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TO THE HOUSE COMMITTEES ON
CONSUMER PROTECTION & COMMERCE
AND JUDICIARY

TWENTY-FOURTH LEGISLATURE
Regular Session of 2008

Thursday, March 13, 2008
2:00 p.m.

TESTIMONY ON SENATE BILL NO. 3023, S.D. 2 – RELATING TO INSURANCE.

TO THE HONORABLE ROBERT HERKES AND TOMMY WATERS, CHAIRS, AND
MEMBERS OF THE JOINT COMMITTEE:

My name is J. P. Schmidt, State Insurance Commissioner (“Commissioner”),
testifying on behalf of the Department of Commerce and Consumer Affairs
(“Department”). The Department strongly supports this Administration bill.

The purpose of this bill is to enhance Hawaii’s position as one of the world’s
leading captive insurance jurisdictions by providing the opportunity for qualified captive
organizers to pursue the securitization of insurance risks through a Hawaii-licensed
captive insurance company and referred to as a “Special Purpose Financial Captive
Insurance Company” (“SPFCIC”). This amended version also provides clarity on
sponsored captive insurance companies. The passage of this bill is necessary to keep
Hawaii at the forefront of the very competitive national and international captive
insurance industry.

Securitization is a financing process that basically allows a company to obtain
current funding from illiquid assets that cannot be readily sold or converted to cash.
Large national and international insurance companies utilize special purpose vehicles,

including SPFCICs, to issue securities to sophisticated capital market investors, and then use the proceeds from the securities to fund their respective operations and/or reserves. This measure proposes to add a new part to Hawaii's existing captive insurance laws to specifically provide for the organization, licensing, operation and regulation of SPFCICs in Hawaii.

The demand for implementing SPFCIC insurance securitization by domestic U.S. life insurers has been very strong over the last three years, with over two dozen transactions involving just over \$10.5 billion. The demand for this type of transaction is anticipated to continue for the next several years as life insurers have to increase their reserves to meet new regulatory reserving standards, as well as catastrophic mortality risks prompted by terrorism and pandemics such as bird flu. SPFCICs are also being explored for other sectors including auto insurance, mortgage insurance and health insurance.

This amended version of the bill also provides an important and timely update for "sponsored captive insurance companies". Sponsored captives are organized by financially strong and operationally stable companies, and allow for the segregation of assets and liabilities ("cells") to insure the risks of the sponsor or those of its customers and clients. This type of captive was enacted in our captive laws in 1999 and was referred to as "Class 4 Leased Capital Facilities". At the time, our "Leased Capital Facilities" was one of the first of its kind in the U.S. and has been used by about 3 captives in Hawaii. However, as the U.S. captive industry has evolved over the last few years, these types of captives have been more commonly referred to as "sponsored captives". These types of captives can be used to insure risks of smaller companies and organizations that may not be large or sophisticated enough to fund their own captive.

We thank this Joint Committee for the opportunity to present testimony on this matter and ask for your favorable consideration.

Alliance Captive Insurance Services, LLC

Wanda L. Jong, CPA, CPCU

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Honolulu, Hawaii 96816

Phone: (808) 737-2000
Fax: (808) 737-2002

wjong@alliancecaptive.com

March 11, 2008

VIA E-MAIL

Representative Robert N. Herkes, Chair
Representative Angus L.K. McKelvey, Vice Chair
Committee on Consumer Protection & Commerce
Hawaii State House of Representatives

Re: SB 3023 SD2 Relating to Insurance

Dear Representatives Herkes and McKelvey:

I am submitting testimony with regard to SB 3023, SD2 relating to insurance, scheduled for committee hearing on Thursday, March 13, 2008 at 2:00 p.m.

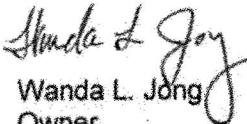
My company is a minority-owned Hawaii small business that services the needs of captive insurance companies domiciled in Hawaii. My clients wrote premiums of approximately \$37 million in 2007 and hold assets in Hawaii banks of about \$19 million.

This bill would allow further opportunities for captives to be formed in Hawaii thereby increasing employment of Hawaii professionals and also additional visitor revenue to the State.

Please support this bill.

Thank you for the opportunity to submit testimony on this important legislation.

Yours truly,


Wanda L. Jong
Owner

TESTIMONY IN SUPPORT OF
S.B. NO. 3023 S.D. 2

THE HOUSE OF REPRESENTATIVES

COMMITTEE ON CONSUMER PROTECTION & COMMERCE

Representative Robert N. Herkes, Chair
Representative Angus L. K. McKelvey, Vice Chair

COMMITTEE ON JUDICIARY

Representative Tommy Waters, Chair
Representative Blake K. Oshiro, Vice Chair

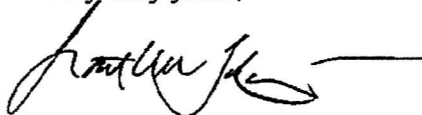
13th day of March, 2008, 2:00 p.m.
State Capitol, House Conference Room 325

My name is Matthew Takamine, Senior Vice President and Office Head of Beecher Carlson Insurance Services, LLC. We thank you for the opportunity to provide this written testimony. Beecher Carlson Insurance Services, LLC is the second largest captive management firm in the State of Hawaii, representing 32 captive insurance companies.

We strongly support S.B. No. 3023 S.D. 2. This legislation is critical in keeping Hawaii competitive as a leading captive insurance domicile in the U.S. and throughout the world. Special Purpose Financial Captive Insurance Companies will allow national and international insurance companies to provide securitization of insurance risks through a Hawaii captive insurance company. Other captive domiciles have had increased activity with regard to securitization captives, and this legislation will help to ensure that Hawaii remains on the forefront as a captive domicile.

We are in strong support of this bill and urge the Committee to pass S.B. No. 3023 S.D. 2. Thank you for this opportunity to testify.

Very truly yours,



Matthew D. R. Takamine, CPA
Senior Vice President
Beecher Carlson Insurance Services, LLC

TESTIMONY ON S.B. NO. 3023, S.D. 2
RELATING TO INSURANCE

HOUSE COMMITTEE ON CONSUMER PROTECTION & COMMERCE

Rep. Robert N. Herkes, Chair
Rep. Angus L.K. McKelvey, Vice Chair

HOUSE COMMITTEE ON JUDICIARY

Rep. Tommy Waters, Chair
Rep. Blake K. Oshiro, Vice Chair

Thursday, March 13, 2008, 2:00 p.m.
State Capitol, Conference Room 325

WRITTEN TESTIMONY ONLY

My name is Gerald C. Yoshida, an attorney in the Honolulu law firm of Char Hamilton Campbell & Yoshida. Our firm provides legal services to a number of captive insurance companies currently licensed in the State of Hawai'i. I am also Chairman of the Hawai'i Captive Insurance Council (HCIC), a trade organization of captive insurance companies and service providers who comprise and support Hawai'i's captive insurance industry.

We strongly support S.B. No. 3023, S.D. 2, which would promote the diversification and development of Hawai'i's captive insurance industry by providing for the securitization of insurance risks through a Hawai'i captive insurance company and clarifying the law with regard to class 4 or "sponsored captive insurance companies."

We believe this bill would enable Hawai'i to maintain its position as a leading captive insurance domicile in the United States and throughout the world. With increasing competition from other domiciles in the United States, it is critical that Hawai'i offers opportunities for securitization and the formation of sponsored captives. This bill will help ensure that Hawai'i will continue to attract new captive formations by reputable business entities in the future.

Thank you for this opportunity to submit testimony on these measures.

Respectfully submitted:

Gerald C. Yoshida
Char Hamilton Campbell & Yoshida
737 Bishop Street, Suite 2100
Honolulu, Hawai'i 96813
Ph: 524-3800



P.O. Box 2815
Honolulu, Hawaii 96803

TESTIMONY IN SUPPORT OF
S.B. NO. 3023 S.D. 2

HOUSE OF REPRESENTATIVES
COMMITTEE ON CONSUMER PROTECTION & COMMERCE
Representative Robert N. Herkes, Chair
Representative Angus L.K. McKelvey, Vice Chair

COMMITTEE ON JUDICIARY
Representative Tommy Waters, Chair
Representative Blake K. Oshiro, Vice Chair

13th day of March, 2008, 2:00 p.m.
State Capitol, Conference Room 325

My name is Denys Kazama, Chair of the Legislative Committee of the Hawaii Captive Insurance Council. As a member of the Hawaii Captive Insurance Council ("HCIC") and Office Head of Marsh Management Services Inc., we thank you for the opportunity to provide this written testimony. HCIC's members represent 164 active captive insurance companies domiciled in the State of Hawaii, and many of the financial institutions, captive insurance managers, accountants, and other professionals and entities that service these Hawaii-domiciled captive insurance companies.

We strongly support S.B. No. 3023 S.D. 2, which would keep Hawaii competitive as a leading captive insurance domicile in the U.S. and throughout the world. Keeping Hawaii at the forefront of the U.S. captive domiciles will ensure that we continue to attract new captive formations by reputable corporations in the future. Special Purpose Financial Captive Insurance Companies will allow national and international insurance companies to provide securitization of insurance risks through a Hawaii captive insurance company. In recent years, we are seeing increased interest and activity in securitization captives in other domiciles such as Vermont and South Carolina.

S.B. 3023 S.D. 2 also includes an amendment introduced by the Hawaii Captive Insurance Council which renames the Class 4 captives (formerly called "leased capital

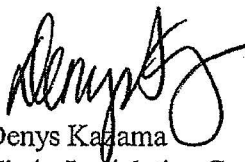
facilities”) to “sponsored captives”. The amendment also proposes a decrease in the minimum capital requirement from \$1,000,000 to \$500,000. Renaming Class 4 captives will enable potential organizers to readily recognize the structure as “sponsored captives” has become the common reference for this captive type.

Although Hawaii is the second largest captive insurance domicile in the United States, we face increasing competition from other states that have recognized the value of implementing captive insurance regulations. While there were only a handful of captive insurance domiciles when Hawaii licensed its first captive insurance company in 1987, there has been a significant increase in U.S. jurisdictions that have enacted captive insurance legislation in recent years.

This is a critical time for Hawaii’s captive insurance industry. By passing this bill you will ensure that Hawaii's captive industry will continue to thrive and develop in an increasingly competitive marketplace. The captive industry in Hawaii has provided professional employment in captive management companies, financial institutions and law firms for Hawaii residents. In addition, local banks and investment firms manage hundreds of millions of dollars in deposits and investments on behalf of the captive insurance companies. Captive insurance companies are required to hold at least one Board meeting a year in the State. As the majority of the captive owners are corporations based outside of Hawaii, this requirement contributes to our visitor industry.

We are in strong support of this bill and urge the Committee to pass S.B. No. 3023 S.D. 2. Thank you for this opportunity to testify.

Respectfully submitted,



Denys Kazama
Chair, Legislative Committee, Hawaii Captive Insurance Council
Office Head, Marsh Management Services Inc.

ARTEX RISK SOLUTIONS, INC.

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TESTIMONY ON S.B. NO. 3023 S.D. 2

HOUSE OF REPRESENTATIVES
COMMITTEE ON CONSUMER PROTECTION & COMMERCE

Rep. Robert N. Herkes, Chair
Rep. Angus L.K. McKelvey, Vice Chair

COMMITTEE ON JUDICIARY

Rep. Tommy Waters, Chair
Rep. Blake K. Oshiro, Vice Chair

13th day of March, 2008, 2:00 p.m.
State Capitol, Conference Room 325

My name is Fay Okamoto, Division Senior Vice President of Artex Risk Solutions, Inc., a subsidiary of Arthur J. Gallagher & Co., the world's fourth largest insurance brokerage firm. We currently serve as the captive manager of fifteen captive insurance companies domiciled in the State of Hawaii, ranging in size from under \$1 million to \$50 million in annual premiums.

We strongly support S.B. No. 3023 S.D. 2, which would support the formation of Special Purpose Financial Captive Insurance Companies for national and international insurance companies to provide securitization of insurance risks through a Hawaii captive insurance company. This bill seeks to provide more specific language for this type of captive, which would be viewed favorably by organizers of these captives. There is increased interest in this type of captive in other captive domiciles.

S.B. 3023 S.D. 2 also includes an amendment related to Class 4 captives (formerly called "leased capital facilities, now proposed to be referred to as "sponsored captives"). This amendment again clarifies language related to this type of captive and reduces the minimum capital requirement from \$1,000,000 to \$500,000.

Hawaii is currently faced with significant competition to attract captive insurance companies to domicile in our state. It is critical that Hawaii maintains its status as a leading domicile for captives.

Not only does the Hawaii captive insurance industry support and provide employment of accounting, insurance, legal, auditing, tax, and banking professionals, it also supports



Hawaii's visitor industry as these captives conduct annual Board meetings in the State each year.

We respectfully request your continued support of this vital and ever-changing industry for the State of Hawaii. Thank you for this opportunity to submit testimony on this bill.

Respectfully submitted:

A handwritten signature in black ink, appearing to read 'Fay Okamoto', written in a cursive style.

Fay Okamoto
Artex Risk Solutions, Inc.



REINSURANCE ASSOCIATION OF AMERICA
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**COMMITTEE ON CONSUMER PROTECTION & COMMERCE
COMMITTEE ON JUDICIARY
Hawaii State House of Representatives
Thursday, March 13, 2008**

Testimony on **SB 3023**, Requesting Amendments

Mr. Chairmen and Members of the Committees:

On behalf of the members of the Reinsurance Association of America (“RAA”), we respectfully submit these comments on Hawaii House of Representatives bill S.B. No. 3023 (the “Bill”).

The RAA is a national trade association representing property and casualty organizations that specialize in reinsurance. The RAA membership is diverse, including large and small, broker and direct, U.S. companies and subsidiaries of foreign companies. RAA underwriting members and their affiliates write more than two-thirds of the gross reinsurance coverage provided by U.S. professional reinsurance companies.

Background

Under HB 3101 “special purpose financial captives” or “SPFCs.” would be permitted. These SPFCs would enable insurers to: (a) transfer certain insurance risks to the broader financial markets; and (b) get insurance financial statement credit for the risk transferred. Conceptually, increasing reinsurance capacity and spreading risk is good.

The Issue

The Bill gives the insurance commissioner essentially unlimited power to authorize special purpose financial captives to provide reinsurance to insurers. Captives, including special purpose financial captives, have a lower capital requirement and weaker financial standards than regular licensed insurers. Licensed insurers are subject to much more conservative financial standards. The apparent logic is that these captives are related to their policyholders in some way and that the policyholders know of the risk presented and are willing to accept it.

In the case of special purpose financial captives, the commissioner can authorize an SPFC to reinsure any or all insurance companies, despite having smaller capital requirements and weaker solvency standards. The RAA believes such discretion is only

appropriate where there is a significant connection or nexus between the ceding insurer and the SPFC. Such a connection lessens the likelihood that the SPFC will be permitted to fail, ultimately harming unknowing consumers and innocent third parties.

The Solution

Requiring a connection between the SPFC and its ceding insurer and strengthening the SPFC's financial foundation will result in a better regulatory environment that will work for captives, their sponsors, and innocent consumers and third parties.

Unaffiliated Transactions Should Not Be Permitted

Section 431:19-D of the Bill states that a Special Purpose Financial Captive insurance company may only insure or reinsure the risks of its counterparty. Section 431:19-C defines "Counterparty" as "the insurer that cedes risk to a special purpose financial captive insurance company which, unless otherwise approved by the commissioner, shall be the parent or an affiliated company of the special purpose financial captive insurance company."

An SPFC should be permitted only to insure or reinsure the risks of its affiliates, parents or other insurance company that sponsored the SPFC. Otherwise, an SPFC essentially becomes a general purpose reinsurer rather than a captive, but is allowed to operate under a different, weaker set of solvency requirements. Moreover, there are no parameters or standards that a commissioner must follow in exercising his discretion under this provision.

Action

The RAA recommends that Section 431:19-C be amended as follows:

"'Counterparty' means the insurer that cedes risk to a special purpose financial captive insurance company which, ~~unless otherwise approved by the commissioner,~~ shall be the parent, ~~or~~ an affiliated company or the insurance company sponsor of the special purpose financial captive insurance company."

Minimum Capital and Surplus Requirement Should Be In Cash

Section 431:19G provides that a SPFC must maintain "unimpaired capital and surplus of not less than \$250,000 in the form of cash or other assets approved by the commissioner."

This minimum capital and surplus should be maintained in cash or in a cash equivalent. As with other insurers, it is important to ensure that the SPFC maintains a degree of liquidity in the event the SPFC finds itself in financial difficulties. Discretion should not be given to the commissioner to waive this important requirement. Moreover, "assets" is not defined and therefore may not be limited to a cash equivalent.

Action

The RAA recommends that Section 431:19-G be amended as follows:

“Minimum capital and surplus. A special purpose financial captive insurance company shall not be issued a license unless it possesses and thereafter maintains unimpaired capital and surplus of not less than \$250,000 in the form of cash or a cash equivalent other assets approved by the commissioner.”

Debt Securities Should Be Accounted For As Debt and Not Surplus

Section 431:19H of the Bill provides that the SPFC may, “[s]ubject to the approval of the Commissioner, account for the proceeds of surplus notes as surplus.”

Debt securities should be accounted for as debt, not as surplus. If this language were adopted, it could allow double counting of and artificially inflate surplus.

Action

We recommend that Section 431:19H of the Bill be deleted in its entirety, as follows:

~~“Subject to the approval of the Commissioner, account for the proceeds of surplus notes as surplus.”~~

SPFCs Should Be Required To Comply With the Captive Laws of Hawaii

Section 431:19-B(c) provides that the commissioner may exempt a SPFC from any provision of this article or from any rule adopted pursuant to Section 431:19-114.

While we understand the desire to create a cutting edge financial services domicile, this section is overly broad and gives the commissioner unfettered discretion without regard for Hawaii’s captive laws. Merely a few bad decisions rendered under this extremely open-ended discretion could wreak havoc on the captive market and the Hawaii insurance industry as a whole. The RAA would suggest deleting this section in its entirety. In the alternative, this section at a minimum should list which provisions the commissioner has discretion to waive.

Action

The RAA recommends that Section 431:19-B(c) be deleted in its entirety, as follows:

~~“The commissioner may, by order, exempt a special purpose financial captive insurance company from any provision of this article or from any rule adopted pursuant to section 431:19-114 if the commissioner determines the provision to be inappropriate, given the~~

~~nature of risks to be insured by the special purpose financial captive insurance company or its approved plan of operation.”~~

Conclusion

Thank you for the opportunity to present the views of the RAA. Please feel free to contact us if you have questions or need further information.

Sincerely,



Dennis C. Burke
Vice President and Director of State Relations



Kimberly M. Welsh
Assistant Vice President and Assistant General Counsel