

Approved: March 24, 1995
Date

MINUTES OF THE HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE.

The meeting was called to order by Chairperson Bill Bryant at 1:00 p.m. on March 23, 1995 in Room 522 of the Capitol.

All members were present except: Representative Dawson, Excused
Representative Landwehr, Excused
Representative Findley, Excused
Representative Gilbert, Excused
Representative Sawyer, Excused
Representative Smith, Excused
Representative Welshimer, Excused

Committee staff present: Bill Wolff, Legislative Research Department
Bruce Kinzie, Revisor of Statutes
Nikki Feuerborn, Committee Secretary

Conferees appearing before the committee: Bob Storey, Lloyds of London
Jay Greer, Lloyds of London
Don Gaskill, Kansas Insurance Department
Frank Kehrwald, Employers Reinsurance

Others attending: See attached list

Hearing on SB 368--Insurance relating to reinsurance

The bill would allow the transfer of insurance risks by Kansas companies to underwriters (Lloyds of London) without Lloyd's having to secure the risk with cash, securities, or a letter of credit otherwise required of reinsurance companies accepting risks from Kansas companies. The bill establishes a requirement that underwriters, to whom Kansas insurers transfer risks, whether as individuals or as a group incorporated, have other security in a qualified United States financial institution.

Bob Storey, apologized for the lateness of the bill but due to the route the proposed legislation took through the Insurance Department, and then the Ways and Means Committee of the Senate, and ultimately being placed in the Financial Institutions and Insurance Committee.

Jay Greer, Lloyds of London, explained that his company was not an insurance company but a marketplace where approximately 20,000 persons called "Names" participate by accepting insurance risks for their own accounts (Attachment 1). They are a leader in the placement of hard-to-place reinsurance and commercial insurance. They handle reinsurance programs for peril such as tornadoes and hail, medical malpractice, and other forms of professional indemnity. Their financial backing includes more than \$10.8 billion in the Lloyd's American Trust Fund with deposits in Citibank in New York. Passage of the legislation would allow flexibility for Kansas domestic companies to place reinsurance.

Don Gaskill, Kansas Insurance Department, voiced support of the proposed legislation due to the solvency of Lloyds of London. There is a comfort level of trust as Lloyds investments far exceed the \$100 million required for reinsurance companies. Lloyds is not commonly used by many Kansas domestic companies but their services would be available with the passage of this legislation.

Frank Kehrwald, Employers Reinsurance Corporation of Overland Park, Kansas, said they could overlook the deficiencies of the proposed legislation if it also addressed a related deficiency concerning the flexibility of resolving reinsurance disputes among reinsurers (Attachment 2). Arbitration is one common method of resolving reinsurance controversies throughout the world but current legislation prohibits such arbitration in reinsurance disputes in Kansas policies of insurance. Such statutes and case law severely limit the flexibility of resolving controversies concerning reinsurance contracts which may involve underlying insurance policies written anywhere in the world. An amendment correcting the situation was submitted: "...The provisions of subsection (b) shall not apply to (1) contracts of insurance except for those contracts between insurance companies including reinsurance contracts;..."

3/2

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE,
Room 527S-Statehouse, at 9:00 a.m. on March 23, 1995.

The need for this amendment was confirmed by the Kansas Insurance Department. The nature of disputes are due to large mass of torts, toxic waste sites, manufacturing cleanup, asbestos problems, etc. Problems arise where there is a serious loss such as if a company has multiple outlets, would it be considered one loss or a loss at each site? The prohibition of arbitration was to protect customers from insurance companies and force the issue into a court of law. It was never meant to apply to reinsurance companies.

Representative Cox moved to accept the proposed amendment. Motion was seconded by Representative Correll. Motion carried.

Representative Correll moved to report the bill favorably as amended. Motion was seconded by Representative Wilson. Motion carried.

The meeting adjourned at 1:35 p.m.

TESTIMONY OF JAMES A. GREER II
PARTNER, LEBOUF, LAMB, GREENE & MACRAE
IN SUPPORT OF SENATE BILL NO. 368

Background:

This legislation relates in part to Lloyd's of London, for which my law firm, LeBoeuf, Lamb, Greene & MacRae, is United States General Counsel. Lloyd's of London is not an insurance company but a marketplace where approximately 20,000 persons called "Names" participate by accepting insurance risks for their own account. Lloyd's is famous for writing unique coverages, such as Betty Grable's legs. But Lloyd's is far more important as a source of world leadership in the placement of hard-to-place reinsurance and commercial insurance. For example, Lloyd's Underwriters have long led the catastrophe reinsurance programs of insurers throughout the world. In Kansas and elsewhere, reinsurance protection against the perils of damage from tornados and hail has been sought from Lloyd's over the years. Lloyd's Underwriters have also provided substantial amounts of reinsurance for medical malpractice and other forms of professional indemnity coverage written by insurers in the United States and elsewhere. Both of these types of reinsurance have been and continue to be in demand. In addition, Lloyd's Underwriters have traditionally provided reinsurance of a wide variety of hard-to-place health, disability and accident coverages.

Historically, membership at Lloyd's has been restricted to natural persons. To enhance the market's capacity, Lloyd's for the first time admitted Corporate Names beginning in January, 1994. This has enhanced Lloyd's financial strength and has helped maintain its capacity to underwrite difficult-to-obtain coverages, including reinsurance against catastrophes and professional liability.

The Legislation:

The bill adopts without change substantial portions of the National Insurance Commissioners' ("NAIC") Model Credit-for-Reinsurance bill as it was amended in 1993.¹

¹Reinsurance is "insurance of insurance companies." It is a well-recognized contractual arrangement, whereby an insurer can transfer excess risks to other insurers, thereby strengthening its financial condition. When an insurer incurs a loss or other liability that is covered by reinsurance it has ceded to another insurer, it may take credit on its financial statement for the receivable from the reinsurer, provided the reinsurer is licensed or otherwise approved ("accredited") by the insurance regulator in the insurer's state of domicile. Heretofore, Kansas domestic companies could only take credit for reinsurance ceded to other companies licensed in the state of Kansas unless the reinsurer provided the insurer with collateral in the form of cash, marketable securities, or a clean, irrevocable, evergreen letter of credit. As a result, Kansas domestic insurers have less freedom to chose
(continued...)

*Sub bill
June 4-27*

The portions of the bill relating to Lloyd's appear in the last two sentences of Sec. 2: (a). The balance of the bill, which is also taken verbatim from the NAIC model, was included at the request of the Kansas Insurance Department.

The proposed amendments do not alter the primary basis of Lloyd's long-established United States trading privileges, which is the continued existence of the Lloyd's American Trust Fund. In this connection, the Trustee of the Lloyd's American Trust has reported that, as of December 31, 1994, the Lloyd's American Trust Fund amounted to more than \$10.8 billion. We are also informed by Lloyd's that this figure included a surplus over liabilities of more than \$1 billion. The financial trust fund standards for Lloyd's in the existing NAIC-approved provisions in the Model Law relating to Lloyd's are unchanged. The new Lloyd's provisions merely contain technical revisions to the previous version of the Model law required in order to describe Lloyd's more accurately now that it has decided to admit corporate members. The new Lloyd's provisions in the Model also contain language to ensure that these corporate entities are subject to the same solvency controls as the rest of Lloyd's members and that they do not engage in any other business besides participating in the Lloyd's market.

The proposed amendments insofar as they relate to Lloyd's are part of a nationwide effort. The NAIC has already approved these credit-for-reinsurance amendments, and similar amendments have been adopted or enacted in 37 states to date, including South Dakota, Minnesota, New York, California, New Jersey, Pennsylvania and Texas. Of the remaining states, action to amend their laws, where required, is anticipated during the 1995 legislative session. *Pending in an additional 8 states.*

Impact on Kansas

Adoption of the NAIC Model Credit-for-Reinsurance law provisions with the Lloyd's amendments will enable the Lloyd's market to improve its service to Kansas domestic insurers as a leading international market for reinsurance, including such classes as medical malpractice and catastrophe reinsurance, and hard-to-place health, accident and disability risks.

If Lloyd's Underwriters' status as accredited reinsurers is accepted, there could be a reduction in cost or increase in availability to the Kansas domestic insurance companies that now obtain reinsurance from the Lloyd's market. Whether or not they currently cede reinsurance to our clients, Kansas domestic insurers may find there would also be an increase in the attractiveness of their reinsurance cessions with a consequent decrease in the cost or increase in availability of reinsurance, or both, at least some of which benefits would

¹(...continued)

the markets to which they may cede reinsurance than non-domestic insurers licensed to do business in Kansas. In addition, they may have had to pay higher prices for the reinsurance they have purchased. Any attendant increase in costs or decrease in availability of coverage may have been passed to the Kansas policyholders of Kansas domestic insurers.

probably be passed on to Kansas direct policyholders in the form of lower premiums, increased coverage, or both. Kansas domestic companies might also benefit because most of their major competitors are licensed in Kansas but domiciled in other states, and therefore would not be subject to the same inhibitions as those currently suffered by Kansas domestic insurers.

Several states have recently enacted legislation which amend their existing Credit for Reinsurance Laws to recognize corporate members at Lloyd's. They are:

Alabama	SB 11	- Approved: 5/6/94 Effective: 5/6/94
Arizona	HB 2205	- Approved: 4/15/94 Effective: 7/15/94
California	SB 959	- Approved: 9/28/94 Effective: 1/1/95
Connecticut	HB 5381	- Approved: 5/2/94 Effective: 10/1/94
Delaware	HB 478	- Approved: 7/13/94 Effective: 7/13/94
D.C.	#10-128 (Law 10-36)	- Approved: 10/15/93 Effective: 10/15/93
Hawaii	HB 2462	- Approved: 4/28/94 Effective: 4/28/94
Idaho	SB 1347	- Approved: 3/15/94 Effective: 7/1/94
Illinois	HB 2082	- Approved: 1/26/94 Effective: 1/26/94
Indiana	HB 1022	- Approved: 3/18/94 Effective: 7/1/94
Kentucky	HB 426	- Approved: 3/22/94 Effective: 7/12/94
Louisiana	HB 1779	- Approved: 6/23/93 Effective: 8/15/94
Maine	HB 1451	- Approved: 4/12/94 Effective: 7/14/94
Michigan	HB 5309	- Approved: 1/7/95 Effective: 1/7/95
	HB 5310	- Approved: 6/27/94 Effective: 6/27/94
Minnesota	HF 1964	- Approved: 4/13/94 Effective: 8/1/94

Mississippi	HB 640	- Approved: 3/14/94 Effective: 3/14/94
Missouri	HB 1449	- Approved: 6/3/94 Effective: 6/3/94
	SB 687	- Approved: 5/10/94 Effective: 5/10/94
Nebraska	LB 978	- Approved: 3/15/94 Effective: 7/16/94
Nevada	AB 569	- Approved: 7/12/93 Effective: 1/1/94
New Hampshire	SB 574	- Approved: 5/6/94 - Effective: 7/5/94
New Jersey	AB 84	- Approved: 9/9/93 Effective: 9/9/93
New Mexico	HB 558	- Approved: 2/15/94 Effective: 2/15/94
New York	Reg. 20 (7th Amend)	- Adopted: 12/14/93 Effective: 1/1/94
North Carolina	SB 626	- Ratified: 7/5/94 Effective: 7/5/94
North Dakota	SB 2129	- Approved: 3/6/95 Effective: 3/6/95
Oklahoma	SB 936	- Approved: 4/19/94 Effective: 9/1/94
Pennsylvania	31 PA Code (Ch. 161)	- Approved: 8/23/93 Effective: 8/28/93
Rhode Island	SB 3168	- Approved: 7/13/94 Effective: 7/13/94
South Carolina	HB 4495	- Approved: 5/2/94 Effective: 5/2/94
South Dakota	HB 1111	- Approved: 2/9/94 Effective: 9/1/94
Tennessee	HB 2349	- Approved: 3/7/94 Effective: 3/7/94

Texas	HB 1461	- Law w/o Approval: 6/17/93 Effective: 9/1/93
Vermont	SB 341	- Approved: 6/21/94 Effective: 7/1/94
Virginia	HB 646	- Approved: 4/10/94 Effective: 7/1/94
Washington	HB 2370	- Approved: 3/23/94 Effective: 3/23/94
West Virginia	HB 4126	- Law w/o Approval: 3/30/94 Effective: 7/1/94
Wyoming	HB 72A	- Approved: 3/24/94 Effective: 4/1/94

In addition, there are several states where legislation relating to corporate capital is still pending further legislative/regulatory action. These include:

Alaska	SB 53
Arkansas	HB 1892
Colorado	HB 1271
Georgia	HB 41
Iowa	HF 247
Kansas	SB 368
Massachusetts	HB 51
Oregon	HB 2583

EMPLOYERS REINSURANCE CORPORATION

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A General Electric Capital Services Company

March 17, 1995

VIA FACSIMILE TRANSMISSION

Senator Richard Bond, Representative William Bryant
Chairman, Financial Institutions and Insurance Committee
State Capital
Topeka, Kansas 66601

Re: SB 368
K.S.A. § 5-401

Dear Senator Bond and Representative Bryant:

As you may be aware, Employers Reinsurance Corporation (ERC, a property and casualty insurance and reinsurance company) and Employers Reassurance Corporation (ERAC, a life insurance and reinsurance company) are international reinsurers with (worldwide) administrative offices in Overland Park, Kansas. During 1994 ERC transacted \$1,866 million and ERAC transacted \$820 million of insurance and reinsurance gross written premium. As such we are very interested in statutes concerning reinsurance and credit for reinsurance especially in Kansas.

We have recently, (Tuesday March 14, 1995) become aware of S.B. 368 which modifies K.S.A. § 40-221 concerning credit for reinsurance. We understand that S.B. 368 is supported by Lloyds of London, a group of incorporated and unincorporated reinsurers also transacting reinsurance worldwide.

In as much as S.B. 368 (as currently drafted) expands K.S. A. § 40-221 to allow for reinsurance credit (a deduction from loss and unearned premium reserves on ceded risks) for reinsurance ceded to reinsurers not authorized to transact reinsurance in Kansas if secured by a trust fund, ERC and ERAC do not conceptually oppose such expansion of credit for reinsurance because such expansion is in accordance with reinsurance credit allowed by other states. Because S.B. 368 does not address all issues concerning U.S. trust funds, S.B. 368 may be a stop-gap measure which may require further refinement in future years.

House ERD
Attachment 2
3-23-94

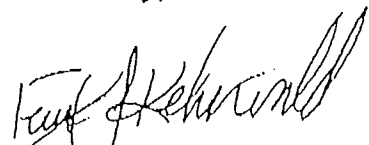
Senator Richard Bond
March 17, 1995
Paage 2

ERC and ERAC could overlook the present deficiencies of S.B. 368 and support S.B. 368 (and its House Bill equivalent) if it also addressed a related deficiency concerning the flexibility of resolving reinsurance disputes among reinsurers. Currently, K.S.A. 5-401 prohibits arbitration of controversies concerning contracts of insurance. Such statute has recently been interpreted to also prohibit arbitration of controversies concerning contracts of reinsurance in a dispute concerning reinsurance of exclusively Kansas policies of insurance. Mutual Reinsurance Bureau v. Great Plains Mutual Insurance Company 969 F.2d 93 (10th Cir., 1992). Such statute and case law severely limit the flexibility of resolving controversies concerning reinsurance contracts which may involve underlying insurance policies written anywhere in the world. And such reinsurance contracts often, in fact, include no Kansas policies among the business reinsured.

ERC and ERAC sincerely believe that S.B. 368 (or its House Bill equivalent) could be greatly improved by also correcting this deficiency in K.S.A. § 5-401 which presently prohibits arbitration of disputes concerning contracts of insurance. Arbitration is one common method of resolving reinsurance controversies, throughout the world. We also sincerely believe that Lloyds syndicates would concur with this improvement. The suggested revision to K.S.A. 5-401 is marked as attached.

If there is anything we could do to assist you with such amendment to S.B. 368 and K.S.A. 5-401, we stand ready to do so. Feel free to contact me directly at 913-676-5480 or fax 913-676-5483.

Yours truly,



Frank J. Kehrwald
Second Vice President and
Associate General Counsel

FJK:ae
C95-0817

Attachment

SUBSTITUTE for SENATE BILL No. 368

By Committee on Financial Institutions and Insurance

3-14

9 AN ACT concerning insurance; relating to reinsurance; amending K.S.A.
10 40-221a and repealing the existing section.
11

12 *Be it enacted by the Legislature of the State of Kansas:*

13 Section 1. K.S.A. 40-221a is hereby amended to read as follows: 40-
14 221a. (a) Any insurance company organized under the laws of this state
15 may (1) with the consent of the commissioner of insurance, cede all of
16 its risks to any other solvent insurance company authorized to transact
17 business in this state or accept all of the risks of any other company, (2)
18 accept all or any part of an individual risk or all or any part of a particular
19 class of risks which it is authorized to insure, and (3) cede all or any part
20 of an individual risk or all or any part of a particular class of risks to
21 another solvent insurer or insurers having the power to accept such re-
22 insurance.

23 (b) Any insurance company organized under the laws of this state
24 may take credit as an asset or as a deduction from loss and unearned
25 premium reserves on such ceded risks to the extent reinsured by an in-
26 surer or insurers authorized to transact business in this state, but such
27 credit on ceded risks reinsured by any insurer which is not authorized to
28 transact business in this state may be taken in an amount not exceeding:

29 (1) The amount of deposits by, and funds withheld from, the assum-
30 ing insurer pursuant to express provision therefor in the reinsurance con-
31 tract, as security for the payment of the obligations thereunder, if such
32 deposits or funds are held subject to withdrawal by, and under the control
33 of, the ceding insurer or are placed in trust for such purposes in a bank
34 which is insured by the federal deposit insurance corporation or its suc-
35 cessor, if withdrawals from such trust cannot be made without the consent
36 of the ceding company; or

37 (2) The amount of a clean and irrevocable letter of credit issued by
38 a bank which is insured by the federal deposit insurance corporation or
39 its successor if such letter of credit is initially issued for a term of at least
40 one year and by its terms is automatically renewed at each expiration date
41 for at least an additional one-year term unless at least 30 days prior written
42 notice of intention not to renew is given to the ceding company by the
43 issuing bank or the assuming company and provided that such letter of

1 credit is issued under arrangements satisfactory to the commissioner of
2 insurance as constituting security to the ceding insurer substantially equal
3 to that of a deposit under paragraph (1) of this subsection; or

4 (3) *the amount of loss and unearned premium reserves on such ceded*
5 *risks to a group of underwriters including incorporated and individual*
6 *unincorporated underwriters, if the assuming underwriters group main-*
7 *tains a trust fund in a qualified United States financial institution, as*
8 *defined in subsection (b)(3)(E), for the payment of the valid claims, as*
9 *determined by the commissioner for the purpose of determining the suf-*
10 *ficiency of the trust fund, of its United States policyholders and ceding*
11 *insurers, their assigns and successors in interest. The assuming under-*
12 *writers group shall report annually to the commissioner information sub-*
13 *stantially the same as that required to be reported on the national asso-*
14 *ciation of insurance commissioners annual statement form by licensed*
15 *insurers to enable the commissioner to determine the sufficiency of the*
16 *trust fund.*

17 (A) *The trust shall consist of a trustee account representing the*
18 *group's liabilities attributable to business written in the United States.*
19 *The group shall maintain a trustee surplus of which \$100,000,000 shall*
20 *be held jointly for the benefit of United States ceding insurers of any*
21 *member of the group. The incorporated members of the group shall not*
22 *be engaged in any business other than underwriting as a member of the*
23 *group and must be subject to the same level of solvency regulation and*
24 *control by the group's domiciliary regulator as are the unincorporated*
25 *members. The group shall make available to the commissioner an annual*
26 *certification by the group's domiciliary regulator and its independent*
27 *public accountants as to the solvency of each underwriter.*

28 (B) *Such trust must be in a form approved by the commissioner of*
29 *insurance. The trust instrument shall provide that contested claims shall*
30 *be valid and enforceable upon the final order of any court of competent*
31 *jurisdiction in the United States. The trust shall vest legal title to its assets*
32 *in the trustees of the trust for its United States policyholders and ceding*
33 *insurers, their assigns and successors in interest. The trust and the assum-*
34 *ing group shall be subject to examination as determined by the commis-*
35 *sioner. The trust, described herein, must remain in effect for as long as*
36 *the assuming group shall have outstanding obligations due under the re-*
37 *insurance agreements subject to the trust.*

38 (C) *No later than February 28 of each year the trustees of the trust*
39 *shall report to the commissioner in writing setting forth the balance of*
40 *the trust and listing the trust's investments at the preceding year end and*
41 *shall certify the date of termination of the trust, if so planned, or certify*
42 *that the trust shall not expire prior to the next following December 31.*

43 (D) *The credit authorized under subsection (b)(3)(A) through (C)*

1 shall not be allowed unless the assuming group agrees in the reinsurance
2 agreements:

3 (i) That in the event of the failure of the assuming group to perform
4 its obligations under the terms of the reinsurance agreement, the assuming
5 group, at the request of the ceding insurer, shall submit to the jurisdiction
6 of any court of competent jurisdiction in any state of the United States,
7 will comply with all requirements necessary to give such court jurisdic-
8 tion, and will abide by the final decision of such court or of any appellate
9 court in the event of an appeal; and

10 (ii) to designate the commissioner or a designated attorney as its true
11 and lawful attorney upon whom may be served any lawful process in any
12 action, suit or proceeding instituted by or on behalf of the ceding com-
13 pany.

14 (iii) This provision is not intended to conflict with or override the
15 obligation of the parties to a reinsurance agreement to arbitrate their
16 disputes, if such an obligation to do so is created in the agreement.

17 (E) A "qualified United States financial institution" means, for pur-
18 poses of those provisions of this law specifying those institutions that are
19 eligible to act as a fiduciary of a trust, an institution that:

20 (i) Is organized, or (in the case of a U.S. branch or agency office of a
21 foreign banking organization) licensed, under the laws of the United States
22 or any state thereof and has been granted authority to operate with fi-
23 duciary powers; and

24 (ii) is regulated, supervised and examined by federal or state author-
25 ities having regulatory authority over banks and trust companies.

26 The foregoing provisions of paragraphs (1) and (2) and (3) of subsec-
27 tion (b) shall not apply to a domestic title insurance company subject to
28 the provisions of K.S.A. 40-1107a and amendments thereto.

29 (c) Any reinsurance ceded by a company organized under the laws of
30 this state or ceded by any company not organized under the laws of this
31 state and transacting business in this state must, pursuant to express pro-
32 visions contained in the reinsurance agreement, be payable by the assum-
33 ing insurer on the basis of the liability of the ceding company under the
34 contract or contracts reinsured without diminution because of the insol-
35 vency of the ceding company and any such reinsurance agreement which
36 may be canceled on less than 90 days' notice must provide in the rein-
37 surance agreement for a run-off of the reinsurance in force at the date
38 of cancellation.

39 Sec. 2. K.S.A. 40-221a is hereby repealed.

40 Sec. 3. This act shall take effect and be in force from and after its
41 publication in the statute book.

Proposed Amendment to Kansas Substitute Senate Bill 368, Relating to Reinsurance

Page 3, by inserting after line 39, the following new section:

"Amend K.S.A. 5-401, Validity of arbitration agreement.

(a) A written agreement to submit any existing controversy to arbitration is valid, enforceable and irrevocable except upon such grounds as exist at law or in equity for the revocation of any contract.

(b) Except as provided in subsection (c), a provision in a written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable except upon such grounds as exist at law or in equity for the revocation of any contract.

(c) The provisions of subsection (b) shall not apply to: (1) contracts of insurance except for those contracts between insurance companies including reinsurance contracts; (2) contracts between an employer and employees, or their respective representatives; or (3) any provision of a contract providing for arbitration of a claim in tort."

Underlined text reflects new language.