Credit for Insolvency Assessments Paid

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Tax Expenditure Evaluation • August 2023 • 2023-TE12

When an insurer with policies written in Colorado is declared insolvent, the Colorado Life & Health Insurance Protection Association (Association) requires other insurers to pay an assessment to cover the claims of policyholders who previously purchased policies from the insolvent insurer. Life and annuity insurers are then allowed to claim a credit, spread evenly over a 5-year period, against their premium taxes owed for the amount of these assessments paid. We considered the purpose of the credit to be to reimburse life and annuity insurers for costs incurred for assessments paid to the Association and to promote stability within the insurance industry.

The credit is meeting its purpose because insurers are generally aware of the credit and most of the available credit amount has been claimed. Additionally, the credit effectively reimburses life and annuity insurers to cover costs associated with assessments paid to the Association.

- According to Division of Insurance staff, the Association, and stakeholders, the credit is commonly known about and used across the industry, providing an important reimbursement for the costs of assessments levied by the Association.

- The credit appears to sufficiently reimburse insurers to cover assessment costs, thereby reducing the risk of instability across insurers in the industry.

- The credit may also prevent the costs of assessments from being passed on to future policyholders in the form of increased policy rates.

Policy Considerations

We did not identify any policy considerations in this evaluation.

Tax Type:	**Insurance Premiums**	Year Enacted:	**1991**
Expenditure Type:	**Credit**	Repeal/Expiration Date:	**None**
Statutory Citation:	**Section 10-20-113(1)(a), C.R.S.**	Revenue Impact (2018 to 2022):	**$305,000**

Purpose given in statute or enacting legislation? **No**

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Background

The Colorado Division of Insurance (Division) is responsible for monitoring and regulating state insurance activity to provide a financially stable insurance market and to protect policyholders if insurance companies no longer have the capital to provide coverage for future claims and benefits of policyholders. The Division determines when an insurance company is in financial distress and should be declared insolvent, at which point the Division assumes control of the company's assets and liabilities and pays the company's outstanding claims.

However, insolvent insurers do not always have the funds necessary to cover outstanding claims and other liabilities. In these cases, the Colorado Life & Health Insurance Protection Association (Association), which was created under Section 10-20-106 and 108, C.R.S, requires its member insurers to pay an assessment to cover the claims of policyholders who previously purchased policies from the insurer that became insolvent. These assessments are called class B assessments (assessments) and they are assessed against all life, annuity, or health insurers that are members of the Association in an amount sufficient to cover the insolvent insurer's outstanding claims. The assessment each insurer pays is proportionate to their market share of premiums collected in the state, capped at 2 percent of each insurance company's average premiums from the most recent 3 years. While health insurers and HMOs may raise policy rates to cover the assessment cost, life and annuity insurers are allowed a premium tax credit to offset the assessment cost.

Technical Note:

Statute defines a member insurer as any insurer that is licensed or holds a certificate of authority in the state to write any kind of insurance [Section 10-20-103(8), C.R.S]. House Bill 23-1303 added health maintenance organizations (HMOs) as member insurers.

The Credit for Insolvency Assessments Paid allows life and annuity insurers to claim a premium tax credit, divided evenly over a 5-year period (i.e., insurers claim 20 percent of their assessment amount paid against their premium taxes each year) following the payment of the assessment to the Association.

Following an assessment, the Association provides insurers with a Credit for Contribution Certificate that outlines the amount of credits they are eligible to claim against their premium tax liability, which insurers submit to the Division when filing their premium tax return.

If a member insurer does not have sufficient tax liability to use the credit, the insurer may carry the credit forward to future years. Additionally, the total combined credit amount that all member insurers can claim is capped at $4 million annually, with excess amounts carried forward; however, based on discussions with the Association, the total amount certified has not exceeded the statutory cap.

While statute does not state a purpose for the Credit for Insolvency Assessments Paid, **we considered the purpose to be to reimburse life and annuity insurers for costs incurred for assessments paid to the Association and to promote stability within the insurance industry.** Specifically, based on our review of legislative audio from the credit's enactment, the General Assembly created the Association, along with assessments, to cover policies that were already purchased to ensure that policyholders were protected during an insolvency. However, there was concern that assessments for life and annuity insurers, who sell fixed premiums and cannot quickly cover additional expenses with a policy rate change, could create additional financial hardships for these types of insurers and lead to instability in the industry and additional insolvencies. Therefore, the General Assembly created the credit to offset the cost of assessments that life and annuity insurers have to absorb. This approach is similar to the policies of other states. All 50 states, including the District of Columbia, have an Association that is part of the National Organization of Life and Health Insurance Guaranty Associations, and 43 states plus the District of Columbia provide a tax credit for insolvency assessments paid by life and annuity insurers. Because health insurers sell policies on a more short-term basis, statute instead allows them to recoup assessment costs through policy rate increases and they are not eligible for the credit.

We considered the intended beneficiaries of the Credit for Insolvency Assessments Paid to be life and annuity insurance companies that can claim the credit to recoup their assessment costs, as well as future policyholders who are likely protected from rate increases due to insurers recouping, rather than passing on, some of the assessment costs.

We developed the following performance measures to evaluate the tax expenditure:

- Are insurers aware of and using the Credit for Insolvency Assessments Paid?

- Does the Credit for Insolvency Assessments Paid effectively reimburse life and annuity insurers to cover costs incurred from assessments paid to the Association, reduce the risk of instability in the industry, and help protect policyholders?

Evaluation Results

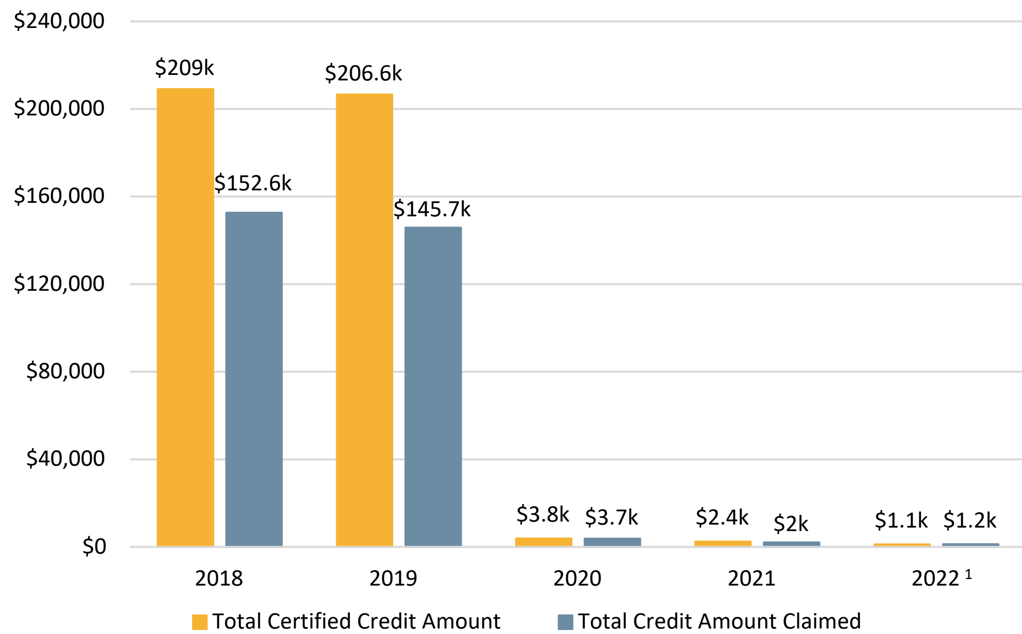
The Credit for Insolvency Assessments Paid is meeting its purpose because insurers are generally aware of the credit and most of the available credit amount has been claimed.

Additionally, the credit effectively reimburses life and annuity insurers to cover costs associated with assessments paid to the Association.

Life and annuity insurers are aware of and claiming the credit. Based on our discussions with Division staff, the Association, and stakeholders, we found that the credit is commonly known and used across the insurance industry. For example, discussions with the Association, member insurers, and trade associations indicated that insurance companies are aware of the credit and the credit provides an important reimbursement for the costs of assessments levied by the Association. In addition, because similar credits are available in most states, insurers that operate in multiple states are likely to be familiar with the credits.

Most insurers claimed the credits they were eligible to claim in recent years. Based on data provided by the Division and the Association, we found that insurers claimed about $305,000 of the nearly $423,000 in credits certified by the Association from Tax Year 2018 through 2022, with a single insurer accounting for nearly 95 percent of the total unclaimed amount. Other insurers' unclaimed amounts were relatively small, ranging from less than $1 to about $5,000 per year. In our discussions with Division staff, they did not know why certain insurers did not claim the full amount of tax credits they were eligible to claim. Exhibit 1 compares the amount of credits insurers claimed and the amount they were certified to claim from Tax Years 2018 through 2022 for a large assessment levied in 2014 and a smaller assessment levied in 2017, which led to higher credit certifications in 2018 and 2019 and lower amounts in subsequent years. As discussed above, insurers are allowed to claim 20 percent of their assessment amount paid as a credit against their premium taxes each year for 5 years. This means that in 2018 and 2019, insurers were able to claim their credits from the larger assessment amount from 2014 and the smaller 2017 assessment.

Exhibit 1
Credits Claimed and Credits Certified for Tax Years 2018 through 2022



Source: Colorado Office of the State Auditor analysis of data provided by the Colorado Division of Insurance (Division) and the Colorado Life & Health Insurance Protection Asssociation.
[1]The amount claimed in Tax Year 2022 is slightly higher than the amount certified, however, the Division did not provide a response to why this occurred.

The Credit provides life and annuity insurers with a sufficient reimbursement to cover assessment costs to reduce the risk of instability in the industry.

Stakeholders indicated that the credit is generally sufficient to cover insurers payments and reduce the financial risks that could occur in the industry as a result of assessments levied against member insurers. Due to the credit being paid over 5 years and inflation reducing the value of money over time, insurers do not receive the full value of the assessments they pay, but the credit covers almost all of it. For example, based on a hypothetical $100 assessment levied against an insurance company, assuming a 2 percent discount rate based on the Federal Reserve Board's target inflation rate, the credit offsets about 94 percent the insurer's assessment costs. However, because assessments in recent years have been relatively small, it is unlikely that they would have had a significant impact on the insurance industry regardless of the credit. For example, the most recent assessment occurred in 2017, with payments from insurers ranging from $2.80 to $852, with a median of $76. While such a small cost is unlikely to have created financial instability for insurers, if more substantial insolvencies resulting in greater assessments levied on member insurers occurred in future years, this would increase the importance of the credit in mitigating insurers' solvency risks.

In addition to meeting its purpose, we also determined that the credit may prevent future policyholders from covering the cost of the assessment through increased policy rates. The credit may also benefit insurance consumers by allowing insurance companies to avoid passing the cost of assessments on to policyholders in the form of higher premiums, although it is unclear the extent to which this would occur in the absence of the credit. Generally, life and annuity insurers are limited in their ability to pass costs on to current policyholders because they cannot raise fixed policy premium rates. However, life and annuity insurers could pass the cost of the assessment on to future policyholders by charging higher life and annuity policy rates. Economic research suggests that consumers' demand for life and annuity insurance is less responsive to price changes, indicating that life and annuity insurers would likely pass on most of the increased cost of assessments in the form of future policy rate increases if they did not receive a reimbursement through the tax credit. Additionally, based on discussions with stakeholders, the credit could be important to smaller domestic insurers in Colorado that receive a relatively larger portion of their premium revenue from Colorado policyholders. Because these insurers have less premium revenue from other states, an assessment in Colorado may be more difficult for them to absorb, as compared to larger insurers for which Colorado policies may make up a small portion of their total premium revenue.

Policy Considerations

We did not identify any policy considerations.

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