expense, not a loss. Thus, the interpretation placed upon K.S.A. 1989 Supp. 12-2621(b), as amended, represents a departure from practices applicable to workers' compensation pools and standard insurance companies.

However, our review of the statutes and relevant case law reveals no mandate that such expense may only come from the administrative account of pools created pursuant to K.S.A. 1989 Supp. 12-2616 et seq.

Unlike these pools, insurance companies are not held to a specific percentage of premiums that must be set aside to fund claims. Rather, the amount of premium paid into the claims fund account of insurance company is flexible and the percentage required or maintained for claims is determined on

a case by case basis. Moreover, K.S.A. 1989 Supp. 12-2617, as amended, specifically states that these pools are not insurance or insurance companies. Thus, despite similarities, a group-funded liability pool created pursuant to K.S.A. 1989 Supp. 12-2616 et seq. is not held to the same standards as other insurance arrangements over which the department has authority, just as standard insurance companies are not held to the same requirements applicable to a pool created pursuant to K.S.A. 1989 Supp. 12-2616 et seq. See K.S.A. 1989 Supp. 12-2617, as amended.

Thus, it is our opinion that the February 15, 1990 decision by the Kansas Insurance Department is permissible under the provisions of K.S.A. 1989 Supp. 12-2616 et seq. Any subsequent review of the financial condition of a pool could result in further or alternate action by the insurance department. However, we do not find evidence that the legislature contemplated, required or dictated that the insurance department prohibit use of moneys in the claims fund for the purpose of paying specific and aggregate insurance premiums. Thus, the decision of the department is not clearly erroneous or contrary to the law and may be permitted to stand.

Very truly yours,

ROBERT T. STEPHAN
ATTORNEY GENERAL OF KANSAS

Theresa Marcel Nuckolls
Assistant Attorney General

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