1-1004-54-2
COM/I-86-019-GB

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE MINNESOTA DEPARTMENT OF COMMERCE

In the Matter of the September 16, 1985 Assessment by the Minnesota Life and Health Insurance Guaranty Association.

FINDINGS OF FACT CONCLUSIONS AND RECOMMENDATION

The above-entitled matter came on for hearing before Administrative Law Judge George A. Beck on December 27, 1985 at 9:00 A.M. in Room 400 South of the State Office Building, Capitol Complex, in the City of St. Paul, Minnesota. The hearing continued on December 30 and December 31 of 1985. The record in this matter closed on March 28, 1986 upon receipt of the final written memorandum by a party.

Timothy R. Thornton, Esq., of the firm of Hart, Bruner, O'Brien & Thornton, Suite 700, 1221 Nicollet Mall, Minneapolis, Minnesota 55403, appeared on behalf of IDS Life Insurance Company, Midwest Life Insurance Company, North Central Life Insurance Company, American General Life Insurance Company, Kemper Investors Life Insurance Company, Federal Kemper Life Assurance Company, Early American Life Insurance Company and Intervenors Sun Life Assurance Company of Canada (U.S.), Variable Annuity Life Insurance Company, Executive Life Insurance Company, Manhattan National Life Insurance Company, Lincoln Liberty Life Insurance Company and North American Company for Life and Health Insurance.

Christopher J. Dietzen, Esq., of the firm of Larkin, Hoffman, Daly & Lindgren, Ltd., 1500 Northwestern Financial Center, 7900 Xerxes Avenue South, Bloomington, Minnesota 55431, and John E. Diehl, Esq., of the firm of Larkin, Hoffman, Daly & Lindgren, Ltd., 2000 Piper Jaffray Tower, 222 South Ninth Street, Minneapolis, Minnesota 55402, appeared on behalf of Sun Life Insurance Company of America and John Alden Life Insurance Company. Carl W. Cummins, Esq. , of the firm of Dorsey & Whitney, 510 North Central Life Tower, 445 Minnesota Street, St. Paul, Minnesota 55101, appeared on behalf of Manufacturers Life Insurance Company. Frank J. Walz, Esq., of the firm of Best and Flanagan, 3500 IDS Center, Minneapolis, Minnesota 55402-2113, appeared representing The Minnesota Life and Health Insurance Guaranty Association. Alan 1. Gilbert, Special Assistant Attorney General, 1100 Bremer Tower, Seventh Place and Minnesota Street, St. Paul, Minnesota 55101, appeared on behalf of the Minnesota Department of Commerce.

The following insurers were granted intervenor status for the purpose of filing written briefs only:

Brian M. Quigley, Counsel, The Travelers Companies, One Tower Square, Hartford, Conneticut 06183. Jean M. Crabb, Assistant Vice President, Metropolitan Life Insurance Company, One Madison Avenue, New York, New York 10010-3690. Jack S. Chrisomalis, Associate Counsel, New York Life Insurance Company, 51 Madison Avenue, New York, New York 10010. Herman T. Bailey, Senior Vice President and General Counsel, The Bankers Life Company, 711 High Street, Des Moines, Iowa 50307.

This Report is a recommendation, not a final decision, The Commissioner of Commerce will make the final decision after a review of the record which may adopt, reject or modify the Findings of Fact, Conclusions, and Recommendations contained herein. Pursuant to Minn. Stat. 14.61, the final decision of the Commissioner shall not be made until this report has been made available to the parties to the proceeding for at least ten days. An opportunity must be afforded to each party adversely affected by this Report to file exceptions and present argument to the Commissioner. Parties should contact Michael A. Hatch, Commissioner, Minnesota Department of Commerce, Fifth Floor, Metro Square Building, Seventh and Robert Street, St. Paul, Minnesota 55101, to ascertain the procedure for filing exceptions or presenting argument.

STATEMENT OF ISSUES

The issues in this contested case proceeding are (1) whether the September 16, 1985 assessment by the Board of Directors of the Minnesota Life and Health Guaranty Association was wrongfully computed and (2) if so, whether a new assessment must be calculated not only for the appealing insurers in this case but also for members of the Association who are not appealing parties in this case.

Based upon all of the proceedings herein, the Administrative Law Judge makes the following:

FINDINGS OF FACT

Definitions.

1. An annuity is a contract sold by an insurer in exchange for one or more premiums, in which the insurer promises to make a stream of payments for a lifetime or a period certain. (Tr. I - 55; Ex 66). An annuity is immediate if payments begin to the owner upon receipt of a premium. (Ex. 66; Tr. I - 154, Tr. III - 18). A deferred annuity is one in which payments begin after a deferral period in which one or more payments are accumulated at interest. (Ex. 66; Tr. I - 73, Tr. III - 18). The contract owner typically has the right to either terminate the agreement and receive a lump sum benefit or exercise the annuity option which would provide a stream of payments to the owner. (Ex. 66; Tr. I - 154). With an individual annuity the owner is generally the annuitant or the one who will receive the benefits, and only one benefit option may be purchased. With a group annuity, however, the contract is owned by an entity, such as an employer, to provide benefits for its annuitant/employees. The annuitants may enjoy limited ownership rights which are evidenced by a certificate of participation. (Ex. 66; Tr. III - 18-19,

30).

2. With a single premium deferred annuity (SPDA) the policy owner makes one lump sum premium payment to the insurer. This lump sum payment earns a guaranteed rate of interest during the deferral period. The owner may either withdraw the accumulated account at some point or may elect to purchase an annuity with the accumulated value of his account and receive a fixed monthly or periodic payment. (Ex. 4, p. 3; Ex. 79, 80). The annuitant, or person who will receive payments, is identified in the contract and is the life by which the insurer's obligation to continue payments or pay death benefits is measured. (Tr. II - 192-193).

3. Guaranteed investment contracts (GICs) and deposit administration contracts (DACs) are both unallocated annuities. Unallocated means that an individual annuitant has not been identified. Both GICs and DACs are group deferred annuities. (Tr. III - 19-20). With a GIC an entity makes a deposit with an insurer which then accumulates over a specified period at a guaranteed rate of interest to the benefit of the participants in the entity's plan. (Tr. I - 55, 86; Tr. II - 130; Tr. III - 20; Ex. 27, 61, 62). With a DAC more than one premium may be paid to the insurer, interest rates may vary by the premium, and the contract may not have a defined period for return of the investment. (Tr. II - 131, Tr. III - 20; Ex. 56-58). Both GICs and DACs have annuity options which permit the accumulated deposit to be applied to purchase annuity benefits for plan participants. (Tr. II - 130; Ex. 56, p. 4; Tr. II - 232). GICs and DACs are reviewed when filed with the Department of Commerce like any other annuity. (Tr. I - 56, 93).

4. GICs and DACs are often purchased by pension plans, banks, broker-dealers, or custodians. (Tr. I - 86, Tr. II - 194). The entity submits an application to the insurer which defines how the premium is to be paid and the class of participants. The insurer then decides to provide coverage and returns a written contract. (Tr. III - 21). The contract will identify the plan participants eligible-to apply for annuity benefits by description of a class, but the individuals covered are not named when the contract is issued. (Tr. II - 239). The names of individuals in the plan is known to the entity or owner but is not known to the insurer before an annuity option is exercised (Tr. I - 89). If a plan participant requests the exercise of an annuity option, the owner sends in an application for benefits to the insurer. (Tr. III - 22). A separate contract is then entered into for payment of the annuity to the individual. (Tr. III - 23; Ex. 64). The annuity option is not commonly exercised for GICs and DACs because they are primarily purchased as an investment. (Tr. II - 242).

Background Matters.

5. University Life Insurance Company of America ("University Life") is an insurance company domiciled in the State of Indiana and is a subsidiary company of Baldwin-United Corporation. (Ex. 4, p. 2).

6. National Investors Life Insurance Company ("National Investors Life") is an insurance company domiciled in the State of Arkansas and is a subsidiary company of Baldwin-United Corporation. (Ex. 4, p. 3).

7. Since approximately 1980 over 2,700 single premium deferred annuities ("SPDA's") of University Life and National Investors Life have been sold to Minnesota residents. (Ex. 4, p. 3). These annuities were primarily allocated

group contracts issued, for example, to broker-dealers who sold them to individuals with a certificate of participation that specified a named annuitant. (Tr. I 173, Tr. II - 104). They were sold for investment purposes. (Tr. I 132).

8. As of June of 1983 University Life had approximately 2,620 SPDAs in effect in Minnnesota with an accumulated account value of approximately $51 million. (Ex. 4, p 4; Ex. 79, 80). National Investors Life had approximately
110 SPDAs in effect in Minnesota as of June 1983 which had an approximate accumulated account value of $2 million. (Ex. 4, p. 4).

9. On July 13, 1983, the Marion Circuit Court in Indianapolis, Indiana issued an Order of Rehabilitation which appointed the Indiana Insurance Commissioner rehabilitator of University Life and directed him to take possession of its assets and to administer them under the general supervision of the Court. (Ex. 1).

10. On July 13, 1983 the Pulaski County Circuit Court in Little Rock, Arkansas issued an Order of Rehabilitation which authorized the Insurance Commissioner of the State of Arkansas to take possession of the property of National Investors Life and to conduct its business with a view towards rehabilitation. (Ex. 2).

11. On October 17, 1983 the Indiana and Arkansas rehabilitators jointly proposed a plan of rehabilitation for University Life and National Investors Life. (Ex. 4, p. 5).

12. On November 10, 1983 Minnesota Commissioner of Insurance, Michael A. Hatch, advised The Minnesota Life and Health Insurance Guaranty Association ("Association" or "Guaranty Association") in writing that University Life and National Investors Life were impaired insurers within the meaning of Minn. Stat. 61B.03, subd. 9 (1982). (Ex. 3).

13. The Association's responsibilities under Chapter 61B. of the statutes, after the notice from the Commissioner, was the subject of litigation between the State and the Association in Ramsey County District Court in 1984. On February 8, 1985, the Ramsey County District Court issued its Order requiring the Association to guarantee payments to Minnesota policyholders of University Life and National Investors Life and requiring the Association to assess its members the maximum amount authorized under Chapter 61B. for the purpose of paying the policyholders. (Ex. 4, 5).

14. A plan of rehabilitation for University Life and National Investors Life was approved by the courts in Arkansas and Indiana and became effective may 1, 1984. The plan has a term of three and one-half years and contemplates that the holders of the annuity contracts will receive a substantial portion but not necessarily all of the sums which the companies are obligated to pay. (Ex. 6, p. 2).

15. On March 15, 1985, the Guaranty Association filed a Notice of Appeal of the Order of the Ramsey County District Court. (Ex. 6. p. 3; Tr. II - 105). This appeal and the order of the Ramsey County District Court were subsequently dismissed pursuant to an Order Upon Stipulation signed by the Association and the Commissioner of Commerce. (Ex. 6). The Order Upon Stipulation provided that the Association would make payments to holders of the annuity contracts of University Life and National Investors Life, but not before November 7, 1987, the termination date of the rehabilitation plans. (Ex. 6, p. 5; Tr. II - 106). The Order also provided that the Guaranty

Association would assess its member/insurers in aggregate amounts no less than
$6 million dollars within 90 days of the issuance of the Order Upon Stipulation. (Ex. 6, p. 13; Tr. II - 107).

The Guaranty Association.

16. The Minnesota Life and Health Insurance Guaranty Association is a non-proflt legal entity. All life and health Insurers transacting business In the State of Minnesota are members by law. (Tr. II - 99). The Guaranty Association operates under a plan of operation and through its Board of Directors. (Tr. II - 99). It is under the immediate supervision of the Commissioner of Commerce. (Minn. Stat. 61B.04). The Association is charged by statute with enabling the guarantee of payment of benefits and continuation of coverages to persons holding policies or contracts of impaired insurers. (Minn. Stat. 61B.02, subd. 2). (Tr. II - 98). In 1982 the Board of Directors of the Guaranty Association consisted of seven members. (Ex. 36). There were nine members in 1985 as required by a statutory amendment (Minn. Laws 1 Sp.Sess. 1985, Ch. 10, 57). (Tr. I - 194). The members of.the Board of Directors are selected by member insurers subject to the approval of the Commissioner of Commerce. (Minn. Stat. 61B.05, subd. 1). The Guaranty Association's written plan of operation provides for its administration and is subject to the approval of the Commissioner of Commerce. (Ex. 36). (Minn. Stat. 61B.08, subd. 1). The plan of operation may be and has been amended after the approval of the Commissioner of Commerce. (Ex. 55).

17. The governing statute is entitled The Minnesota Life and Health Insurance Guaranty Association Act, which was passed by the Legislature in 1977. (Minn. Stat. 61B.01 - 61B.16). The Act authorizes the Association to make assessments against its members to make prompt payment of an impaired insurer's contractual obligations to Minnesota residents. (Minn. Stat. 61B.07, subd. 1-3; 61B.06, subd. 2). The assessment is limited to two percent of an insurer's premiums covered by an account, such as the annuity account, each year. (Minn. Stat. 61B.07, subd. 4). If the maximum assessment in any one year is insufficient, additional funds can be assessed as soon thereafter as permitted. (Minn. Stat. 618.07, subd. 5). The liability of the Association cannot exceed $100,000 in cash values, or $300,000 for all benefits, including cash values, with respect to any one life. (Minn. Stat. 61B.06, subd. 8; Tr. II - 99). The Act is based upon

the model (state) Life and Health Insurance Guaranty Association Act adopted by the National Association of Insurance Commissioners. (Ex. 35). There was no controversy about the coverage of the Act at the time of its passage in Minnesota. (Tr. II -- 215).

Actions of the Board of Directors.

18. On April 4. 1985 the Board of Directors of The Guaranty Association conducted a special meeting by telephonic conference call. Participating were the following Directors: George M. Hof, of Western Life Insurance Company; Robert J. Hasling, of the Minnesota Mutual Life Insurance Company; John C Bloom, of North American Life and Casualty Company; Brian M. Quigley, of The Travelers Insurance Company; Jean M. Crabb, of Metropolitan Life Insurance Company; Royce N. Sanner, of Northwestern National Life Insurance Company; Paul E. Brown, of Bankers Life Insurance Company; Cathy Waldhauser, of IDS Life Insurance Company and Kirsten Cecil of Prudential Life Insurance Company. Others also participated in the telephone call, including Richard O'Brien of IDS Life Insurance Company. (Ex. 47, p. 1). The determination of the premium base to be used in making an assessment of the members was

discussed. Mr. Sanner stated that annuity contracts should be included in the premium base only if they had a "clear nexus to a human life". Mr. O'Brien stated that the covered policies under Chapter 61B. should include any contract which has annuity mortality guarantees. (Ex. 47, p. 3-4).

19. By a vote of seven to one the Board of Directors then passed the following motion on April 4, 1985:

> RESOLVED, the premium base to be used in assessments under the terms of the Order shall be all premiums or considerations received by members of this Association from the sale in Minnesota during calendar year 1982 of annuity contracts or annuity certificates, EXCEPT premiums or considerations rising from any annuity contract or any annuity certificate issued under a group annuity contract which was not issued to and owned by an individual, except to the extent of any annuity benefits guaranteed to any such individual by the insurer under any such annuity contract or certificate.

(Ex. 47, p. 4). It was the-Board's intent in adopting this resolution to exclude guaranteed investment contracts (GICs) and deposit administration contracts (DACs) from the assessment base unless the policyholder had applied benefits to individual participants in a plan. (Tr. II - 131). Approximately 16 insurers write 85% of the GICs and DACs in the United States, and approximately 6 companies write 60% of the business. (Tr. I - 136). Included among the large writers of GICs and DACs is Northwestern National Life Insurance Co., Bankers Life Company, The Travelers Insurance Company, Metropolitan Life Insurance Co., and the Prudential Life Insurance Co. (Tr. I - 145).

20. The language of the Association's resolution excluding annuity contracts "not issued to and owned by an individual" from the assessment base and therefore from coverage under the Act means that Minnesota residents who participate in the following plans would be excluded from coverage under the Act:

a. Defined contribution pension plans, such as profit-sharing plans or 401K plans where the employer owns the annuity. In such a plan the employer is obligated to provide only a contribution as opposed to a benefit. (Tr. I - 112-113; Tr. II - 172; Tr. III - 63).

b. Governmental deferred compensation plans where the public employer must own the annuity in order to meet IRS requirements. (Tr. I 115; Tr. III - 64).

C. IRA and Keogh plans where annuities are held by a custodian in order to meet IRS requirements. (Tr. I - 116-17).

d. Structured settlements of a lawsuit in which the defendant casualty company purchases and owns an annuity which provides a stream of payments to the plaintiff. (Tr. I - 117, 169-170).

21. The Board of Directors of the Guaranty Association met in a special meeting by telephonic conference call on April 23, 1985. The Board approved

paragragh 6B of the Order Upon Stipulation which recognized its-determination of the assessment base as approved on April 4 and 16, 1985. (Ex. 47, Ex. 48). The Board also voted to request a legal opinion from the law firm of O'Connor and Hannan concerning the reasonableness of the Board's determination of the assessment base described In the proposed Order Upon Stipulation under the applicable provisions of Chapter 61B. of Minnesota statutes. (Ex. 49, p. 2; Tr. II - 137).

22. On May 20, 1985, Frank J. Walz, Esq., then of the firm of O'Connor and Hannan, submitted a written opinion to the Board of Directors of the Guaranty Association which concluded that the Board's resolution defining the appropriate assessment base for an annuity account assessment, to exclude GICs and DACs as to which deposit funds have not been identified to specific individual employees by annuity option elections, incorporates a reasonable construction of the Minnesota Life and Health Insurance Guaranty Association Act. (Ex. 51; Tr. II - 139).

23. On May 30, 1985, the Commissioner of Commerce sent a questionnaire and instructions to all life insurers authorized to transact business in Minnesota. (Ex. 33, Ex. 34). The questionnaire called for the data necessary to make an assessment under Chapter 61B. of the Minnesota.statutes. The questionnaire called for data consistent with The Guararty Association's premium base determination, namely, "premiums or considerations arising from any annuity contract or any annuity certificate issued under a group annuity contract which was not issued to and owned by an indidivual, except to the extent of any annuity benefits guaranteed to any such individual by the insurer under any such annuity contract or certificate." (Ex. 34, p. 1). However, the questionnaire also asked for "all considerations received from Minnesota residents in calendar year 1982 for individual and group contracts and certificates, including but not limited to, guaranteed investment contracts (GIC), group deposit administration accounts (GDAA) and any immediate or deferred annuity contracts." (Ex. 34, p. 1).

24. On September 13, 1985, the Board of Directors of the Guaranty Association met again by telephonic conference call. Director Cathy Waldhauser of IDS Life Insurance Company, recommended that the Board revise the assessment base described in the Order to include premiums received on group pension business not issued to individuals. After discussion however, the Board passed a motion unanimously calling for a Class C assessment of members of the Association in the aggregate sum of $6 million dollars using the assessment base described in paragraph 6B of the Order Upon Stipulation. (Ex. 52, p. 2).

25. Upon receipt of the questionnaires returned by the members of the Association, the Department of Commerce proceeded to assemble the data for each company. (Ex. 37). This data was then transferred to the Guaranty Association for the computation of an assessment. (Tr. II - 12). The Association proceeded to compute the assessment using the premium figures from line 10 of the questionnaire. (Tr. II - 14). Line 10 excluded annuity

contracts which were not issued to and owned by an individual. This has been
referred to as the "narrow base". Essentially, the assessment was computed by
first dividing the $6 million assessment by the total net premiums of all
companies as reported on line 10. The resulting ratio was then multiplied by
the net premiums reported by each individual insurance company to arrive at
each company's assessment. (Tr. II 18-19). Adjustments also were made to

account for negative premiums for some companies as well as a $10 minimum assessment. (Tr. II - 16, 18; Ex. 38). The Association calculated the assessments for each company on approximately September 6 or 7, 1985. (Ex. 39; Tr. II - 70).

26. Once the assessments had been computed, each member of the Guaranty Association was sent a written notice dated September 16, 1985 which was mailed on approximately September 18, 1985. (Tr. II - 20). The notice advised each company that the total assessment to be made was $6 million and that the total Minnesota annuity premiums were calculated to be $388,862, 911. The notice did not specifically describe how the assessment base had been calculated. The notice listed each company's assessment and stated that it could be satisfied by execution of an attached promissory note or by direct payment to the Association. It requested payment or a signed note no later than October 16, 1985. (Ex. 41). Approximately 260 insurance companies were mailed the notice. (Tr. II - 68).

27. On October 31, 1985 the Guaranty Association sent a duplicate notice and promissory note to each member of the Association who had not responded to the September 16, 1985 notice. (Tr. II - 24; Ex. 42). Approximately 60 insurance companies had not Tesponded as of the end of October and were mailed the second notice. (Tr. II - 26; Ex. 6, Ex. 37). The cover letter asked each member to remit immediately. (Ex. 42). -As of December 16, 1985, approximately 22 companies still showed a balance due on the assessment in a total amount in excess of $2 million dollars. (Ex. 44; Tr. II - 31). As of the date of hearing, however, only approximately six to eight companies had not forwarded a promissory note or a cash payment. (Tr. II - 31). Those companies are Appellants in this case and promised to provide promissory notes during the course of the hearing or immediately thereafter. It is now estimated that the total assessment in Minnesota will be less than $1 million. (Tr. I - 177; Tr. II - 112).

28. The Guaranty Association also computed the assessments for each individual insurance company using the so-called broad base, which means that premium figures did not exclude annuity contracts which were not issued to and owned by an individual. This figure was arrived at by not subtracting Line 8 on the questionnaire from the gross premiums reported. This computation, which was not used in the Association's assessment, resulted in a net premium base for all companies of $641,450,460. (Ex. 49). A comparison of the resulting assessment for certain insurance companies under the narrow base and the broad base is as follows:

Company Name	Narrow Base	Broad Base	Difference If Broad Base Had Been Used
American General Life Insurance Company of Delaware	$ 12,421.51	$ 7,460.15	- $ 4,961.36
Bankers Life Co.	194,389.58	198.861.95	+ 4,472.37
Early American Life Ins. Co.	41,897.79	25,163.11	- 16,734.68
Executive Life Ins. Co.	178,847.11	107,412.57	- 71,434.54
Federal Kemper Life	2,222.19	1,344.65	- 877.54
IDS Life Inc. Co.	797,218.26	509,464.11	- 287,754.15
John Alden Life Ins- Co.	183,285.08	110,077.94	- 73,207.14
Kemper Investors Life Ins. Co.	41,274.77	24,788.94	- 16,485.83
Lincoln Liberty Life Ins. Co.	2,652.13	1,592.83	- 1,059.30
Manhattan National Life Ins. Co.	44,027.04	26,441.90	- 17,585.14
Manufacturers Life Ins. Co.	193,856.04	129,180.10	- 64,675.94
Metropolitan Life Ins. Co.	178,262.24	207,445.62	+ 29,183.38
Midwest Life Ins. Co.	289,027.32	168,698.74	- 120,328.58
Minnesota Mutual Life Ins. Co.	72,788.75	203,401.24	+ 130,612.49
New York Life Ins. Co.	10,389.45	7,636.99	- 2,752.46
North American Company for Life and Health Ins.	12,195.67	7,324.51	- 4,871.16

North American Life and Casualty Co.	26,530.12	21,261.93	- 5,268.19
North Central Life ins. Co.	41,051.98	24,655.13	- 16,396.85
Northwestern National Life Ins. Co.	69,342.28	207,770.00	+ 138,427.72
Prudential Ins. Co. of America	266,364.94	359,535.38	+ 93,170.44
Sun Life Assurance Co. of Canada (US)	209,631.74	125,901.31	- 83,730.43
Sun Life Ins. Co. of America	4,445.33	2,669.79	- 1,775.54
Travelers Ins. Co.	85,840.91	425,047.71	+ 339,206.80

Variable Annuity Life Ins. Co.	172,490.61	103,594.96	68,895.65
Western Life Ins. Co.	3,009.93	1,807.71	1,202.22

(Ex. 39, Ex. 46; tr. II - 45-55).

Appeals.

29. The following members of The Guaranty Association filed timely written notices of appeal of the action of The Guaranty Association in computing the assessment: Early American Life Insurance Company (Ex. 7); IDS Life Insurance Company (Ex. 8); Manufacturers Life Insurance Company (Ex. 9); Sun Life Insurance Company of America (Ex. 10); American General Life Insurance Company (Ex. 11); Midwest Life Insurance Company (Ex. 12); John Alden Life Insurance Company (Ex. 13); Federal Kemper Life Assurance Company (Ex. 14); Kemper Investors Life Insurance Company (Ex. 15); and North Central Life Insurance Company (Ex. 16). Additionally, Sun Life Assurance Company of Canada (U.S.) (Ex. 71); Executive Life Insurance Company (Ex. 72); and Variable Annuity Life Insurance Company (Ex. 72) perfected their appeals within the meaning of Minn. Stat. 61B.09(c), despite a late filing since they demonstrated that they did not have-timely actual notice of the assessment. (Ex. 71, Ex. 72, Ex. 73; Tr. III - 72).

30. In response to the appeals filed by the members of the Guaranty Association the Commissioner of Insurance issued an Order and Notice of Hearing dated October 25, 1985 setting a hearing date of December 16, 1985. (Ex. 17). The Order and Notice of Hearing was served upon all members of the Association. (Ex. 18, Ex.19). On November 26, 1985 the Commissioner of Commerce issued an Amended Order and Notice of Hearing after a prehearing conference in this matter. The Amended Order and Notice of Hearing amended the statement of issues to add the issue of "whether a new assessment must be calculated for member insurers who are not appealing parties in this case" if it is determined that the assessment by the Board of Directors of the Guaranty Association was wrongfully computed. The hearing date was changed to December 27, 30 and 31 of 1985. (Ex. 20). The Amended Order and Notice of Hearing was served upon all member insurers of the Guaranty Association on December 2, 1985. (Ex. 21, Ex. 22).

31. Approximately 60 life insurance companies joined together in September of 1985 to provide an "enhancement plan" consisting of a $50 million fund for nationwide reimbursement of Baldwin-United policyholders. (Ex. 53; Tr. II - 152, 250). Participants in this enhancement plan include The Bankers Life Company, John Alden Life Insurance Company, Kemper Investors Life Insurance Company, Federal Kemper Life Assurance Company, Metropolitan Life

Insurance Company, Minnesota Mutual Life Insurance Company, Northwestern National Life Insurance Company, Prudential Insurance Company of America, Sun Life Assurance Company of Canada, The Travelers Insurance Company, and others. (Ex. 54; Tr. II - 155). Payments to the enhancement plan may become a credit against assessments in the various states. (Tr. II - 197; Tr. III - 62).

Based upon the foregoing Findings of Fact, the Administrative Law Judge makes the following:

CONCLUSIONS

1. That the Commissioner of Commerce and the Administrative Law Judge have jurisdiction in this matter pursuant to Minn. Stat. 61B.09(c) and 14.50.

2. That the Department of Commerce has fulfilled all relevant substantive and procedural requirements of law or rule.

3. That the Department of Commerce has given proper notice of the hearing in this matter.

4. That the burden of proof in this proceeding Is upon the appealing insurer members of the Guaranty Association to prove any facts at issue by a preponderance of the evidence.

5. Minn. Stat. 61B.06, subd. 2 provides that the Guaranty Association shall guarantee covered policies of Minnesota residents and make prompt payment of any contractual obligations due and owing to Minnesota residents of a foreign impaired insurer under an Order of Rehabilitation.

6. Minn. Stat. 61B.07, subd. 3(b) provides that assessments against member insurers for this purpose shall be in proportion that the premiums received on business in this state by each assessed member insurer on policies covered by each account bear to premiums received on business in this state by all assessed member insurers. The Association has established a separate annuity account for the purposes of assessments. Minn. Stat. 61B.04, subd. l(c).

7. "Covered policy" means any policy or contract to which 61B.01 to 61B.16 apply, as provided in 61B.02. Minn. Stat. 61B.03, subd. 6.

8. Minn. Stat. 61B.02, subd. 1 provides that the Act's provisions apply to direct life insurance policies, health insurance policies, and annuity contracts.

9. "Annuity Contracts" means "contracts subject to Chapter 61A. wherein

the policyowner agrees to make payments to the insurer at the beginning of the contract period and the insurer agrees to make payments thereafter to the insured for a specified period of time or until the insured's death." Minn. Stat. 618.03, subd. 3.

10. The purpose of the Act is to "protect policyowners, death benefit certificate holders, insureds, beneficiaries, annuitants, payees, and assignees of life insurance policies, health insurance policies, annuity contracts, and supplemental contracts, subject to certain limitations against failure in the performance of contractual obligations due to the impairment of the insurer issuing the policies or contracts." Minn. Stat. 61B.02, subd. 2.

11. Minn. Stat. 61B.02, subd. 3 provides that "Sections 61B.01 to 61B.16 shall be liberally construed to effect the purpose of sections 61B.01

to 61B.16. Subdivision 2 shall constitute an aid and guide to Interpretation." Subdivision 2 is quoted in part in Conclusion No. 10.

12. That guaranteed investment contracts (GICs) and deposit administration contracts (DACs) and other unallocated annuities are "annuity contracts" and therefore are "covered policies" within the meaning of Minn. Stat. 61B.03, subds. 3 and 6.

13. That the Guaranty Association improperly computed the assessment issued on September 16, 1985.

14. That due to the preceding Conclusion, it is necessary to compute a new assessment and that such an assessment should be calculated not only for the appealing insurers in this case but also for all members of the Guaranty Association.

15. That the above Conclusions are arrived at for the reasons set out in the Memorandum which follows and which is incorporated into these Conclusions.

Based upon the foregoing Conclusions, the Administrative Law Judge makes the following:

RECOMMENDATION

IT IS RESPECTFULLY RECOMMENDED that the Commissioner of Commerce issue an Order requiring the Board of Directors of the Minnesota Life and Health Guaranty Association to recompute its assessment of September 13, 1985, for all members, so that the assessment base includes premiums attributable to annuity contracts not issued to and owned by an individual.

Dated: April 9th, 1986.

GEORGE A. BECK
Administrative Law Judge

NOTICE

Pursuant to Minn. Stat. 14.62, subd. 1, the agency is required to serve its final decision upon each party and the Administrative Law Judge by first class mail.

Reported: Court Reported by Janet R. Shaddix
Janet R. Shaddix & Associates
9100 West Bloomington Freeway
Suite 103
Bloomington, MN 55431

Transcript Prepared.

MEMORANDUM.

This case presents a question of statutory construction. The object of all interpretation and construction of statutes is to ascertain and give effect to the intention of the Legislature. Minn. Stat. 645.16. The statutes must be construed in order to determine whether the actions of the Guaranty Association in assessing its members for the insolvencies of two life insurance companies doing business in the State of Minnesota, was proper. Only "covered policies" are included within the Guaranty Act's protection. The Act requires the Association to make prompt payment on behalf of an impaired insurer to Minnesota residents. The question to be determined then is whether certain annuity contracts generally described as either guaranteed investment contracts (GICs) or deposit administration contracts (DACs) fall within the definition of annuity contracts contained in Chapter 61B., the Minnesota Life and Health Insurance Guaranty Association Act.

Chapter 60A. of the Minnesota statutes relates to the administration of insurance in general. Chapter 61A. relates to the administration of life insurance generally. Annuities are sold only by companies authorized to issue life insurance contracts and an annuity contract is considered part of the life and accident and health insurance portion of the insurance industry. There is no dispute among the parties that GICs and DACs are annuity contracts for the purposes of those two Chapters of the statutes. There is no specific definition of annuity contract in either Chapters 60A. or 61A., however. The question is whether the definition contained in Chapter 61B. is by its terms more restrictive. Minn. Stat. 60A.06, subd. 1(4), for example, speaks in terms of "annuities or endowments of any kind."

The outcome of this case must be controlled by the determination of legislative intent. Therefore, if the Legislature intended that the citizens of this state, including "widows and orphans" should be excluded from coverage if they are employee participants in the pension plan funded by a GIC or a DAC, then that is the appropriate result. Likewise, if the Legislature intended that unallocated annuities (like GICs and DACs) purchased for deferred compensation plans, IRAs or Keogh plans are to be excluded from the Act, then that must be the result even if their inclusion might be more logical in terms of consumer protection. Whether consumers are aware that their participation in plans utilizing GICs or DACs provides them with no coverage under the Act, or whether the Association's interpretation violates the insurance principle of "pooling", is also irrelevant. That having been said, however, it is nonetheless true that the effects of a particular interpretation may be relevant to whether or not that interpretation is proper when matched against the legislative directives contained in Chapter 61B.

The Association's argument in support of its interpretation of Chapter 61B. begins with the definition of "annuity contracts" which is quoted in

Conclusion of Law No. 9. The Association argues that the definition contemplates the existence of an individual insured, capable of death. In the case of GICs or DACs the contracts do not identify specific individuals with rights to annuity benefits. Instead, GICs and DACs have annuity options which permit the purchase of annuity benefits. (Finding of Facts No. 3, 4). Typically the contract identifies the plan participants eligible to apply for annuity benefits by class. However, a separate contract is entered into for the payment of an annuity to an individual. The Association suggests that the

common understanding of an annuity does not include any reference to a human life so that the statutory definition therefore adds a unique qualification when it refers to an insured's "death". In fact, however, several dictionary definitions reference a human lifetime. The American Heritage Dictionary (2nd College Ed.) defines annuity as "An investment on which a person receives fixed payments for a lifetime or a specified number of years." See also, Black's Law Dictionary (Fourth Ed. Rev. 1968) and Finding of Fact No. 1. The statutory definition appears to embody a common understanding rather than an unusual meaning. The Association also argues that had the Legislature intended to include all annuities within the Chapter 61B. definition the "wherein" clause might have been deleted. However, as the Appellants point out the clause does serve the function of making a distinction between "annuity contracts" and "direct life insurance."

An important consideration in determining legislative intent is whether or not the definition of "annuity contract" is ambiguous as it is written. The rules of statutory construction adopted by the Legislature provide that if the definition is clear and free from all ambiguity, the letter of the law shall not be disregarded. However, when the words of a statute are not explicit the intention of the Legislature is to be ascertained by reference to a number of factors. Minn. Stat. 645.16. It Must be concluded that the definition is ambiguous as it stands. It requires a good deal of interpretation to proceed from the words "insured's death"-to the exclusion of GICs and DACs from coverage. The Association's witness admitted that the Act was not a model of clarity in relation to the issue of the determination of the proper assessment base. (Tr. II - 147). Given the ambiguity it is necessary to examine all provisions of Chapter 61B. for clues as to legislative intent, as well as to apply the canons of construction. This issue might have been rendered unambiguous had the Legislature included GICs and DACs within the list of exclusions set out at Minn. Stat. 61B.02, subd. l(a)-(e). For example, in Railroad Roofing & Building Supply Co. v. Financial Fire & Casualty Co., 85 N.J. 384, 427 A.2d 66, 70 (1981), the court found that an addition to the Model Act clearly excluded certain lines of insurance. The Minnesota Legislature made no clear exclusion, however.

Perhaps the most obvious argument in favor of the construction of the definition as urged by the Appellants is that had the Legislature meant to exclude such a large portion of the annuity business from Chapter 61B. it would have clearly said so. No express provision excludes GICs and DACS. Where the Legislature has found it necessary to particularly describe annuities such as GICs and DACS, it has described them with specificity. See, Minn. Stat. 61A.245, subd. 2 and 61A.25, subd. 3b and subd. 4a. The Association points out that these provisions were adopted in 1978 and 1982

while the Act was adopted in 1977. But two of the more specific provisions were, then, reasonably contemporaneous with the Act. If unallocated annuities were well enough understood in the 1978 legislative session to produce a specific definition, the situation could not have been that much different one year before.

Another means of ascertaining the intent of the Legislature in enacting Chapter 61B. is by reference to the model act upon which it was based. The Model Guaranty Association Act adopted by the National Association of Insurance Commissioners (NAIC) was, for the most part, enacted in Minnesota. When the Model Act was drafted in 1970 and when it was adopted in Minnesota in 1977, the record indicates that unallocated or non-individually owned

annuities were common and popular. Single premium deferred annuities, SDPAs were less common. It seems unlikely then that the drafters of the Model Act intended to exclude unallocated annuities without specifically stating that. The drafters of the Model Act specifically invited state legislators to specify types of policies that are to be excluded from coverage under the Act. (Ex. 35, p. 2). The Minnesota Legislature did not choose to specifically exclude GICs and DACs.

The Association has pointed out that the NAIC Model Act contained no definition of "annuity contract." The Model Act suggests that each state will wish to examine its own statutes to determine whether definitions should be added to or deleted from the Model Act. The addition of a definition of annuity contract to the Minnesota Act may have been necessary because the term is not specifically defined elsewhere in Minnesota law, e.g., Chapters 60A. or 61A. Most other states apparently do not have a definition of annuity contract in their Acts. The Association seems to infer that the addition of this definition was meant to restrict coverage in the Guaranty Act. It seems more likely, however, that the definition was added because annuity contracts were not defined elsewhere.

Perhaps equally important in determining the legislative intent is the directions given by a Legislature itself within Chapter 61B. A fundamental rule of statutory construction is that a statute is to be read and construed as a whole so as to harmonize and give effect to all its parts. Van Asperen v. Darling Olds, Inc., 93 N.W.2d 690, 698 (Minn. 1958). Minn. Stat. 61B.02, subd. 3 specifically states that the Act "shall be liberally construed to effect the purpose of 61B.01 to 61B.16. It also states that subdivision 2 shall constitute an aid and guide to interpretation. Subdivision 2, which is quoted in part in Conclusion No. 10 makes it clear that the purpose of the Act is to protect consumers against failure in the performance of contractual obligations due to the impairment of the issuing insurer. Although there is little case law available on the construction of guaranty acts, that which does exist suggests that it should be interpreted as remedial legislation for the protection of consumers. Duchess & Columbia Cooperative Ins. Co. v. State, 367 N.Y.2d 365, 368, aff'd. 43 A.D.2d 769, 350 N.Y.2d 766, aff'd. 36 N.Y.2d 835. 331 N.E.2d 686 (1975). In Louisiana Ins. Guaranty Ass'n. v.

Guglielmo, 276 So.2d 720, 724 (La.App. 1973), the Court saw the purpose of the Act as "protecting the public against financial loss to claimants or policyholders because of insolvency on the part of insurers." One'court analogized the Guaranty Act protection to that of the Federal Deposit Insurance Corporation in relation to the banking industry. Excess and Casualty Reinsurance Ass'n. v. Insurance Comm'r. of State of Calif,, 656 F.2d 491, 492 (9th Cir. 1981).

It seems clear based upon this record, that should the Association's actions prevail, many persons with an interest in an annuity would be outside of guaranty fund protection. The Association acknowledges that if its interpretation is upheld, the Act will not cover annuity products which account for a significant share of total industry business. (Ass'n. brief, p. 37). This would include a large number of employee participants in defined contribution pension plans and profit sharing plans. Also individuals who participate in governmental deferred compensation plans, custodial IRA accounts, custodial Keogh plans and structured settlements would be excluded from coverage under the Act since the annuity contract is owned by someone other than the individual participants in order to gain the advantages of the

tax law. See Finding of Fact NO. 20. Although the Association argued that some of these plans could be structured to secure Act coverage, the preponderance of the evidence in this record establishes otherwise. It seems unlikely that it would be possible to create individual ownership in an annuity contract sufficient to afford Guaranty Act coverage under the Association's interpretation, and still avoid ownership for purposes of federal taxation. Additionally, the adoption of the Association's interpretation had the effect of reducing the assessment base of the assessment under consideration in this case by some $258 million. Given the 2% maximum assessment permissible under the statute this means that approximately $5 million more would have been available to provide coverage for an insolvency if the assessment base included premiums attributable to unallocated annuities. In the event of a major insolvency, it could take more years under the Association's interpretation to provide protection to consumers. These results cannot be easily squared with the Act's direction to protect consumers with interests in annuity contracts.

The Association has also pointed to other provisions of Chapter 61B. which they believe to be indications that GICs and DACs were not intended to be "covered policies." First, 61B.03, subd. 11 defines "premiums" as "direct gross insurance premiums and.annuity considerations . . .." The Association argues that historically annuity considerations received from individual annuities have been reported separately-from unallocated annuities like GICs and DACs. Chapter 61B. does not itself define "annuity considerations." It would appear, however, that the meaning of the phrase is not uniform. For example, the phrase "annuity considerations" was used in the questionnaires sent to member/insurers to collect assessment data to include unallocated annuities. (Ex. 33, 34).

The Association has also cited Minn. Stat. 618.06, subd. 8 to support its interpretation. That provision limits the aggregate liability of the Association to less than $100,000 in cash values, or $300,000 for all benefits, including cash values,."with respect to any one life." The Association suggests that the "one life" reference supports the construction of the definition of annuity contracts to include only contracts in which a specified individual insured is present. It would seem more likely, however, that this language could also refer to a participant in a profit sharing plan since it would be unlikely that the Legislature would intend the limitation on liability to relate only to the policy owner or insured, which could be a large corporation owning millions of dollars of annuity contracts. The "one

life" phrase does not, therefore, necessarily exclude unallocated annuities.

Some light may also be shed on legislative intent by an examination of the similarities and differences between annuity contracts which all parties agree are covered under Chapter 61B. and unallocated annuities. There are a large number of similarities. GICs and DACs, as well as SPDAs provide for the payment of funds to an insurance company in return for the insurer's promise to accumulate those funds at a guaranteed rate of interest. All have annuity options but none of the contracts are sold primarily for that purpose. They are principally investment vehicles and the contract is customarily terminated by a lump sum payment. A very small percentage of either GIC or DAC owners or SPDA owners ever start receiving a stream of annuity payments. The annuity options are seldom exercised. The difference however, is that with GICs or DACS, individual employees to whom annuity payments are to be directed are not identified until the annuity option has been elected by the trustee and the

trustee then identifies the individual to the insurer. There are however. a very large number of characteristics that individual and unallocated annuities have in common. (Ex. 67).

The Association has also advanced a policy argument to the effect that the Legislature may well have intended to exclude unallocated contracts from coverage since they are typically held by large corporations who may be sophisticated enough to select solvent Insurers or able to protect themselves in the event of an insolvency. At least one court however, Cos concluded that a Guaranty Act should provide coverage to a corporation as well as individual claimants or policy holders. In Broadway Bank and Trust Co. v. New Jersey Property-Liability Ins. Guaranty Ass'n., 146 N.J.Supen 80, 368 A.2d 983 (1976), afforded a corporate commercial claimant coverage as against the Association's claim that only individuals were afforded the protection of the Act. 368 A-2d at 986. It is also, of course, true that behind the large corporate "owner" of the annuity are many individuals "participants" who have contributed their money to pay for the annuity.

Finally, two other arguments advanced by the Appellants are persuasive and compel the interpretation supporting a broad based assessment. The Appellants point out that the Association's interpretation of "annuity contract" assumes that an obligation must be directly owed to a person who is capable of dying. The Appellants point out however, that an annuitant may be a measuring life and nothing more. Even if the annuitant must be a natural person that does not necessarily mean that the insured must be a natural person. The statutory definition then may be nothing more than an acknowledgement that annuities frequently measure benefits in terms of a life. Secondly, there is a reasonable interpretation of the definition which permits the conclusion that the broad based assessment is appropriate, i.e., permits a liberal construction as opposed to the Interpretation advanced by the Association. The definition can be interpreted to mean that individual lives must be identified during either a deferral period or the commencement of the benefit period.

GICs and DACs do identify individual lives during the benefit phase of the contract. That is to say that once the annuity option is exercised by a trustee a contract is then entered into with an identified individual. This annuity option is clearly set out in unallocated annuity contracts. The word "thereafter" in the statutory definition may well refer to the commencement of the stream of payments to a person who selects the annuity option. It is therefore concluded that the proper interpretation of Chapter 618. includes unallocated or non-individual annuities as covered policies and that the Association's interpretation to the contrary was improper.

The other issue added to the Notice of Hearing by the Department of Commerce is the question of if the assessment was wrongfully computed whether a new assessment must be calculated for all members of the Association or just for the appealing parties in this case. The Association argues that the only assessments legally subject to recalculation and reassessment would be those of member insurers who took timely appeals. It suggests that since the requirement of a timely appeal is jurisdictional, any result in this contested case proceeding cannot benefit non-appellants. There is, however, case law in Minnesota which seems to suggest that where an assessment for an insolvent insurance company against a member insurer was computed contrary to law, this act renders the entire assessment void. Swing v. H.C. Akeley Lumber Co., 62 Minn. 97, 64 N.W.97, 98 (1895); Minnesota Farmers Mutual Ins. Co. v. Landkammer, 148 N.W. 305, 306 (1914). In Landkammer the court voided an

assessment that charged one class of members a greater amount than another in violation of contract and statute. This case is similar. The fact that the taking of an appeal is jurisdictional, that is to say that a failure to appeal timely would deprive the Commissioner of Commerce of any jurisdiction, does not necessarily mean that only the appellants are entitled to the benefits of prevailing in the contested case proceeding. If the assessment was wrongfully computed it is logically void ab initio and therefore must be redetermined for all members of the Association.

Certain portions of some of the briefs in this case contain alleged facts which were not offered through testimony or exhibits at the hearing. (See, for example, Travelers brief, p. 1-2). Any factual allegations not made a part of the record through oral testimony or the submission of written exhibits at the hearing do not appear in the Findings of Fact in this Report and were not used to support the Conclusions or reasoning contained in this Report The parties devoted a portion of their briefs to a discussion of the common law duties of corporate directors. The self-interest of the directors who supported the interpretation adopted on April 4. 1985 may of course have some relevance to the propriety of that decision. See Findings of Fact Nos. 18. 28. However, since the common law duties of directors is not clearly relevant to the issues set opt in the amended Notice of and Order for Hearing, it is not discussed in this Memorandum.

G.A.B.