

**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 Committee on Banking and Insurance

BILL: SB 1408

INTRODUCER: Senator Richter

SUBJECT: Captive Insurance

DATE: April 6, 2013

REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Burgess	Burgess	BI	<b>Pre-meeting</b>
2.	_____	_____	CM	_____
3.	_____	_____	AP	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

**I. Summary:**

SB 1408 redefines “captive insurance company” to include an industrial insured captive insurance company and a protected cell subsidiary company. The bill defines “incorporated protected cell” to mean a company formed in accordance with s. 628.921(2), F.S. The bill defines “participant” to mean an industrial insured or its affiliated company or companies, or its controlled affiliate business, which are insured by a protected cell subsidiary company, where the losses of it are limited to the assets of one or more protected cells. The bill defines “protected cell” to mean a separate account established and maintained by a protected cell subsidiary company for one or more participants in accordance with the participant agreement and includes an “incorporated protected cell.” The bill defines “protected cell subsidiary company” to mean a company that has as its sole stockholder an industrial insured captive insurance company and only insures or reinsures risks through protected cells.

The bill provides that a protected cell subsidiary company can insure or reinsure risks only through protected cells and cannot insure or reinsure any risks other than those of the industrial insureds and their affiliated companies, who are the stockholders or members of the industrial insured captive insurance company that is the sole stockholder of the protected cell subsidiary company, and controlled unaffiliated businesses.

The bill allows an industrial insured captive insurer or a protected cell company to provide the following coverage:

- Workers compensation and employer’s liability risks of the industrial insured and its affiliated companies in excess of \$25 million in the annual aggregate; and

- Excess life and health risks of the industrial insured and its affiliated companies.

The bill provides that a protected cell subsidiary company must be incorporated as a stock insurer with its capital divided into shares that are held by its industrial insured captive insurance company parent, and must possess and maintain unimpaired paid-in capital of at least \$200,000, and unimpaired surplus of at least \$300,000.

The bill creates s. 628.921, F.S., governing the establishment of protected cells, and the formation of and requirements for protected cell subsidiary companies.

This bill substantially amends the following sections of the Florida Statutes: 628.901, 628.905, 628.907, 628.908, 628.910, 628.9142, 628.915, and 628.917.

This bill creates the following section of the Florida Statutes: 628.921.

## II. Present Situation:

A captive insurance company is an insurer 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 insurance company for specified insurance coverages. 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 insurance company” as a domestic insurer established under part V, and includes a pure captive insurance company, a special purpose captive insurance company, and an industrial captive insurance company, with each of these formations also separately defined.

Each formation may vary in allowable corporate structure, capital and surplus, underwritten risks, and number of owners. Most captive insurance companies are formed as pure captives,<sup>1</sup> meaning that the captive is a wholly-owned subsidiary that insures the risks of its parent and affiliates.<sup>2</sup>

An “industrial insured captive insurance company”<sup>3</sup> is defined as a captive insurance company that provides insurance only to industrial insureds that are its stockholders or members, or affiliates of the stockholders or members, or to the stockholders of its parent corporation, or their affiliates. An industrial insured captive insurance company can also provide reinsurance, but only on risks written by a direct insurer for the industrial insureds that are the stockholders or members, or affiliates thereof, of the industrial insured captive insurance company, or to the stockholders of the parent corporation, or their affiliates, of the industrial insured captive insurance company.

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<sup>1</sup> Theriault, Patrick. *Captive Insurance Companies* (2008). Page 9. [www.captive.com](http://www.captive.com).

<sup>2</sup> S. 628.901(12), F.S.

<sup>3</sup> S. 628.901(9), F.S.

An “industrial insured”<sup>4</sup> is defined as an insured that:

- Has gross assets in excess of \$50 million;
- Procures insurance through the use of a full-time employee who acts as an insurance manager or through the services of a person licensed as a property and casualty insurance agent in his or her state of domicile;
- Has at least 100 full-time employees; and
- Pays annual premiums of at least \$200,000 for each line of insurance purchased from the industrial insured captive insurance company or at least \$75,000 for any line of coverage in excess of at least \$25 million in the annual aggregate.

A “captive reinsurance company”<sup>5</sup> is defined as a stock corporation reinsurer formed under part V of ch. 628, F.S., that is wholly owned by a qualifying reinsurance parent company. A “qualifying reinsurance parent company” is defined as a reinsurer that:

- Holds a certificate of authority or a letter of eligibility; or
- Is an accredited or a satisfactory non-approved reinsurer in Florida and possesses consolidated GAAP net worth of at least \$500 million and a consolidated debt to total capital ratio of not greater than 0.50.

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:

- 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.

Potential disadvantages of a captive insurance arrangement may include:

- Administrative Costs. Forming a captive may require extra personnel and management as well as time and attention that can distract from the core business of the parent company or companies. Administering a possible acquisition or merger may also become more

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<sup>4</sup> S. 628.901(8), F.S.

<sup>5</sup> S. 628.901(3), F.S.

complicated when a captive is involved. Regulatory compliance is an additional component that may impose added administrative costs.

- Long-term Financial Risks. The formation of a captive insurer is a long-term investment with benefits that often are not realized immediately. Captives may also expose a company to increased risk and exposure to volatile capital and reinsurance markets. The financial commitment to a captive insurer is less flexible than the simple purchase of an annual policy through a commercial insurer.

In 2012, the Legislature passed and the Governor signed CS/CS/HB 1101 into law,<sup>6</sup> which made significant changes to Florida's captive insurance statute. These changes were intended to update the statute and make Florida more attractive to companies seeking to domicile captive insurance companies in the state, which could benefit Florida economically. Among numerous provisions, CS/CS/HB 1101 made the following changes to 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. Prior to CS/CS/HB 1101, an industrial insured captive insurer was permitted to provide workers' compensation and employer's liability insurance in excess of \$25 million in the annual aggregate. CS/CS/HB 1101 removed that provision. It has since come to light 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.

### III. Effect of Proposed Changes:

**Section 1** amends s. 628.901, F.S., to redefine "captive insurance company" to include an industrial insured captive insurance company and a protected cell subsidiary company. The bill defines "incorporated protected cell" to mean a company formed in accordance with s. 628.921(2), F.S. The bill defines "participant" to mean an industrial insured or its affiliated company or companies, or its controlled affiliate business, which are insured by a protected cell subsidiary company, where the losses of it are limited to the assets of one or more protected cells. The bill defines "protected cell" to mean a separate account established and maintained by a protected cell subsidiary company for one or more participants in accordance with the

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<sup>6</sup> Sections 19 – 34, ch. 2012-151, L.O.F.

participant agreement and includes an “incorporated protected cell.” The bill defines “protected cell subsidiary company” to mean a company that has as its sole stockholder an industrial insured captive insurance company and only insures or reinsures risks through protected cells.

**Section 2** amends s. 628.905, F.S., to allow an industrial insured captive insurance company to insure risks of its stockholders or members, and affiliates thereof, or the stockholders or affiliates of the parent corporation of the captive insurer. The bill provides that a protected cell subsidiary company can insure or reinsure risks only through protected cells and cannot insure or reinsure any risks other than those of the industrial insureds and their affiliated companies, who are the stockholders or members of the industrial insured captive insurance company that is the sole stockholder of the protected cell subsidiary company, controlled unaffiliated businesses, or a combination.

The bill allows an industrial insured captive insurer or a protected cell company to provide the following coverage:

- Workers compensation and employer’s liability risks of the industrial insured and its affiliated companies in excess of \$25 million in the annual aggregate; and
- Excess life and health risks of the industrial insured and its affiliated companies.

**Section 3** amends s. 628.907, F.S., to provide that a protected cell subsidiary company must possess and maintain unimpaired paid-in capital of at least \$200,000.

**Section 4** amends s. 628.908, F.S., to provide that a protected cell subsidiary company must possess and maintain unimpaired surplus of at least \$300,000.

**Section 5** amends s. 628.910, F.S., to make conforming changes to add protected cell subsidiary companies to the applicability of specific provisions of the Insurance Code.

**Section 6** amends s. 628.910, F.S., to provide that a protected cell subsidiary company must be incorporated as a stock insurer with its capital divided into shares that are held by its industrial insured captive insurance company parent.

**Section 7** amends s. 628.9142, F.S., to provide that a ceding captive insurance company can reinsure risks with an assuming insurer for the limited purpose of assuming risk from a protected cell subsidiary company with respect to one or more protected cells.

**Section 8** amends s. 628.915, F.S., to remove current language that provides that an industrial insured captive insurer is prohibited from joining or from receiving any benefit from a joint underwriting association or guaranty fund.

**Section 9** amends s. 628.917, F.S., to make technical changes.

**Section 10** creates s. 628.921, F.S., governing the establishment of protected cells, and the formation of and requirements for protected cell subsidiary companies. The bill provides that an industrial insured captive insurance company can form a protected cell subsidiary company, subject to the following conditions:

- A protected cell of a protected cell subsidiary company requires the insurance commissioner's prior written approval;
- Each protected cell must be accounted for separately on the books and records of the protected cell subsidiary company to reflect the financial condition of the protected cell;
- The assets of a protected cell are not chargeable with liabilities arising out of any other insurance business that the protected cell subsidiary company conducts;
- An insurance policy or reinsurance agreement issued or assumed for a protected cell must provide that:
  - The amount of all claims by insureds or reinsureds of the protected cell cannot exceed the aggregate of the funds designated by the protected cell subsidiary company;
  - In the event that the funds held by the protected cell subsidiary company are insufficient to pay all claims, the claims must be reduced as provided in the insurance policy; and
  - A claim cannot be made under an insurance policy or reinsurance agreement on any funds held by the protected cell subsidiary company other than those funds held with respect to the protected cell.
- Sale or transfer of assets cannot be made by the protected cell subsidiary company without the consent of the protected cells, and the insurance commissioner's approval.
- The shareholder of a protected cell subsidiary company must be an industrial insured captive insurance company licensed as such under this chapter;
- A risk retention group cannot be a shareholder or a participant of a protected cell subsidiary company;
- Any industrial insured who is a stockholder or member of the industrial insured captive insurance company that is the parent of the protected cell subsidiary company may be a participant in the protected cell subsidiary company; and
- The industrial insured captive insurance company that is the parent of the protected cell subsidiary company can itself be a participant in the protected cell subsidiary company.

The bill defines the term "incorporated protected cell" as a protected cell that is formed as a corporation or a limited liability company separate from the protected cell subsidiary company of which it is a part. The bill provides that for incorporated protected cells:

- A protected cell of a protected cell subsidiary company may be formed as an incorporated protected cell with limited liability separate from the protected cell subsidiary company, but the sole shareholder of an incorporated protected cell must be the shareholder that is the parent of the protected cell subsidiary company;
- The articles of incorporation of an incorporated protected cell must refer to the protected cell subsidiary company for which it is a protected cell; and
- A protected cell subsidiary company has the option to establish one or more protected cells as a separate corporation or limited liability company.

**Section 11** provides an effective date of July 1, 2013.

**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:**

The bill would allow an industrial insured captive insurance company to insure risks of its stockholders or members, and affiliates thereof, or the stockholders or affiliates of the parent corporation of the captive insurer. The bill would allow an industrial insured captive insurance company to form a protected cell subsidiary company to insure or reinsure risks through protected cells, limited to the industrial insured and its affiliated companies, who are the stockholders or members of the industrial insured captive insurance company that is the sole stockholder of the protected cell subsidiary company or controlled unaffiliated businesses.

The bill allows an industrial insured captive insurer or a protected cell company to provide workers compensation and employer's liability risks of the industrial insured and its affiliated companies in excess of \$25 million in the annual aggregate; and excess life and health risks of the industrial insured and its affiliated companies.

**C. Government Sector Impact:**

The OIR would be required to approve the establishment or termination of a protected cell and the addition or withdrawal of any participant to a protected cell. The OIR would be required to approve any sale, exchange, transfer of assets, dividends or distributions made from a protected cell to a shareholder or participant. The OIR reports that these requirements can be absorbed within current resources.<sup>7</sup>

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<sup>7</sup> See, Bill Analysis of HB 1101, by the Office of Insurance Regulation, p. 2 – 4; published March 8, 2013.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

**VIII. Additional Information:**

**A. Committee Substitute – Statement of Substantial Changes:**

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

None.

**B. Amendments:**

None.

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This Senate Bill Analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.

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