

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** CS/HB 1191 Captive Insurance  
**SPONSOR(S):** Insurance & Banking Subcommittee; Nelson  
**TIED BILLS:** **IDEN./SIM. BILLS:** SB 1408

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	12 Y, 0 N, As CS	Vanlandingham	Cooper
2) Regulatory Affairs Committee	17 Y, 0 N	Vanlandingham	Hamon

### SUMMARY ANALYSIS

Captive insurance is a form of self-insurance whereby an insurer is created, owned, and controlled by one or more parent companies. Unlike traditional self-insurance, however, the parent owner does not retain specific underlying risks but instead transfers those risks to the wholly owned captive insurer in exchange for payment of premiums. Companies generally pursue this alternative risk transfer arrangement when commercial insurance becomes unavailable or reaches excessive costs.

In 2012, the Legislature passed and the Governor signed HB 1101, which made significant changes to Florida's captive insurance law. These changes were intended to modernize the statute and make Florida more attractive to companies seeking to domicile captive insurance companies in the state, which could help generate new jobs and revenues.

One provision of the law limited the extent to which captive insurers could insure risks relating to workers' compensation and excess employer liability. Following the law's enactment, it emerged that this provision negatively affected the ability of at least one Florida captive insurer to write new policies for workers' compensation and excess employer liability coverage. It appears this effect was unintended by the drafters of the legislation or by the Office of Insurance Regulation (OIR).

CS/HB 1191 makes several changes intended to remedy any unintended consequences that may have resulted from the 2012 law. OIR has not raised any objections to the changes proposed in the bill. The bill restores language from before the 2012 law that permits an industrial insured captive insurance company with unencumbered capital and surplus of at least \$20 million to continue to write workers' compensation and employer's liability insurance in excess of \$25 million in the annual aggregate.

Further, the bill makes pure captive insurance companies responsible for adopting risk management standards for controlled unaffiliated business. The bill requires such pure captive insurers to submit these standards to OIR for approval. This approach provides pure captive insurers with more flexibility than current law, which requires the Financial Services Commission to adopt such risk management standards by rule.

Finally, the bill corrects an inconsistency in current insurance law by exempting captive insurance companies from deposit requirements that now exceed the surplus requirements to form a captive. The BILL also clarifies terms to conform to definitions.

The bill has no fiscal impact to the state, but it may allow existing captive insurers to write new policies for workers' compensation and excess employer liability coverage.

The bill has an effective date of July 1, 2013.

# FULL ANALYSIS

## I. SUBSTANTIVE ANALYSIS

### A. EFFECT OF PROPOSED CHANGES:

#### Background on Captive Insurance

Captive insurance is a form of self-insurance whereby an insurer is created, owned, and controlled by one or more parent companies.<sup>1</sup> Unlike traditional self-insurance, however, the parent owner does not retain specific underlying risks but instead transfers those risks to the wholly owned captive insurer in exchange for payment of premiums.<sup>2</sup> Companies generally pursue this alternative risk transfer arrangement when commercial insurance becomes unavailable or reaches excessive costs.<sup>3</sup>

Captives may take many forms, which vary in allowable corporate structure, capital and surplus, underwriting risks, and ownership. Most captive insurance companies are formed as pure captives, which are wholly-owned subsidiaries of a parent company with the sole purpose of insuring the risk of the parent, its affiliates, or other subsidiaries.<sup>4</sup> Group captives, which are owned by and insure a group, include association captives, industrial captives, risk retention groups, and reciprocals.<sup>5</sup>

Other structures available for insuring risks include branch captives and rent-a-captives. A branch captive is essentially the extended arm of a pure captive from a separate domicile. Instead of forming a new pure captive, the branch captive remains within the same corporation.<sup>6</sup> Rent-a-captives allow companies unwilling or unable to establish a captive on their own to use an outside entity's capital, surplus, and administrative services for a rental fee.<sup>7</sup> Rent-a-captives today are commonly formed as segregated or protected cell captives, which organize legal barriers to protect its renters' assets.<sup>8</sup>

Forming a captive insurance company may provide a number of advantages including:

- *Tailored insurance policy.*<sup>9</sup> A captive insurer may offer coverage and policy provisions that are unique to the risk profile of the individual business being insured.
- *Reduced premiums.*<sup>10</sup> A captive insurer need not factor elements such as profit margin or overhead such as advertising and commissions into the premium it charges, which may allow it to offer lower premiums than commercial insurers.
- *Cohesion of interest.* Because the control of the insured and the insurer reside in a single entity, there is a lower risk of disputes regarding claim verification, investigation, and valuation.
- *Access to Reinsurance.* Captive insurance companies acquire direct access to wholesale reinsurance markets, thus evading extraneous costs commercial carriers may assess.<sup>11</sup>
- *Tax Deductions.* Premiums paid to a captive insurer may be deductible expenses for federal income tax purposes.<sup>12</sup> Income tax against the captive insurer will vary depending on the coverage and amount, though certain companies may qualify for a full exemption.<sup>13</sup>

Some disadvantages to forming a captive insurance company may include:

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<sup>1</sup> <http://www2.iii.org/glossary/c/> (last viewed March 17, 2013).

<sup>2</sup> [http://www.iii.org/issue\\_updates/captives-and-other-risk-financing-options.html](http://www.iii.org/issue_updates/captives-and-other-risk-financing-options.html) (last viewed March 17, 2013).

<sup>3</sup> *Id.*

<sup>4</sup> Theriault, Patrick. *Captive Insurance Companies* (2008). Page 9. Retrieved March 17, 2013.

<sup>5</sup> <http://www.captive.utah.gov/rrg.html> (last viewed March 17, 2013). See also: Theriault, Patrick. *Captive Insurance Companies* (2008). Page 9.

<sup>6</sup> Theriault, Patrick. *Captive Insurance Companies* (2008). Page 9. Retrieved March 17, 2013.

<sup>7</sup> [http://www.iii.org/issue\\_updates/captives-and-other-risk-financing-options.html](http://www.iii.org/issue_updates/captives-and-other-risk-financing-options.html) (last viewed March 17, 2013).

<sup>8</sup> <http://captive.com/newsstand/articles/GlosAlt.html> (last viewed March 17, 2013).

<sup>9</sup> <http://www.vermontcaptive.com/captive-basics/why-captive.html> (last viewed March 17, 2013). See also:

<http://www.dccaptives.org/i4a/pages/index.cfm?pageid=3382>; <http://captive.insurance.ky.gov/CapHome.aspx>; Captive Insurance Basics:

<http://www.sccia.org/displaycommon.cfm?an=3>

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> 26 U.S.C. 162(a)

<sup>13</sup> 26 U.S.C. 501(c)(15)

- *Administrative Costs.*<sup>14</sup> Forming a captive may require extra personnel and management as well as time and attention that may distract from the core business of the parent company or companies. Administering a possible acquisition or merger may also become more complicated when a captive is involved. Regulatory compliance is an additional component that may impose added administrative costs.
- *Long-term Financial Risks.*<sup>15</sup> The formation of a captive insurer is a long-term investment whose benefits often are not realized immediately. Captives may also expose a company to elevated risk and exposure to volatile capital and reinsurance markets. This financial commitment to a captive insurer is far less flexible than the simple purchase of an annual policy through a commercial insurer.

## 2012 legislative changes to Florida's captive insurance law

In 2012, the Legislature passed and the Governor signed HB 1101 into law, which made significant changes to Florida's captive insurance statute. These changes were intended to modernize the statute and make Florida more attractive to companies seeking to domicile captive insurance companies in the state, which could help generate new jobs and revenues.

Among its numerous provisions, the law:

- Adopted new definitions for pure captive insurance companies, special purpose captive insurance companies, and industrial insured captive insurance companies;
- Made changes providing for the formation and incorporation of different varieties of captive insurance and reinsurance companies;
- Substantially reduced the capital and surplus requirements for industrial insured captives and pure captives;
- Established new procedures for licensure of captive insurers or reinsurers by the Office of Insurance Regulation (OIR);
- Fixed annual reporting requirements applicable to captive insurance companies;
- Provided net asset requirements for nonprofit captive insurance companies formed as pure captives and special purpose captives;
- Required the Financial Services Commission to set standards ensuring that a parent or affiliated company exercises risk management control of any unaffiliated business to be insured by a pure captive; and
- Made new provisions governing the allowable coverage a captive insurer or reinsurer may provide.

This final provision limited the extent to which captive insurers could insure risks relating to workers' compensation and excess employer liability. Following the law's enactment, it emerged that this provision negatively affected the ability of at least one currently existing captive insurer to write new policies for workers' compensation and excess employer liability coverage. It appears that this effect was unintended by the drafters of the legislation or by OIR.

### Effect of the bill

The bill makes several changes intended to remedy any unintended consequences that resulted from the 2012 changes to Florida's captive insurance statute. OIR has not raised any objections to the changes proposed in the bill. Among its provisions, the bill:

**Remedies inadvertent negative effects the 2012 captive insurance reform had on existing Florida captive insurance companies.** The bill restores language from before the 2012 changes that permits an industrial insured captive insurance company meeting a certain unencumbered capital and

<sup>14</sup> <http://www.captive.com/service/SCG/ProsAndCons.html> (last viewed March 17, 2013).

<sup>15</sup> *Id.*

surplus requirement to continue to write workers' compensation and employer's liability insurance in excess of \$25 million in the annual aggregate. The bill requires such firms to maintain unencumbered capital and surplus of at least \$20 million in order to continue to write such excess workers' compensation insurance in Florida.

**Exempts captive insurance companies from certain deposit requirements.** The bill corrects an inconsistency in current insurance law by exempting captive insurance companies from deposit requirements that now exceed the surplus requirements to form a captive. Because a deposit is merely a subset of the capital surplus required to form a captive insurance company, it would be incongruous if the required deposit was higher than the required surplus.

**Revises the procedure for the adoption of risk management standards for pure captive insurers.** The bill removes the Financial Services Commission from responsibility for adopting rules establishing risk management standards regarding pure captive insurance companies' controlled unaffiliated business. A pure captive insurance company insures the risks of its parent, affiliated companies, or controlled unaffiliated businesses.<sup>16</sup> The bill puts the responsibility on such pure captive insurers to adopt their own risk management standards, which they then must submit to OIR for approval. This change gives pure captive insurers the flexibility to tailor their own risk management strategies to fit the particular business risks against which they insure. This may be a more appropriate approach because pure captives are likely to be more familiar with the details of the business risks they insure than the Financial Services Commission is likely to be.

**Clarifies terms to conform to definitions.** To promote consistency, the bill revises the term "captive insurer" to "captive insurance company," which is defined in s. 628.901, F.S. The bill also revises s. 629.905, F.S., to make language regarding the risks that an industrial insured captive may insure consistent with the definition of an industrial insured captive insurance company under s. 628.901, F.S.

B. SECTION DIRECTORY:

**Section 1.** Amends s. 628.901, F.S., revising definitions.

**Section 2.** Amends s. 628.905, F.S., revising terminology and authorizing the licensure of industrial insured captive insurance companies to provide workers compensation and employer's liability insurance in excess of a specified amount.

**Section 3.** Amends s. 628.907, F.S., conforming a provision.

**Section 4:** Amends s. 628.909, F.S., providing applicability of specified provisions to captive insurance companies and industrial insured captive insurance companies.

**Section 5.** Amends s. 628.9142, F.S., conforming a provision.

**Section 6.** Amends s. 628.915, F.S., conforming a provision.

**Section 7.** Amends s. 628.917, F.S., conforming a provision.

**Section 8.** Amends s. 628.919, F.S., requiring a pure captive insurance company to submit certain standards relating to the risk management of controlled unaffiliated businesses to the Office of Insurance Regulation for approval.

**Section 9.** Establishes an effective date of July 1, 2013.

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<sup>16</sup> Definition in s. 928.901(12), F.S.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

### A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

None.

### B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

### C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill remedies an inadvertent negative effect the 2012 captive insurance reform had on existing Florida captive insurance companies, and it may allow existing captive insurers to write new policies for workers' compensation and excess employer liability coverage.

### D. FISCAL COMMENTS:

None.

## III. COMMENTS

### A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. The bill does not appear to: require counties or municipalities to spend funds or take an action requiring the expenditure of funds; reduce the authority that counties or municipalities have to raise revenues in the aggregate; or, reduce the percentage of a state tax shared with counties or municipalities.

2. Other:

None.

### B. RULE-MAKING AUTHORITY:

None.

### C. DRAFTING ISSUES OR OTHER COMMENTS:

The bill's definition of a "qualifying reinsurer parent company" in s. 628.901(13), F.S., is different from the definition contained within HB 635, and this difference will need to be resolved if both bills advance.

## IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On March 19, 2013, the Insurance & Banking Subcommittee heard the bill, adopted a proposed committee substitute (PCS), and reported the bill favorably with a committee substitute. The PCS removed from the

originally filed bill certain definitions and provisions relating to protected cell subsidiary companies. The staff analysis was updated to reflect the committee substitute.