STATE OF LOUISIANA LEGISLATIVE AUDITOR

Louisiana Insurance Guaranty Association

Staff Study
February 1995

Performance Audit Division

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Legislative Auditor

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Louisiana Insurance Guaranty Association

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State of Louisiana

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February 8, 1995

Honorable Samuel B. Nunez, Jr.,
President of the Senate
Honorable John A. Alario, Jr.,
Speaker of the House of Representatives
and
Members of the Legislative Audit Advisory Council

Dear Legislators:

This is our report of the staff study of the advisability of increasing Louisiana Insurance Guaranty Association assessments and/or abolishing the associated tax credits. This staff study was conducted as part of Phase Two of the Select Council on Revenues and Expenditures in Louisiana's Future (SECURE) project.

This staff study represents our findings, conclusions, and recommendations. We have also identified matters for legislative consideration. Included as Appendix B is the response of the Louisiana Insurance Guaranty Association.

Sincerely,

Daniel G. Kyle, CPA, CFE
Legislative Auditor

DGK/jl

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Office of Legislative Auditor

Executive Summary

Staff Study
Louisiana Insurance Guaranty Association

The Louisiana Insurance Guaranty Association (LIGA) was established by Act 81 of the 1970 Regular Legislative Session to pay Louisiana residents who had claims against insolvent property and casualty insurance companies. During Phase Two of the SECURE effort, the Legislative Auditor conducted further study of two issues relating to LIGA.

1. To analyze the possibility of increasing assessments charged to insurance companies to ensure sufficient revenue to pay required claims without resorting to bond issuance, and

2. To study the benefits and costs of abolishing the tax credit for insurance company assessments.

Our study of these two issues found that:

- Increasing the amount that LIGA is allowed to collect from its members has a negative effect on the state's budget.

- Amending the types and amounts of claims paid by LIGA as well as developing a mechanism for getting liquidation proceeds to LIGA from the Department of Insurance timely could be alternatives for LIGA's financial problems.

Existing tax credits probably cannot be taken away. Also, if future tax credits are eliminated, it would be 10 years before the state would see the full benefit.

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Glossary

Assessment — Amount charged to member insurers to cover the obligations of the insurance guaranty fund, the expenses of handling claims, and other costs.

Insolvency — The financial condition in which an insurer is unable to pay claims as they fall due in the normal course of business.

Insurance Guaranty Fund — An organization formed by legislative act to cover insolvent insurers' financial obligations, within statutory limits, to policyowners, annuitants, beneficiaries, and third-party claimants. These funds are financed by assessments on member insurers' premiums.

Liquidation — A process in which an insolvent insurance company's assets are converted to cash and applied toward its outstanding debt.

National Association of Insurance Commissioners — A voluntary organization of chief insurance regulatory officials of the 50 states, the District of Columbia, and four United States' territories.

National Conference of Insurance Guaranty Funds — A national organization formed to coordinate state guaranty fund activities in the event of multistate insolvencies and provide various information, data and administrative services to assist state guaranty funds in carrying out their responsibilities.

Rehabilitation — A process in which steps are taken to resolve the cause and condition underlying an insurance company's problems so that it can be returned to normal operations.

Chapter One: Introduction

Study Initiation and Objectives

The Louisiana Legislature established the Select Council on Revenues and Expenditures in Louisiana's Future (SECURE) through Senate Concurrent Resolution (SCR) 192 in the 1993 Regular Legislative Session. The council was created to develop recommendations to improve the financial future of the state and the quality of life of its citizens. The resolution provided for the council to be composed of 27 members representing state and local government, private industry, education, labor, and special interest groups.

The SECURE effort has thus far consisted of two phases of study. In Phase One, SECURE contracted with the consulting firm of KPMG Peat Marwick (KPMG) to conduct a preliminary study of various facets of state government. In response to a directive in SCR 192, the Louisiana Legislative Auditor dedicated 35 members of his staff to work under the direction of KPMG.

During Phase One, staff from KPMG and the Office of Legislative Auditor conducted studies of Personnel and Benefits, Organization and Staffing, and State Cash Management Practices. The staff also conducted policy analyses on a variety of topics. These policy analyses identified areas with potential opportunities for immediate financial savings and issues with possible long term impacts that warranted further study. SECURE issued a report containing its recommendations to the legislature before the 1994 Regular Legislative Session. After the Phase One report, the legislature passed several concurrent resolutions and a constitutional amendment designed to improve the efficiency of state government operations.

The legislature reauthorized SECURE in the 1994 Third Extraordinary Legislative Session (SCR 17) to continue its efforts in developing recommendations to improve the financial future of the state and the quality of life of its citizens. The composition of the council was increased from 27 members to 30 members. This continuation of efforts became known as Phase Two of the SECURE project.

In Phase Two of SECURE, the legislature again directed the Office of Legislative Auditor to provide services to the project and SECURE again contracted with KPMG. The scope of the work in Phase Two was to continue some studies begun in Phase One and to conduct some new studies. The Phase Two agenda consists of two performance audits, a tax policy and fiscal model analysis, and follow-up of various issues identified in the Phase One work. SECURE divided the individual study items between the Office of Legislative Auditor and KPMG and assigned the following Phase Two projects to the Office of Legislative Auditor:

- Performance Audit of Planning, Budgeting, and Program Evaluation
- Performance Audit of State Procurement Practices
- Follow-up to Performance Audit of Personnel and Benefits
- Further study of Corrections and Justice
- Further study of General Fiscal
- Further study of General Government
- Further study of Infrastructure

This report addresses the Phase Two staff study of the area of general fiscal relating to the state's property and casualty insurance guaranty fund.

Report Conclusions

The financial problems of the Louisiana Insurance Guaranty Association (LIGA) began after a period of poor regulation of the insurance industry in Louisiana. The amount that LIGA could assess to cover the expenses of these massive insolvencies was not adequate. However, any increase to this amount has negative effects on the state's budget. Amending the types and amounts of claims paid by LIGA could be an alternative solution to this problem.

The existing tax credits will soon cost the state $65 million per year. Since these tax credits appear to be the property of LIGA members, they probably cannot be taken away. In 1993, an attempt was made to abolish any future tax credits. However, this attempt was unsuccessful. Even if future tax credits were not allowed, it would be at least 10 years before the state would see the full benefit.

Introduction

In Phase One, SECURE recommended further study regarding the Louisiana Insurance Guaranty Association (LIGA). In Phase Two, we:

- analyzed the possibility of increasing assessments charged to insurance companies to ensure sufficient revenue to pay required claims without resorting to bond issuance, and
- studied the benefits and costs of abolishing the tax credit for insurance company assessments.

This report contains our findings and recommendations in those areas.

Background

Act 81 of the 1970 Regular Legislative Session (referred to as the Insurance Guaranty Association Law) created the Louisiana Insurance Guaranty Association (LIGA). The association is not a state entity but was created by the legislature to pay claims of insolvent property and casualty insurance companies. All 50 states, the District of Columbia, the Virgin Islands, and Puerto Rico have property and casualty insurance guaranty funds that pay the claims left by insolvent insurance companies.

According to the Insurance Guaranty Association Law, LIGA's purposes are to:

- provide a mechanism for the payment of covered claims under certain insurance policies;
- avoid excessive delay in payment and financial loss to claimants or policyholders because of insolvent insurers;
- assist in detection and prevention of insurer insolvencies;
- provide financial assistance to member insurers under rehabilitation or liquidation; and
- provide an association to assess the cost of such protection among insurers.

LIGA is directed by a nine-member board comprised of the following members:

- two consumer representatives appointed by the Commissioner of Insurance;
- one member appointed by the speaker of the House of Representatives;
- one member appointed by the president of the Senate; and
- five members selected by member insurers approved by the Commissioner of Insurance.

The consumer representatives as well as the legislative appointees must be Louisiana residents. The board members serve without compensation, but they are reimbursed for their expenses by LIGA.

All insurers are required to be members of LIGA as a condition of their authority to transact insurance business in Louisiana. LIGA operates entirely on self-generated funds. Its primary source of revenue is an assessment on member insurance companies. The maximum assessment is two percent of the insurance premiums on policies covered by LIGA. Currently, LIGA is levying the two-percent maximum. In addition, LIGA receives investment income and proceeds from the liquidation of insolvent insurance companies.

LIGA's revenues are used largely to pay the loss claims of insolvent insurance companies. The next largest expenditure is for legal fees. LIGA officials estimate that from 22 to 45 percent of the claims of insolvent insurance companies are in litigation at the time that these claims are received by LIGA. The third largest expense for LIGA is the return of unearned premiums to policyholders of the insolvent insurance companies. The remaining expenses that LIGA must pay include claims handling and management fees, bond interest expense, administrative, and other miscellaneous items.

Insurance companies recoup the assessments they pay to LIGA via tax credits against their premium tax liability. Insurers may deduct one-tenth of the assessment annually until the full assessment is recouped. Consequently, although LIGA is not a state entity, it indirectly impacts the state's budget by reducing the amount the state would otherwise collect in premium tax revenue. LIGA estimates the tax credits to increase by approximately $6.8 million per year until it reaches $65 million annually in the year 2000. Tax credits are discussed further in Chapter Three.

At the end of our fieldwork, four companies qualified for an 80 percent reduction in their assessments. The Insurance Guaranty Association Law requires that these companies have at least one-half of their assets invested in qualified Louisiana investments to be eligible for the reduction. According to the Executive Director of LIGA, the purpose of this reduction is to give a break to smaller Louisiana-domiciled companies. These companies only pay 20 percent of what they normally would pay in assessments.

From its inception in 1970 to September 30, 1994, LIGA has paid out nearly $500 million in claims and related expenses.

Scope and Methodology

This report is a staff study and not a performance audit. Preliminary work began in August 1994 and fieldwork concluded in December 1994.

This staff study only focused on SECURE's Phase One recommendations to study the possibility of increasing assessments charged to insurance companies to avoid future bond issuances and to study the benefits and costs of abolishing the tax credits.

To address the study objectives, we obtained and reviewed studies and reports from the sources listed below. We did not audit the information that was provided to us.

- Louisiana law
- Media news articles
- Louisiana Insurance Guaranty Fund
- State Bond Commission
- National Conference of Insurance Guaranty Funds
- United States General Accounting Office
- Performance audits conducted by other states of their insurance guaranty funds

We also interviewed officials with the Louisiana Insurance Guaranty Association, officials at the Department of Insurance, staffs of the Legislative Fiscal Office and House and Senate Insurance Committees, the Director of Taxation and Finance

Council for the Louisiana Association of Business and Industry, and an official with the California Insurance Guarantee Fund.

We summarized and compared data on insurance guaranty funds in all 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands obtained from the National Conference of Insurance Guaranty Funds. This data was not audited by us. This summarized data is reproduced as Appendix A.

We calculated the adjustments that would have to be made to the LIGA assessment rate to cover LIGA's costs. We also calculated possible effects the tax credits would have on the state's budget.

We developed an example to illustrate how the tax credits accumulate and to determine approximately how long it would take the state to see the full benefit if future tax credits were abolished.

Officials at LIGA were given an opportunity to provide written responses to report conclusions and recommendations. Their response is included as Appendix B of this report.

Report Organization

The remainder of this report is organized into two additional chapters and two appendixes.

- **Chapter Two** addresses the issue of increasing LIGA's assessments.
- **Chapter Three** addresses the benefits and costs of abolishing the tax credits granted to insurance companies.
- **Appendix A** contains a comparison of insurance guaranty funds in all 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands.
- LIGA officials were given an opportunity to respond to this report. LIGA's response is reproduced as **Appendix B**.

Chapter Two: Increasing LIGA Assessments

Chapter Conclusions

Poor regulation of the insurance industry in the past has caused financial problems for LIGA. In 1991, Louisiana had the second highest total guaranty fund assessment in the nation. However, assessments have not been adequate to keep pace with the volume of insolvencies. Increasing assessments to head off future financial woes for LIGA would also increase the corresponding tax credits, which would negatively impact the state's budget. Alternatively, excluding certain types of claims from the Insurance Guaranty Association Law could lower LIGA's expenses, thus reducing the need to increase the assessment.

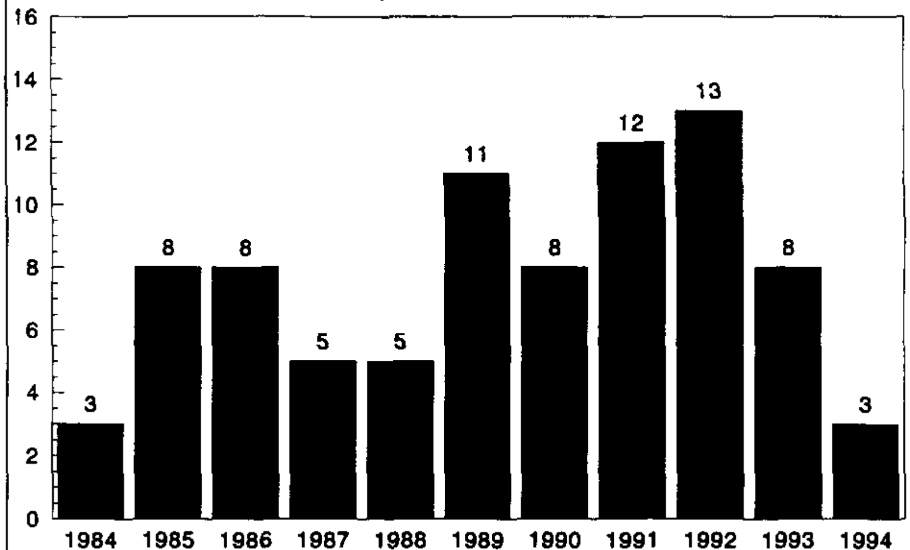
Poor Regulation Led to Insolvencies

Poor regulation of the insurance industry in the 1980s has been blamed for the numerous and costly insurance company insolvencies. LIGA has paid nearly $500 million since its inception for property and casualty insurance company failures. The majority of these insolvencies have occurred since 1988. Nearly 25 percent, or $125 million, of the total paid to date was for claims resulting from the 1989 insolvency of Champion Insurance Company. Exhibit 2-1 on the next page illustrates the number of insolvencies in Louisiana for each year from 1984 to 1994.

According to documents prepared by LIGA officials and presented to the State Bond Commission to support LIGA's 1993 bond issue, the Department of Insurance has identified companies with weak financial conditions and will soon have them all in rehabilitation (action taken by the Commissioner of Insurance to improve an adverse situation in an insurance company) or insolvency proceedings. These documents also state that while adequate regulation of the insurance industry will not totally prevent insolvencies, it will assure that massive insolvencies such as that being faced today will not occur again. The Office of Legislative Auditor concurs that better regulation of the insurance industry should help reduce insolvencies.

Exhibit 2-1

Number of Insolvencies from 1984 to 1994



Source: Prepared by Legislative Auditor's staff using data from LIGA's Report of Insolvent Insurance Companies.

Some improvements being made in the regulation of the insurance industry in Louisiana include the following:

- Louisiana now has tougher insurance regulatory laws. With Act 811 of 1992, the legislature enacted the entire package of legislation recommended by the National Association of Insurance Commissioners.
- The Department of Insurance also began to conduct annual and quarterly desk audits of insurance company financial statements in 1992.
- In December 1993, Louisiana became one of 26 states which are accredited by the National Association of Insurance Commissioners.
- The Department of Insurance is taking additional measures in pre-licensing of new companies including asset verifications, background checks, and in-depth examinations of the company principals' qualifications to manage an insurance company.

Second Highest Assessment in the Nation

In 1991, Louisiana was levying the second highest amount of insurance guaranty fund assessments in the nation, including the District of Columbia. Only Texas levied more than Louisiana. At the same time, Louisiana was also one of only two states that levied the maximum assessments allowable by law. Rhode Island also levied the maximum allowable.

Most states are allowed by statute to levy up to a two percent assessment on insurance premiums. According to a 1992 study by the National Conference of Insurance Guaranty Funds, 48 states and 3 territories (District of Columbia, Puerto Rico, and the Virgin Islands) levy a two percent assessment or less. Thirty-three of these entities can levy two percent.

LIGA Assessments Have Not Been Adequate

Even though Louisiana has been assessing the maximum allowable assessment rate, collections have not been sufficient to cover payments for claims left by insolvent insurance companies. We estimated that LIGA would have to levy almost a four percent assessment (twice what it is currently levying) in 1994 to cover its expenses for that year, even with its other sources of income.

Exhibit 2-2 on the next page shows the rates LIGA would have had to levy from 1991 to 1995 to fully pay claims of insolvent insurance companies and its other expenses that exceeded other sources of income. The expenses shown in the exhibit have been reduced by LIGA's other income for each year shown, such as interest income and proceeds from liquidated insurance companies.

The Insurance Guaranty Association Law allows LIGA to assess member insurance companies up to two percent of the net premiums on insurance policies written in the state. The association receives one-half of the assessment in January and the other half in July (about $30 million each). The funds generated by this assessment are used to pay the following expenses:

- the claims of insolvent insurance companies greater than $100, but less than $150,000 per claim or $300,000 per occurrence;
- claims for unearned premiums up to $10,000;
- the full amount due under any workers' compensation policy;

Exhibit 2-2
Amount LIGA Assessment Would Have Had to Be Increased to Fully Pay Claims

Year	Actual Assessments Collected	Actual LIGA Expenses (Reduced by Other Income)	Actual Rate Assessed	Rate Needed to Cover All Expenses	Increase in Rate Needed to Cover All Expenses
1991	$62,651,940	$60,356,278	2.0%	2.0%	0.0%
1992	63,813,082	68,867,829	2.0%	2.2%	0.2%
1993	62,250,957	71,205,231	2.0%	2.3%	0.3%
1994	61,152,348	119,354,372	2.0%	3.9%	1.9%
*1995	64,000,000	94,200,000	2.0%	2.9%	0.9%

*Projected figures from LIGA's 1995 budget

Source: Prepared by Legislative Auditor's staff from data taken from LIGA's financial statements.

- expenses of board of directors;
- LIGA's operating expenses and legal expenses.

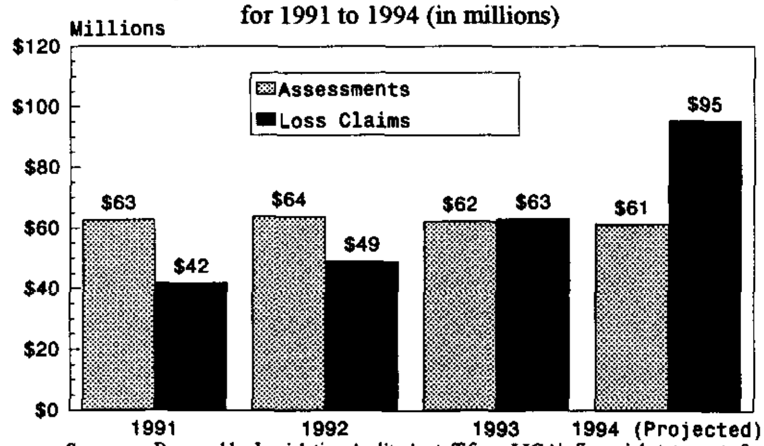
LIGA operates on a calendar year basis. LIGA began actively collecting assessments in 1985. The assessment rate fluctuated annually from 1985 to 1990. The rate was 0.25 percent of premiums in 1985, one percent in 1986 and 1987, 0.50 percent in 1988, and one percent in 1989. From 1990 until the present, the assessment rate has been two percent.

The assessments have generated over $60 million each year from 1990 to 1994. However, claims and related expenses have grown steadily. Exhibit 2-3 on the following page shows that assessments exceeded loss claims for 1991 and 1992. In 1993, assessments were slightly less than loss claims. For 1994, the projected loss claims eclipsed the assessments. The other expenses of LIGA such as administration and returned premiums and other income such as investment income have not been included in this exhibit.

In 1989 alone, 11 insolvencies occurred, including Champion Insurance Company. In 1990, LIGA issued $50 million in bonds because it ran short of funds to pay these and other claims.

Exhibit 2-3

Comparison of LIGA Assessments and Loss Claims for 1991 to 1994 (in millions)



Source: Prepared by Legislative Auditor's staff from LIGA's financial statements for 1991-994.

In 1993, LIGA again experienced a cash shortage. From April 1993 to August 1993, LIGA paid claims at only 30 percent of their total value. Once again, LIGA had to issue bonds to pay claims in full. This time, LIGA issued $136 million in bonds to cover the shortfall and to refund the entire 1990 bond issue. Because the two percent assessment secures this second issue of bonds, the assessment rate cannot be reduced before the year 2003.

For 1995, LIGA estimates beginning the year with approximately $20 million and that assessments and interest income for the year will generate approximately $65 million for a total of $85 million. However, projected expenditures will exceed $145 million, leaving a cash shortfall in excess of $60 million.

According to its executive director, LIGA hopes to avoid any borrowing in 1995 by obtaining funds from liquidated insurance companies. These funds are being held by the Department of Insurance. At June 30, 1994, the department was holding over $43 million in cash and cash equivalents from the liquidation of several property and casualty insurance companies for which LIGA pays claims. LIGA's executive director plans to obtain $30 million of this amount early in 1995 to apply to the expected cash shortage. In an October 6, 1994, memorandum, the department cautioned LIGA that only $2.8 million was immediately available with another $10.1 million to be available shortly thereafter. According to the memorandum, these remaining amounts will "require careful liquidation of investments over the next several months."

At the same time, LIGA must pay the claims of these failed companies from its assessments and other income while waiting for the department to distribute the money from liquidated insurance companies. The amounts received from liquidated insurance companies are a significant source of income for LIGA. However, LIGA has no control over when this money is received. The Department of Insurance determines when this money will be turned over to LIGA.

In addition, LIGA is pursuing funds due from liquidators of out-of-state insolvencies. The executive director said that after 1995, LIGA's cash flow crisis will probably be over.

Increasing Assessment Increases Tax Credits

Increasing the assessment on insurance companies would also increase the tax credit allowed for recouping the assessment. At their current level, tax credits taken by insurance companies will soon reduce revenues the state collects from premium taxes at a rate of $65 million per year.

When an insurance company pays the assessment, LIGA issues a certificate of contribution for the amount paid. State law allows the insurance company to recoup these assessments through tax credits against their premium tax liability. The Insurance Guaranty Association Law says:

> A certificate of contribution issued to a member company shall be offset against its premium tax liability in an amount not to exceed ten percent of the assessment for the year of assessment and not to exceed ten percent of the assessment per year for each succeeding year, not to exceed a total offset of one hundred percent for each assessment.
> --LSA-R.S. 22:1382(A)(3)(c)

Thus, any change in the assessment causes a proportionate change in the tax credits. Each year, the insurance company may deduct 10 percent of that year's assessment plus 10 percent of each prior year's assessment from its premium taxes until all of each assessment has been recouped.

Exhibit 2-4
XYZ Insurance Company
Example of How the LIGA Tax Credit Increases
(For illustration purposes only)

Year	Assessment	Tax Credits										
		1988	**1989**	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**
1988	$100,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	
1989	120,000		12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000
1990	110,000			11,000	11,000	11,000	11,000	11,000	11,000	11,000	11,000	11,000
1991	105,000				10,500	10,500	10,500	10,500	10,500	10,500	10,500	10,500
1992	106,000					10,600	10,600	10,600	10,600	10,600	10,600	10,600
1993	107,000						10,700	10,700	10,700	10,700	10,700	10,700
1994	50,000							5,000	5,000	5,000	5,000	5,000
1995	60,000								6,000	6,000	6,000	6,000
1996	55,000									5,500	5,500	5,500
1997	60,000										6,000	6,000
1998	53,500											5,350
Total	$926,500	$10,000	$22,000	$33,000	$43,500	$54,100	$64,800	$69,800	$75,800	$81,300	$87,300	$82,650

Source: Prepared by *Legislative Auditor's staff based on description of tax credit in* LSA-R.S. 22:1382(A)(3)(c).

Exhibit 2-4 on the preceding page shows how the assessment amount affects the tax credit. Note that when the amount assessed increases, such as from 1988 to 1989, so does the tax credit. Also note that when the assessment was halved in 1994, so was the tax credit *for that year*. However, the overall tax credit to be taken against premium tax liability for 1994 exceeds the amount assessed. This situation will exist in Louisiana when the assessment is reduced to one percent beginning in the year 2003. Tax credits are also discussed in Chapter Three of this report.

A situation in the insurance industry similar to Louisiana's existed in the state of Florida. Because of the monumental losses left by Hurricane Andrew, the state of Florida's insurance guaranty fund had to issue bonds just as Louisiana did after the Champion insolvency. Florida is the only state other than Louisiana that had to resort to bond issuance because of insurance company failures. Florida's legislature added a temporary two percent assessment to its permanent two percent assessment to pay for the bonds. However, insurance companies there are only allowed to recoup the permanent two percent assessment. Once the bonds are paid off, the temporary assessment will be dropped.

Louisiana could consider limiting the recoupment of its tax credit to 50 percent. This measure could save Louisiana about $32.5 million per year once the tax credits have peaked.

Possible Alternatives to Increasing Assessment Rate

As previously discussed, increasing the assessment rate has a negative effect on the state's budget and sufficient cash from liquidations may not be available in time to ease LIGA's cash flow problems. However, options for future consideration could be to increase the minimum amounts that LIGA will pay and to amend the definition of a "covered claim." The Insurance Guaranty Association Law allows payment for some claims that the model legislation and some other states exclude. Excluding these claims could reduce LIGA's expenses, and thereby reduce the need to borrow money, prorate claims, or increase assessments.

All 50 states and the 3 territories have similar legislation governing their insurance guaranty funds. The National Association of Insurance Commissioners developed a model act for property and casualty insurance guaranty funds in 1969. This act was developed to eliminate the need for legislation introduced in Congress which would have led to a federal property and casualty insurance guaranty fund. Most states based their laws on the model act but made modifications to suit their unique situations. Thus, some differences exist among the different guaranty funds.

We noted two major provisions of the model act that could help LIGA lower its claims expenses. These provisions were in the areas of claim limits and the definition of a "covered claim."

Claim Limits. State law provides that LIGA pays the covered claims that exceed $100 but are less than $150,000; unearned premiums up to $10,000; and workers' compensation claims in full. In other words, there is a deductible of $100 per claim, excluding unearned premiums and workers' compensation. These types of claims are paid in full. According to data gathered from a 1992 publication on guaranty funds, the author found that 28 out of 53 states and territories (53 percent) have deductibles of $100 or more per claim. The remaining 25 entities have deductibles ranging from less than $100 to no deductible at all.

Three states had deductibles greater than $100. The states of South Carolina and Wyoming have deductibles of $250 while the state of Wisconsin's deductible is $200.

If LIGA's deductible was increased to $200, LIGA could save an additional $100 for each loss claim. The executive director could not quantify exactly how many claims this would effect. According to LIGA's 1995 budget, there are approximately 25,000 claims open at August 1994. Assuming all are paid in 1995 with a $100 increase to the deductible per loss claim, LIGA could save approximately $2.5 million.

In addition, there is no deductible for claims for unearned insurance premiums. Three states have limits on the amount of unearned premiums that the guaranty fund will pay. According to data from a 1991 study by the National Conference of Insurance Guaranty Funds, Indiana pays 80 percent of the claim for unearned premiums. Michigan pays up to $500 and Texas pays 75 percent of the claim up to $1,000.

Louisiana could consider imposing the same deductible to unearned premium claims as it does the loss claims. For the year 1993, LIGA processed 24,628 claims for unearned insurance premiums totaling $5,445,914, an average of $221 per claim. If a deductible of $200 per claim were imposed, LIGA could have saved as much as $4,925,600 in 1993. Of course, this amount is reduced for those claims which are less than $200.

Definition of a "covered" claim. Louisiana law's definition of a "covered" claim is similar in many ways to the one in the model act mentioned previously. However, the model act suggests that covered claims should not include noneconomic losses. Louisiana's law does not exclude noneconomic losses, such as general damages, from this definition. According to an estimate by the Associate Executive Director of LIGA, approximately 45 to 50 percent of loss payments is made up of general damages. The preliminary figure for claim payments in 1994 is approximately $88 million. If general damages were excluded from the payments by LIGA, $39-$44 million could have been saved in 1994.

Four states specify in their legislation that the guaranty association will only pay out-of-pocket expenses and lost wages. These states are Indiana, Missouri, Nebraska, and Tennessee. This provision does not apply to workers' compensation claims. Tennessee's guaranty association, at its discretion, can pay an additional sum as compensation for permanent physical impairment.

The model act also suggests that the guaranty association should have the right to recover guaranty fund payments from any **insured** whose net worth was $50 million on December 31 of the year preceding the date the insurer became insolvent. This provision, commonly referred to as a net worth provision, could be further modified to exclude **third party claimants** with a net worth of $50 million or more as well as claimants who are **self-insured**. Louisiana's law does not have this provision. Again, LIGA's executive director could not quantify the amounts paid out to self-insureds or to third party claimants or insureds with a net worth of $50 million or more, but said it may be significant.

Recommendation

The Department of Insurance and LIGA should work together to develop a mechanism that gets proceeds from liquidated insurance companies to LIGA as soon as they become available.

Matter for Legislative Consideration

The legislature may wish to consider the following:

1. **Reducing the tax credit for LIGA assessments to 50 percent of assessments paid after the year 2003.**
2. **Increasing the deductible for loss claims from $100 to $200 per claim.**
3. **Imposing a $200 deductible for unearned premiums claims.**
4. **Excluding claims for general damages from losses payable by LIGA.**
5. **Excluding claims of self-insureds and third party claimants with net worths of $50 million or more from the definition of a "covered" claim.**

Chapter Three: Abolishing Tax Credits

Chapter Conclusions

Existing tax credits appear to be the property of the insurance companies and thus probably cannot be taken away, and a past attempt to abolish prospective tax credits failed. Furthermore, if tax credits are eliminated or reduced, it will be at least 10 years before the state realizes the full benefit.

Constitution Prohibits Taking of "Property"

Abolishing existing tax credits could be illegal and unconstitutional unless the owners of these credits are compensated. LSA-R.S. 22:1382(A)(3)(c), of the Insurance Guaranty Association Law, gives the members of LIGA the right to show a certificate of contribution as an asset on their balance sheets:

> . . . a member shall at its option have the right to show a certificate of contribution as an **asset** . . . at percentages of the original face amount . . . equal to the unused offset as of each such calendar year. (Emphasis added)

Assets are defined in Black's Law Dictionary as:

> **Property** of all kinds, real and personal, tangible and intangible, including . . . patents and causes of action which belong to any person including a corporation . . .

Article 1, Section 4 of the Louisiana Constitution of 1974 gives every person the right to acquire, own, control, use, enjoy, protect, and dispose of property, subject to reasonable statutory restrictions. However, this section goes on to say that:

> **Property** shall not be taken or damaged by the state . . . except for public purposes **and** with just compensation paid to the owner . . . (Emphasis added)

In other words, if the state were to abolish the tax credit for LIGA assessments, other financial problems could occur. The state may have to compensate the insurance companies for credits taken retroactively to avoid possible costly litigation.

Prior Attempt to Abolish Tax Credit Failed

A previous attempt to abolish the tax credit failed. In the 1993 First Extraordinary Legislative Session, House Bill 25 was introduced to repeal the segment of law which provides for the premium tax offset (tax credit). This legislation did not pass.

Opponents of the legislation argued that the state, through the Department of Insurance, failed to regulate the insurance industry and allowed fiscally unsound insurance carriers to operate in the state. Opponents say that this situation is evidenced by the imprisonment of two former insurance commissioners and that this failure to regulate left consumers with worthless insurance policies. LIGA's funds were depleted because it was called upon to pay the outstanding claims of these insolvent insurance companies.

No Immediate Benefit to Eliminating or Reducing Tax Credit

Without eliminating all existing tax credits, it would take 10 years from the effective date of the abolishment or reduction of the tax credit for the state to realize the full benefit. As described in Exhibit 2-4 in Chapter Two, the tax credits accumulate over time. Insurance companies deduct one-tenth of their assessment for each year and for each prior year until they recover all of their assessments.

Exhibit 3-1 on the following page lists LIGA's estimate of existing tax credits for 1993-1997 and our projections of the tax credits for 1998-2000. The existing tax credits are expected to continue to climb at a rate of $6.8 million per year until they reach $65 million per year in the year 2000. If the tax credit is eliminated or reduced to 50 percent of the assessment, then this figure would begin to slowly decline after that.

Exhibit 3-1 LIGA's Estimate of Tax Credits 1993 through 1997	
Year	**Tax Credits to be Taken**
1993	$27,441,641
1994	30,873,740
1995	31,471,375
1996	38,071,375
1997	44,771,375
1998	*51,571,375*
1999	*58,371,375*
2000	*65,171,375*

Note: The figures in italics were calculated by Legislative Auditor's staff based on the assumption that the tax credits will increase $6.8 million per year.

Source: Prepared by Legislative Auditor's staff from data prepared by LIGA and submitted to the Bond Commission.

Who Should Pay for Insurance Company Insolvencies?

Whether taxpayers or insurance policyholders bear the burden of insurance guaranty funds varies by state. Data from the National Conference of Insurance Guaranty Funds shows that all states allow insurance companies to recoup the guaranty fund assessments in one manner or another.

Only about 35 percent of 53 states and territories allow insurance companies to recoup the assessment for the state's guaranty fund through premium tax offsets (credits). The remaining states and territories allow the assessment to be recouped either through increased rates and premiums or by policyholder surcharge. This data is shown in Exhibit 3-2 on the following page. Appendix A contains detailed information on all 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands.

According to officials at the Department of Insurance, the policyholder would pay more if the assessments are recouped through increased rates and premiums. Insurance agents' fees (which are 15 percent of the rate) would be added on, thus increasing the amount the policyholder would pay for the LIGA assessment.

Exhibit 3-2
Methods of Recouping Insurance Guaranty Fund Assessments

Method	Number of States	Percent
Rates and Premiums	30	56.6%
Premium Tax Offsets (Credits)	19	35.9%
Policyholder Surcharges	4	7.5%
Total	**53**	**100.0%**

Note: This data includes the 50 states, plus District of Columbia, Puerto Rico, and the Virgin Islands.

Source: National Conference of Insurance Guaranty Funds Property/Casualty Guaranty Association 1991 Assessment and Financial Information Report.

Four states allow assessments to be recouped by policyholder surcharges: California, Georgia, Minnesota, and New Jersey. In a telephone interview with the executive director of California's guaranty fund, we learned that California has used the policyholder surcharge since 1982. The insurance companies pay the guaranty fund one percent of their premiums as an assessment. Then, the companies are allowed to assess the one percent to policyholders via a "surcharge." If a company collects more than the one percent through surcharges, the excess is sent to the guaranty fund. Alternatively, if a company collects less than one percent through surcharges, the amount owed to the guaranty fund is reduced.

Matter for Legislative Consideration

The legislature may wish to consider a policyholder surcharge if the LIGA assessment on insurance companies and tax credit are eliminated.

Appendix A

Data on Insurance Guaranty Funds in Other States and Territories

Insurance Guaranty Funds in Other States
1991

State	Assessment Cap	Assessments for 1991(Net)	Unused Capacity	Premium Tax Offsets?	Recoupment Method	Deductible/ Covered Claim	Maximum Paid per Claim
Alabama	1%	$0	$27,697,712	Yes		$100	$150,000
Alaska	2%	2,163,468	8,505,480	Yes		100	300,000
Arizona	1%	0	41,160,545	Yes		100	100,000
Arkansas	2%	0	32,439,461	Yes		none	300,000
California	1%	21,251,454	294,147,396	No	Policyholder surcharge	100	500,000
Colorado	1%	-500,000	26,343,313	No	Rates & premiums	100	100,000
Connecticut	2%	16,456,050	66,160,286	No	Rates & premiums	100	300,000
Delaware	2%	0	0	Yes		none	300,000
Florida	2%	48,119,360	166,623,774	Yes		100	300,000
Georgia	2%	0	107,095,764	No	Rates & premiums	only >$25 paid	100,000
Hawaii	2%	0	22,630,607	No	Policyholder surcharge	none	300,000
Idaho	1%	-1,000,000	6,628,613	No	Rates & premiums	100	300,000
Illinois	1%	11,443,014	90,457,935	No	Rates & premiums	none	300,000
Indiana	1%	1,901,410	38,264,909	Yes		none	$100K/claim; $300K occ.
Iowa	2%	-7,000,000	36,557,569	No	Rates & premiums	100	300,000
Kansas	2%	0	36,810,368	Yes		100	300,000
Kentucky	1%	5,787,386	23,626,759	No	Rates & premiums	none	100,000
Louisiana	2%	62,651,940	0	Yes		100	$150K/claim; $300K/occ.
Maine	2%	7,509,874	14,875,603	No	Rates & premiums	none	300,000
Maryland	2%	3,500,000	75,303,361	No	Rates & premiums	100	$300K/claim;$1,000K/bond
Massachusetts	2%	30,000,000	104,257,839	No	Rates & premiums	none	300,000
Michigan	1%	-808,730	74,158,723	No	Rates & premiums	10	.05% of P/Y Prem
Minnesota	2%	13,425,000	69,422,950	No	Policyholder surcharge	100	300,000
Mississippi	1%	0	17,486,000	No	Rates & premiums	100	300,000
Missouri	1%	7,068,865	31,064,590	Yes		100	300,000
Montana	2%	-4,500,000	10,616,977	No	Rates & premiums	100	300,000
Nebraska	1%	253,176	11,810,406	Yes		100	300,000
Nevada	2%	-1,092,658	18,642,013	Yes		none	300,000
New Hampshire	2%	4,869,688	14,884,927	No	Rates & premiums	50	300,000
New Jersey	2%	20,502,256	123,154,937	No	Policyholder surcharge	none	$300K/claim; $75K/auto claim
New Mexico	2%	0	21,476,420	No	Rates & premiums	25	$100K/claim or claimant
New York	(2)			No	Rates & premiums	none	$1MM/claim; $5 MM/Pol

Insurance Guaranty Funds in Other States
1991

State	Assessment Cap	Assessments for 1991(Net)	Unused Capacity	Premium Tax Offsets?	Recoupment Method	Deductible/ Covered Claim	Maximum Paid per Claim
North Carolina	2%	$5,950,000	$71,932,050	No	Rates & premiums	50	$300,000
North Dakota	2%	0	0	No	Rates & premiums	100	300,000
Ohio	1.50%	28,170,000	77,148,972	No	Rates & premiums	none	300,000
Oklahoma	(1)	-317,015	25,485,225	No	Rates & premiums	none	150,000
Oregon	2%	1,998,621	44,217,932	Yes		none	300,000
Pennsylvania	2%	611,423	154,353,840	No	Rates & premiums	100	300,000
Rhode Island	2%	19,661,783	0	No	Rates & premiums	none	300,000
South Carolina	1%	4,565,554	14,804,933	No	Rates & premiums	250	300,000
South Dakota	1%	0	4,675,115	No	Rates & premiums	100	300,000
Tennessee	1%	0	35,432,439	Yes		100	100,000
Texas	2%	110,855,184	185,908,618	Yes		none	100,000
Utah	2%	0	26,817,879	Yes		100	300,000
Vermont	2%	501,131	9,688,547	No	Rates & premiums	none	300,000
Virginia	2%	10,736,440	74,487,497	Yes		none	300,000
Washington	2%	7,500,000	57,168,653	Yes		100	300,000
West Virginia	2%	2,645,000	5,261,832	No	Rates & premiums	100	300,000
Wisconsin	2%	-3,450,330	70,000,000	Yes		200	$300,000/risk, loss, or life
Wyoming	1%	-750,000	2,748,600	No	Rates & premiums	250	$150K/claimant
District of Columbia	2%	-788,532	14,105,780	No	Rates & premiums	100	300,000
Puerto Rico	2%	0	12,579,171	No	Rates & premiums	50	150,000
Virgin Islands	3%					50	50,000
TOTALS		$429,890,812	$2,499,122,320	Yes=19 No=34			

Sources:
A. Report of the Task Force on Insurance Company Insolvencies (Supplementary Materials), January 1992
B. Assessment amounts taken from National Conference of Insurance Guaranty Funds 1991 Information Report
C. Issues Concerning Insurance Guaranty Funds (June 1992)

Legend:
(1) Lesser of 2% of premium and 1% of surplus as of preceding calendar year
(2) Pre-insolvency fund--Assessments are made before insolvencies occur.

Appendix B

Louisiana Insurance Guaranty Association's Response

LOUISIANA INSURANCE GUARANTY ASSOCIATION
Executive Offices
P.O. Box 15709
Baton Rouge, Louisiana 70895-5709
504/291-4775
504/292-0129 Fax

February 7, 1995

Ms. Kerry E. Fitzgerald, CPA
Performance Audit Manager
Office of the Legislative Auditor
1600 North Third Street
P.O. Box 94397
Baton Rouge, LA 70804-9397

Dear Ms. Fitzgerald:

Thank you for giving LIGA the opportunity to respond to your staff study conducted for the SECURE Project. Following are my comments:

Claim Limits

The report recommends increasing the LIGA deductible. It should be noted that the LIGA deductible is taken in addition to any policy deductible and is even taken on third party claims. This means that the person who is not at fault in an automobile accident, for example, still has the deductible taken from their settlement amount. The statutory deductible causes much confusion for the average claimant, and also is a burden to many at the current $100 level. LIGA's claimants experience financial loss anyway due to length of time it takes for a company to be put into liquidation and the claims to be sent to LIGA. It is often six or more months before claimants receive their checks. This often increases their final costs. Increasing the deductible will only increase the loss, once again, for these claimants.

Most of LIGA's claims are from the insolvencies of minimum liability automobile insurers. Although consumers are forced to carry minimum liability coverage, many already do not because of the cost of this insurance. To those consumers who purchase this coverage to be in compliance with the law, I am sure $200 is a lot of money. If you have a deductible on these types of premiums, it could result in these insureds not purchasing new insurance following an insolvency, adding to the problem of non-compliance with the law.

Definition of a "covered" claim

Your proposal to add a "net worth" provision to the LIGA law is welcome. Those with a net worth of more than $50 million certainly should have the ability to pay their own claims up to the LIGA limits. Also, on first party claims, this type of claimant should have the resources to evaluate and select solvent insurance companies.

Proceeds from liquidated insurance companies

It is agreed that there is a better mechanism needed to get proceeds from liquidated insurance companies to LIGA as soon as they become available. Some type of regular, standardized reporting by liquidators on the assets of the estates might be helpful to accomplish this goal. In many other states, a quarterly report is required that all creditors can examine. This public scrutiny should result in quicker distributions.

Thank you again for the opportunity to add our comments to your report. You and your staff are to be commended for the interest and hard work that has resulted in this very thorough and knowledgeable report.

Please do not hesitate to contact me if I can ever be of any assistance to you.

Sincerely,

Sally A. Nungesser

Sally A. Nungesser
Executive Director