

The Florida Senate
BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Banking and Insurance Committee

BILL: CS/SB 610

INTRODUCER: Senate Banking and Insurance and Senator Diaz de la Portilla

SUBJECT: Captive Insurance

DATE: December 7, 2011 REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Burgess	Burgess	BI	Fav/CS
2.			BC	
3.				
4.				
5.				
6.				

Please see Section VIII. for Additional Information:

- | | | |
|------------------------------|-------------------------------------|---|
| A. COMMITTEE SUBSTITUTE..... | <input checked="" type="checkbox"/> | Statement of Substantial Changes |
| B. AMENDMENTS..... | <input type="checkbox"/> | Technical amendments were recommended |
| | <input type="checkbox"/> | Amendments were recommended |
| | <input type="checkbox"/> | Significant amendments were recommended |

I. Summary:

Under current law captive insurance is regulated by the Office of Insurance Regulation (OIR) under part V of ch. 628, F.S., which defines a “captive insurer” as a domestic insurer that is owned by, or is under common ownership with, a specific corporation or group of corporations for which the captive insurer provides insurance coverage.¹ Every captive insurer must maintain unimpaired paid-in capital of at least \$500,000 and unimpaired surplus of at least \$250,000.² Current law also specifically defines “industrial insureds” and “industrial insured captive insurer.”³ An industrial insured captive insurer is a captive insurer that is owned by, and provides insurance coverage for, only industrial insureds. An industrial insured must have gross assets in excess of \$50 million, at least 100 full-time employees, and pay annual premiums of at least \$200,000 for each line of insurance. The industrial insured captive insurer must maintain unimpaired capital and surplus of at least \$20 million.

¹ Section 628.901, F.S.

² Section 628.907, F.S.

³ Section 628.903, F.S.

Other than the requirements for captive insurers and industrial insured captive insurers, current law does not delineate any other type of captive insurance.

The bill deletes the current definition of captive insurer and redefines it as meaning a domestic insurer established under part V of ch. 628, F.S., including any of the five following specified types of captive formation, each of which are defined in turn as:

1. Pure captive insurance company means a company that insures the risks of its parent, affiliated companies, controlled unaffiliated business, or a combination thereof.
2. Association captive insurance company means a company that insures risks of the member organizations of the association and their affiliated companies.
3. Captive reinsurance company means a reinsurance company that is formed or licensed under ch. 628, F.S., and is wholly owned by a qualifying reinsurance parent company. A captive reinsurance company cannot directly insure risks, it can only reinsure risks.
4. Special purpose captive insurance company means a captive insurance company licensed under ch. 628, F.S., that does not meet the definition of any other type of captive insurance company.
5. Industrial insured captive insurance company means a company that insures risks of the industrial insureds that comprise the industrial insured group and their affiliated companies.

The bill establishes capital and reserve requirements for each type of captive insurer and removes the current requirement⁴ that captive insurers are also subject to the same level of surplus⁵ specified for various lines of insurance written in this state.

This bill substantially amends the following sections of the Florida Statutes: 628.901, 628.905, 628.907, 628.909, 628.911, 628.913, and 626.7491.

This bill creates the following sections of the Florida Statutes: 628.906, 628.908, 628.910, 628.912, 628.914, 628.9141, 628.9142, 628.918, 628.919, and 628.920.

This bill repeals the following section of the Florida Statutes: 628.903.

II. Present Situation:

Captive Insurance

A captive insurer is an insurance company that primarily or exclusively insures a business entity, or entities, that owns or is an affiliate of the captive insurer. The insured business entities pay premiums to the captive insurer for specified insurance coverages. A captive insurance arrangement can provide a number of benefits, depending on the type of business arrangement, the domicile of the insured business and the captive insurer, and the coverages involved. Some benefits of captive insurance may include:

⁴ See s. 628.909(2)(a), F.S.

⁵ Sections 624.407, F.S., and 624.408, F.S.

- Lower insurance cost. Two elements that an arm's length insurer must recover are acquisition cost (often in the form of agent commissions and advertising) and profit. A captive insurer would not need to factor these elements into the premium it charges.
- Potential tax savings. The premium paid by the insured entity is a deductible expense for Federal income tax purposes, and, under some circumstances, a portion of the captive insurer's income from the collected premium may not be recognized as taxable. Further, a captive insurer may be domiciled in a country where its investment income may receive more favorable tax treatment than in the United States.
- More tailored insurance plan. A captive insurer may be able to create overall savings through coverage and policy provisions that are unique to the individual business being insured.
- Cohesion of interest. Because the control of the insured and the insurer would reside in a single entity, there could be a reduction in some of the areas of potential disagreement over claim verification, investigation and valuation.

In Florida, captive insurance is regulated by the Office of Insurance Regulation (OIR) under Part V of ch. 628, F.S. That part defines a captive insurer to be “a domestic insurer established under part I⁶ to insure the risks of a specific corporation or group of corporations under common ownership owned by the corporation or corporations from which it accepts risk under a contract of insurance.”⁷ Captives may apply to OIR to provide commercial property, commercial casualty, and commercial marine insurance coverage, except workers' compensation or employer's liability insurance.⁸ An industrial insured captive insurer, however, may provide workers compensation and employer's liability insurance, but only in excess of at least \$25 million in the annual aggregate.⁹ Section 628.903(2), F.S., defines an “industrial insured captive insurer” as a captive insurer that:

- Has as its stockholders or members only industrial insureds¹⁰ that are insured by the captive;
- Provides insurance only to the industrial insureds that are its stockholders or members and affiliates of its parent cooperation, or provides reinsurance to insurers only on risks written for the industrial insureds who are stockholders or members and affiliates of the industrial insured captive or its parent company; and
- Maintains unimpaired capital and surplus of at least \$20 million.

Section 628.907, F.S., requires all captives to maintain unimpaired paid-in capital of at least \$500,000 and unimpaired surplus of at least \$250,000. Section 628.909, F.S., further requires that all captive insurers are also subject to the same level of surplus¹¹ that is specified for various lines of insurance written in this state.

⁶ Part I of ch. 628, F.S., is entitled “STOCK AND MUTUAL INSURERS: ORGANIZATION AND CORPORATE PROCEDURES.”

⁷ Section 628.901, F.S.

⁸ section 628.905(1), F.S.

⁹ Section 628.905(6), F.S.

¹⁰ Section 628.903(1), F.S. An industrial insured must have gross assets in excess of \$50 million, at least 100 full-time employees, and pay annual premiums of at least \$200,000 for each line of insurance.

¹¹ Sections 624.407, F.S. and 624.408, F.S.

III. Effect of Proposed Changes:

Section 1 – Amends s. 628.901, F.S., to delete the current definition of captive insurer and redefines it as meaning a domestic insurer established under part V of ch. 628, F.S., including any of the four following specified types of captive formation, each of which are defined in turn as:

1. Pure captive insurance company means a company that insures the risks of its parent, affiliated companies, controlled unaffiliated business, or a combination thereof.
2. Association captive insurance company means a company that insures risks of the member organizations of the association and their affiliated companies.
3. Special purpose captive insurance company means a captive insurance company licensed under ch. 628, F.S., that does not meet the definition of any other type of captive insurance company.
4. Industrial insured captive insurance company means a company that insures risks of the industrial insureds that comprise the industrial insured group and their affiliated companies. An industrial insured captive insurance company can also provide reinsurance only on risks written for the industrial group.

In addition to defining the specific types of authorized captive insurance company formations, the bill provides twelve more definitions, including the following:

- “Affiliated company” means a company in the same corporate system as a parent, an industrial insured, or a member organization by virtue of common ownership, control, operation, or management.
- “Association” means a legal association of individuals, corporations, limited liability companies, partnerships, political subdivisions, or associations that has been in continuous existence for at least 1 year.
- “Captive reinsurance company” means a reinsurance company that is formed or licensed under ch. 628, F.S., and is wholly owned by a qualifying reinsurance parent company. A captive reinsurance company cannot directly insure risks, it can only reinsure risks.
- “Controlled unaffiliated business” means a company that is not in the corporate system of a parent, but that has an existing contractual relationship with the parent or affiliated company and has its risks managed by a captive insurance company.
- “Industrial insured” means an insured that: (a) has gross assets in excess of \$50 million; (b) procures insurance through the use of a full-time employee of the insured who acts as an insurance manager or through the services of a person licensed as a property and casualty insurance agent, broker, or consultant in that person’s state of domicile; (c) has at least 100 full-time employees; and (d) pays annual premiums of at least \$200,000 for each line of insurance purchased from the industrial insured captive insurer or at least \$75,000 for any line of coverage in excess of at least \$25 million in the annual aggregate.
- “Qualifying reinsurer parent company” means a reinsurer that is authorized in Florida to write reinsurance and that has a consolidated GAAP net worth of at least \$500 million and a consolidated debt to total capital ratio of no more than 0.50.

Section 2 –Amends s. 628.905, F.S., to require captives to apply for their license through the commissioner of insurance at the OIR. The bill allows captives to write any insurance authorized by the insurance code except workers compensation, health, personal motor vehicle, or personal residential property insurance, with the following restrictions:

- A pure captive insurance cannot insure any risks other than those of its parent, affiliated companies, controlled unaffiliated businesses, or a combination thereof.
- An association captive insurance company cannot insure any risks other than those of the member organizations of its association and their affiliated companies, and must provide on the first page of the policy certain disclosures specified in the bill.
- An industrial insured captive insurance company cannot insure any risks other than those of the industrial insureds that comprise the industrial insured group and their affiliated companies.
- A special purpose captive insurance company can only insure the risks of its parent.
- A captive insurance company may not accept or cede reinsurance except as explicitly provided.

The bill requires that to conduct business in Florida, a captive must obtain from OIR a license to conduct insurance in Florida and must: hold at least one board of directors' meeting each year in Florida; maintain its principal place of business in Florida; and appoint a resident registered agent to act on its behalf in Florida.

Before receiving a license, a captive formed as a corporation must file with the OIR:

- A certified copy of its articles of incorporation and bylaws;
- A statement of its financial condition under oath by its president and secretary;
- Evidence of the amount and liquidity of the proposed captive's assets relative to the risks to be assumed;
- Evidence of adequate expertise, experience, and character of the person(s) who will manage the company;
- Evidence of the overall soundness of the company's plan of operation;
- Evidence of adequate loss prevention programs of the company's parent, member organizations, or industrial insureds; and
- Any other factors considered relevant by the OIR in determining whether the company will be able to meet its obligations.

The bill provides that a captive insurer or a captive reinsurance company must pay to the OIR a nonrefundable fee of \$1,500 for processing the application, and an annual renewal fee of \$1,000. The OIR may also charge \$5 for any document requiring authentication.

Upon approval by the OIR, a foreign or alien captive insurance company may become a domestic captive insurance company by complying with the requirements of a domestic captive insurance company, and filing the necessary organizational documents with the Secretary of State, along with a certificate of good standing issued by the OIR.

The bill retains the provision in current law that an industrial insured captive insurer does not need to be incorporated in Florida if it has been validly incorporated in another jurisdiction.

Section 3 – Creates s. 628.906, F.S., relating to restrictions on eligibility of officers and directors. The bill requires that a prospective captive insurer filing for a license under s. 628.905, F.S., must include background investigations, biographical affidavits, and fingerprint cards as evidence of the trustworthiness and competence of its officers and directors. OIR may deny,

suspend or revoke the certificate if a captive insurer's officer or director served in that capacity for an specified entity that became insolvent within 2 years of the service of the officer or director, unless the officer or director demonstrates that he or she did not contribute to the insolvency. OIR may deny, suspend or revoke the captive insurer's certificate if any person who has the ability to exercise control or influence over the captive insurer has been found guilty of any felony crime involving moral turpitude punishable by imprisonment of 1 year or more.

Section 4 –Amends s. 628.907, F.S., establishing the following amounts of unimpaired paid-in capital and net assets:

- Pure captive must have at least \$100,000 of unimpaired paid-in capital, and in the case of a pure captive incorporated as a stock insurer, at least \$250,000 of unrestricted net assets.
- Association captive must have at least \$400,000 of unimpaired paid-in capital.
- Industrial insured captive incorporated as a stock insurer must have at least \$200,000 of unimpaired paid-in capital.
- Special purpose captive insurance company must have an amount of unimpaired paid-in capital and unrestricted net assets determined by the OIR.

The bill provides that the OIR may prescribe additional capital or net asset requirements, depending on the type, volume, and nature of the insurance. The bill states a captive insurance company may not pay a dividend out of capital or surplus in excess of the limitations specified in ch. 628, F.S., without the prior approval of the OIR.

Section 5 - Creates s. 628.908, F.S., relating to surplus requirements and restrictions on payment of dividends. The bill states that the OIR may not issue a license to a captive insurance company unless the company possesses and maintains unimpaired surplus of:

- For a pure captive insurance company, at least \$150,000.
- For an association captive insurance company incorporated as a stock insurer, at least \$350,000.
- For an industrial insured captive insurance company incorporated as a stock insurer or organized as a limited liability company, at least \$300,000.
- For an association captive insurance company incorporated as a mutual insurer, at least \$750,000.
- For an industrial insured captive insurance company incorporated as a mutual insurer, at least \$500,000.
- For a special purpose captive insurance company, an amount determined by the OIR.

The bill states a captive insurance company may not pay a dividend out of capital or surplus in excess of the limitations set forth in ch. 628, F.S., without the prior approval of the OIR.

Section 6 – Amends s. 628.909, F.S., relating to the applicability of other statutory provisions to captive insurers. Among other changes, the bill exempts captives from the requirements of:

- Sections 624.407, F.S., and s. 624.408, F.S., which, under current law require that that captives maintain the same level of surplus specified for various lines of insurance in this state.
- Section 624.4085, F.S., which defines the requirements for risk-based capital for insurers in Florida.

- Section 624.4095, F.S., which establishes standards for required ratios of written premiums to surplus for various lines of insurance.

Section 7 – Creates s. 628.910, F.S., relating to incorporation options and requirements. The bill provides that:

- A pure captive insurance company may be incorporated as a stock insurer with its capital divided into shares and held by the stockholders, or incorporated as a public benefit, mutual benefit, or religious nonprofit corporation.
- An association captive insurance company or an industrial insured captive insurance company may be incorporated as a stock insurer with its capital divided into shares and held by the stockholders, or incorporated as a mutual insurer without capital stock, the governing body of which is elected by the member organizations of its association.

The bill provides that a captive insurance company must have at least three incorporators, of whom at least two must be residents of Florida. The bill provides that for a captive insurance company formed as a corporation, before the articles of incorporation or organization are transmitted to the Secretary of State, the incorporators must file in triplicate the articles of incorporation with the OIR. If OIR finds the articles to conform with law, it will endorse its approval and return two sets of the articles to the incorporators for submission to the Department of State.

In the case of a captive insurance company formed as a corporation or a nonprofit corporation, at least one of the members of the board of directors must be a resident of Florida. The bill specifies that a captive formed as a corporation will be subject to all provisions of the general corporation law, as well as the provisions of ch. 628, F.S. If there is a conflict between the general corporation law and ch 628, the provisions of ch. 628, F.S., will govern.

Section 8 – Amends s. 628.911, F.S., relating to reports and statements. The bill requires captive insurance companies and captive reinsurance companies to submit an annual report on financial condition to the OIR before March 1st. The bill retains current law requiring the report to be verified by oath from two executive officers, and the report must be compiled using generally accepted accounting principles unless the OIR approves alternative accounting measures. The bill retains the provision in current law allowing the Financial Services Commission to adopt by rule the form in which captive insurers must report.

The bill allows a captive insurer to apply for filing the annual report on a fiscal year-end that is consistent with its parent company's fiscal year-end. If an alternative reporting date is granted the report is due 60 days after the parent company's fiscal year end.

Section 9 – Creates s. 628.912, F.S., relating to discounting of loss and loss adjustment expense reserves. The bill allows a captive reinsurance company to discount its loss and loss adjustment expense reserves at treasury rates applied to the expected payment pattern associated with the reserves. A captive reinsurance company must file annually an actuarial opinion on the loss and loss adjustment expense reserves provided by an actuarial opinion on loss and loss adjustment expense reserves provided by an independent actuary. The actuary may not be an employee of the captive company or its affiliates.

Section 10 – Amends s. 628.913, F.S., relating to captive reinsurance companies. The bill allows a captive reinsurance company to apply to the OIR for a license to write reinsurance covering property and casualty insurance or reinsurance contracts. A captive reinsurance company authorized by the OIR may write reinsurance contracts covering risks in any state; however, a captive reinsurer is not allowed to directly insure risks.

The bill requires that to conduct business in this state, a captive reinsurance company must:

- Obtain from the OIR a license authorizing it to conduct business as a captive reinsurance company in this state;
- Hold at least one board of directors' meeting each year in Florida;
- Maintain its principal place of business in Florida; and
- Appoint a registered agent to accept service of process and act on its behalf in Florida.

Additionally, before receiving a license, a captive reinsurance company must file with the OIR:

- A certified copy of its charter and bylaws.
- A statement under oath of its president and secretary showing its financial condition.
- Other documents required by the OIR.
- Evidence of the amount of liquidity of the captive reinsurance company's assets relative to the risks to be assumed.
- Evidence of the adequacy of the expertise, experience, and character of the person who manages the company.
- Evidence of the overall soundness of the company's plan of operation.
- Other overall factors considered relevant by the OIR in ascertaining if the company would be able to meet its policy obligations.

Section 11 – Creates s. 628.914, F.S., relating to minimum capitalization and reserves for captive reinsurance companies. The bill states the OIR may not issue a license to a captive reinsurance company unless the company possesses and maintains capital or unimpaired surplus of the greater of \$300 million or 10% of reserves. The surplus may be in the form of cash or securities. The OIR may prescribe additional capital or surplus based upon the type, volume, and nature of the insurance business transacted. Further, a captive reinsurance company may not pay a dividend out of capital or surplus in excess of these limitations without the prior approval of the OIR.

Section 12 – Creates s. 628.9141, F.S., relating to incorporation of a captive reinsurance company. The bill requires a captive reinsurance company must be incorporated as a stock insurer with its capital divided into shares and held by its shareholders. A captive reinsurance company must have at least three incorporators of whom at least two must be residents of Florida. The capital stock must be issued at a par value of at least \$1 and no more than \$100. At least one of the board of directors must be a resident of Florida.

Section 13 – Creates s. 628.9142, F.S., relating to provisions on the effect of reinsurance on required reserves. The bill allows a captive insurance company to provide reinsurance on risks ceded by any other insurer. Additionally, a captive insurance company may take credit for reserves on risks ceded to authorized insurers or reinsurers and unauthorized insurers or reinsurers complying with s. 624.610, F.S.

Section 14 – Creates s. 628.918, F.S., relating to management of assets of a captive reinsurance company. The bill requires that at least 35 percent of the assets of a captive reinsurance company must be managed by an asset manager domiciled in Florida.

Section 15 – Creates s. 628.919, F.S., establishing regulations and standards to ensure risk management control by a parent company. The bill requires the Financial Services Commission to adopt rules to establish standards to ensure that a parent company or affiliated company is able to exercise control of the risk management function of any controlled unaffiliated business to be insured by a pure captive insurance company.

Section 16 – Creates s. 628.920, F.S., relating to the eligibility of a captive insurance company to obtain a certificate of authority to act as an insurer. The bill specifies that a licensed captive insurance company that meets requirements imposed on an insurer must be considered for a certificate of authority to act as an insurer in Florida.

Section 17 – Amends s. 626.7491, F.S., making a technical conforming change.

Section 18 – Repeals s. 628.903, F.S., which contains the definitions in the current law which are being replaced by the definitions the bill.

Section 19 – Provides that the act shall take effect upon becoming law.

Other Potential Implications:

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

States that have seen growth in captive insurance companies report positive economic impact through job creation. The legislation is intended to make captive insurance a more

attractive alternative than it currently is, and thereby expand the proportion of Florida insureds that rely on captive insurance domiciled in Florida. To the extent that insureds move to a captive form of coverage, their current form of insurance coverage will be displaced. The net effect may be a growth in jobs for insurance personnel such as actuaries, lawyers, accountants, adjusters, administrators, and support personal, but that effect is indeterminable at this time. Additionally, the bill requires a captive insurer to maintain its principal place of business and hold at least one annual board of directors meeting in Florida.

For a company forming a captive insurance company, an insurance policy tailored to the individual company's risk profile should effectuate overall premium savings.

C. Government Sector Impact:

The bill requires the Financial Services Commission to engage in rulemaking to establish the standards necessary to ensure that a parent company is able to exercise control of the risk management function of a controlled unaffiliated business insured by a pure captive insurance company.

Regulators in some states that have seen significant growth in captive insurance have established positions dedicated specifically to oversee this form of coverage. It is unclear whether this regulatory approach necessitated a net increase in personnel. The OIR is not able to determine the net fiscal effect at this point.

To the extent that insureds move to a captive form of coverage, their current form of insurance coverage will be displaced, as will the premium tax collected for that coverage. Part of the purpose for captive insurance is to provide lower overall premiums for the insured. If the amount of taxes and fees collected for new captive insurance is less than the premium tax being displaced, there will be a net reduction in total premium tax collected. Any effect from this is indeterminable at this time.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Additional Information:

Committee Substitute – Statement of Substantial Changes:

CS by Banking and Insurance on December 7, 2011

The CS requires, by definition, that a captive insurance company be a domestic insurance company.

The original bill included captive reinsurers within the definition of captive insurer. The CS narrows the definition of captive insurer to removes captive reinsurers.

The CS prohibits a captive reinsurance company from directly insuring risks.

The CS provides that an industrial insured captive insurance company can also provide reinsurance only on risks written for the industrial group.

The CS requires that an association captive insurance company must provide on the first page of the policy certain disclosures specified in the bill.

The CS provides that a captive insurer or a captive reinsurance company must pay to the OIR a nonrefundable fee of \$1,500 for processing the application, and an annual renewal fee of \$1,000, and that the OIR may also charge \$5 for any document requiring authentication.

The CS reinstates the provision in current law that an industrial insured captive insurance company does not need to be incorporated in Florida if it has been validly incorporated in another jurisdiction.

The original bill required that before the articles of incorporation for a captive insurer could be submitted to the Secretary of State, the OIR needed to find that the proposed captive insurer “will promote the general good of the state.” Further the original bill established the elements that the OIR must consider to determine whether that standard was met. The CS removed those provisions and replaced them with:

- The requirement that a prospective captive insurer filing for a license under s. 628.905, F.S., must include background investigations, biographical affidavits, and fingerprint cards as evidence of the trustworthiness and competence of its officers and directors.
- The provision that the OIR may deny, suspend or revoke the certificate if a captive insurer’s officer or director served in that capacity for an specified entity that became insolvent within 2 years of the service of the officer or director, unless the officer or director demonstrates that he or she did not contribute to the insolvency.
- The provision that the OIR may deny, suspend or revoke the captive insurer’s certificate if any person who has the ability to exercise control or influence over the captive insurer has been found guilty of any felony crime involving moral turpitude punishable by imprisonment of 1 year or more.

The original bill allowed pure captives to apply for filing the annual report on a fiscal year-end that is consistent with its parent company's fiscal year-end. The CS broadened that allowance to include all captive insurance companies.

The CS removed a specific reference to portions of the NAIC annual report that would be necessary as sufficient detail to support the premium tax return.

The CS removed a provision in the original bill that required an annual captive reinsurance tax of \$5,000, and a provision that that tax is the only tax collectible from a captive reinsurance company, other than occupation tax and ad valorem taxes on real and personal property.

A. Amendments:

None.