Approved February 9, 1988
Date

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE.

The meeting was called to order by Sen. Neil H. Arasmith at
Chairperson

9:00 a.m./~~p.m.~~ on February 3, 1988 in room 529-S of the Capitol.

All members were present except:

Sen. Harder - Excused

Committee staff present:

Bill Wolff, Legislative Research
Myrta Anderson, Legislative Research
Bill Edds, Revisor of Statutes

Conferees appearing before the committee:

Sen. Dave Kerr
Dick Brock, Kansas Insurance Department
Charles Crews, Collins Industry, Hutchinson
Herb Gronemeyer, R.O. Products, Olathe

The meeting began with the Chairman calling the committee's attention to copies of a letter from Richard Kready of KPL Gas Service indicating that he has no concerns regarding SB 489 now but is concerned about future developments. (See Attachment I.)

The minutes of February 2 were approved.

The hearing began on SB 489 concerning captive insurance companies with the testimony of Sen. Dave Kerr. (See Attachments II and III) Sen. Kerr said the bill was copied almost exactly from Vermont legislation so some of it does not fit Kansas' needs, but he has no problem with making necessary changes. He feels SB 489 will enhance corporate activity in Kansas, not inhibit it.

The Chairman questioned Sen. Kerr as to why prohibitions concerning personal liability and health insurance are in the bill if the reason for the bill concerns only products liability and completed works. Sen. Kerr said the only reason they are there is because it is in Vermont law. With regard to line 113, the Chairman asked if the required board of directors meeting to be held in Kansas would apply only to companies formed in Kansas. Sen. Kerr said the intent was not to make them meet once a year in Kansas if the headquarters were in some other state and that this needs to be stated more clearly.

Dick Brock, Kansas Insurance Department, followed with testimony offering suggestions for the bill. The Department has no problem with the concept of captive insurance companies or with the general framework for captive insurance companies this bill would provide for. However, some provisions need further study. For example, association captives, because if one looks at the definition, it seems there is a lot of latitude which invites promoters as opposed to pure captives which is restricted to writing only on its company or its affiliate. If a pure captive fails, the only one hurt is the parent company, but this is not so in the case of association captives. Also, industrial captives need to be looked at. If it is intended that the bill have a broader application than pure captive, then there is a need to place restrictions and definitions of what association and industrial captives can do.

Mr. Brock continued with further suggestions. He said more clarification is needed as to how it relates to foreign (out-of-state) captives. The taxation provision for domestic captives needs to be looked at. Furthermore, to allow reinsurance from other companies needs to be carefully considered. Also, it needs to be clear on workers' compensation fund as to whether captives get more favorable treatment than even the self-insured get. Also, no-fault insurance is involved. Captives cannot write auto insurance, but the company

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE,

room 529-S, Statehouse, at 9:00 a.m./p.m. on February 3, 1988.

captives insure may write auto insurance. Finally, the bill provides for the service process to the Secretary of State, but it needs to be changed to 40-218 with the service process to the Commissioner.

The Chairman asked where the reinsurance provision is located in the bill. Mr. Brock said it is in Section 11, subsection (a), lines 296-298. The Chairman asked further how the Department feels regarding lines 234-235 in Section 7 which does not require captives to make an annual report. Mr. Brock answered that he was not sure because the following section requires an annual report.

Sen. Werts asked for examples of the different types of captives domiciled outside the state but not doing business in Kansas. Mr. Brock said he could not give any examples because there is no way the Department would know unless there had been a problem reported. Also, under the Federal Risk Retention Act, they do not have to comply to Kansas law.

Sen. Karr asked if there would be different types of groups that fit into the pure, association, and industrial captives. Mr. Brock said there would and gave Beech Aircraft as an example of a pure captive. Sen. Warren asked further if captives are like self-insurance. Mr.Brock said that pure captives are a formal means of self-insurance.

The chairman called on Charles Crews of Collins Industries who testified in support of the bill. He said Collins Industries is a manufacturer in Hutchinson with subsidiaries in other states. They manufacture vehicles for special transportation. The electrohydraulic wheelchair is one of its products that has presented most of the product liability cases.

The bill would be beneficial for the State of Kansas and businesses located in the State of Kansas. He explained that product liability insurance went up drastically in 1978 which forced him to go to the Cayman Islands and incorporate a captive insurance company. He added that the Risk Retention Act does not fill the need for captive insurance companies. Seven years later, he went to Vermont for product liability insurance but could not get them interested. By 1985, the best quote was if he could insure for the first million, they would insure the second million for $1 million, which, of course, was not satisfactory. Mr. Crews feels that this bill will get this cost under control in the State of Kansas. At the present time, his company does not have the coverage they would like. This legislation would allow them to form their own captive insurance company. In 1985 they went without insurance for six months, and, therefore, lost contracts on many public vehicles. This legislation would have allowed them to continue the business they lost. This bill was drafted after the Vermont version and has been very successful there so it follows it will be successful in Kansas. It allows structure for companies so they can control their own destiny instead of being swayed by other things. The Vermont version is successful because it is so versatile but is not so liberal that the Insurance Commissioner does not have powers. Mr. Crews concluded by recommending that the bill be adopted as presented because it is so successful in Vermont and has the best of both worlds.

Herb Gronemeyer of R. O. Products, a manufacturer of construction equipment, followed with testimony in support of SB 489. His company has had a difficult time since the product liability crisis in the past few years. In 1986 they could not afford insurance but were able to get some in 1987. They have had difficulty in finding insurance to protect them, and most prospective customers want to see proof of insurance before ordering.

Sen. Werts asked if the product liability bill that Congress is considering would be relative to this bill. Ron Smith, Kansas Bar Association, stood to explain that there would be no relationship as the Congressional bill deals only with the legal side.

There being no further time, the Chairman said the hearing on SB 489 would be continued on February 12.

The meeting was adjourned.

SENATE COMMITTEE

ON

FINANCIAL INSTITUTIONS AND INSURANCE

OBSERVERS
(Please print)

DATE	NAME	ADDRESS	REPRESENTING
2-3-	Bob Arbuthnot	Topeka	KTLA
	LARRY MAGILL	"	IIAK
	Dick Brock	"	Ins Dept.
	WALT DARLING	TOPEKA	DIV. OF BUDGET
	[illegible] Oliver	"	PIA of Ks
	[illegible] Wright	Conexa	Farmers Ins.
	TERRY TIEDE	Topeka	Ins. Dept
	Joe A. Morris	TOPEKA	KCSI
	L M CORNISH	"	Ks Assoc of P/C Ins Cos.
	JERRY SLAUGHTER	TOPEKA	KS. MEDICAL SOCIETY

KPL GAS SERVICE

RICHARD D. KREADY
Director of Governmental Affairs

February 3, 1988

Senator Neil H. Arasmith, Chairman
Financial Institutions and Insurance Committee
State Capitol, Room #128-S
Topeka, Kansas 66612

SB: SB 489
Captive Insurance Companies

Dear Senator Arasmith:

We urge your committee as they work on SB 489, to clarify that the legislation's intent is to provide an easier method for formation of captive insurers in Kansas and not to adversely affect any other captive insurers domiciled outside of the state.

There are many captive insurance companies domiciled outside of the state of Kansas serving many industries such as aviation, manufacturers, chemical companies, gas and electric utility companies, banks, farm implement companies, etc. In conversations I have had with the bill's author, Senator Dave Kerr assured me that it is not his intent to mandate further regulation of those existing captives. Senator Kerr said his intent is to improve the business and economic development climate in Kansas to retain existing and encourage new business through making it easier to "form" captive insurance companies in this state. We hope this is the intent of the full committee which can be demonstrated in the committee minutes or in this bill.

Very truly yours,

Richard D. Kready

Richard D. Kready

RDK:lal

cc: Committee members and staff

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Attachment I

Sen D. Kerr

SB 489 CAPTIVE INSURANCE COMPANIES

Purpose: To make it easier for Kansas companies, principally manufacturers, to form captive insurance companies to insure against product and completed works liability.

Problems with Existing Laws:

Because our existing laws were designed for insurance companies which sell insurance to outsiders, they include measures which are not appropriate for a captive insurance company. Examples include:

- Minimum capital - $900,000
- Minimum surplus - $600,000
- Maximum for one policyholder - 10% of cap & surplus
- Many regulations and examinations

Benefits of enacting a captive law:

* More large and medium sized Kansas companies will pay premiums to Kansas captives rather than out of state insurance companies
* Kansas captives will keep more capital and surpluses in Kansas financial institutions.
* Profitability of Kansas manufacturers will be improved and thereby employment will be enhanced.
* Some additional premium taxes might be collected.

Attachment II

'Captives' Worth $1 Million In Tax Revenue to Vermont

By SUSAN YOUNGWOOD
Free Press Staff Writer

Many United States companies have found a way to lower their insurance costs — and Vermont is benefiting from their discovery.

Companies are creating their own insurance companies — known in the industry as captives — in response to rising liability insurance bills. Many of them are locating these new companies in Vermont, because of a 1981 state law.

There are now 52 captive insurance companies in the state, which makes Vermont the largest domicile of captives in the United States.

"Everyone and his brother wants to set up a captive here," said Edward E. Meehan, chief examiner for the state Department of Banking and Insurance.

With a captive, companies are insuring themselves instead of going to a traditional insurance firm. They can control their losses and their premiums, while not paying for a traditional insurance company's overhead.

Captives started coming to Vermont when the state changed the statutes in 1981. The new law treats captives separately from traditional insurance companies, requiring less capitalization, for example, and not asking for preapproval of forms and rates, like other states do.

Before Vermont changed its law, companies set up captives offshore, mainly in Bermuda and the Cayman Islands. Since 1981, such companies as Boeing, Mobil Corp., Citicorp and Toyota Motors have created captives in Vermont.

The impact of the captives has been substantial.

Last year captives paid $800,000 in state premium taxes. This year, Meehan projects, the tax could exceed $1 million — about the same amount state banks pay.

In the past five years, 10 risk management firms have opened offices in the state. Captives use these firms to manage their policies.

Some of these firms were started in Vermont; others are satellite offices of nationwide companies.

"We have jobs that weren't here before the law," said H. Lincoln Miller Jr., president and founder of Vermont Insurance Management, one of the state's larger management firms.

Vermont Insurance manages a dozen captives, and recently bought a building in Berlin for its five employees.

"We've really grown," he said. "We've gotten five new captives in the last three months."

Vermont attorneys and banks also benefit from the captives, from the additional workload and increased bank deposits.

The three captives that use Vermont National Bank have more than $1 million in deposit accounts, said John Hashagen, senior vice president at the bank.

The captives use the bank to issue letters of credit, for which the bank charges a fee.

"It's good business for the bank," Hashagen said. "They have brought a lot of money into the state."

Vermont also sees increased business

Turn to CAPTIVES, 8C

Captives Lucrative for State

From Page 6C

travel, when the parent company executives visit the state.

Marlin Henning, the risk manager for LLC Corp., runs the firm's captive insurance company from Dallas. Henning comes to Vermont six or seven times each year, sometimes spending a whole week. The captive has a Vermont bank account with a $1 million balance.

Henning explains why his company decided to come to Vermont in 1983.

"One of my selling points here was patriotic — we wanted to bring our money back into the states," Henning said. "It cost a lot less to operate in Vermont (than Bermuda) — the travel is a little bit less, room and board is significantly less, the corporate secretary costs are a lot less."

Other states have captive insurance laws, but Henning chose Vermont.

"Oh, I did look at all the other states. There was just no comparison. Vermont is the best," Henning said.

Being in Vermont, he added, "saves us a lot of money in premiums."

Just because Vermont's law is flexible does not mean the captives are not regulated, risk managers say.

Meehan studies each applicant carefully, turning down captives which are not well-capitalized. Because captives are backed by financially solid, often multimillion-dollar conglomerates, the chances of the captives' going insolvent are slim, Meehan explained, because the whole firm would have to go bankrupt for the captive to collapse.

Plus, he added, "No one in Vermont could be hurt if a captive became insolvent."

The number of captives coming to Vermont started burgeoning when liability insurance became scarce and expensive.

"The insurance crisis is definitely pushing people into our laps," said Vincent Bell, who heads American Risk Management.

Tax law changes also brought more companies to Vermont, and the pending tax reform could bring even more, said Ray Oberg, vice president of M & M Insurance Services Inc., another managment firm.

"Captives will really prove to be a boom for Vermont," he said.

From Sen D. Kerr

Attachment III