

**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 Commerce and Tourism

**BILL:** CS/SB 1408

**INTRODUCER:** Banking and Insurance Committee and Senator Richter

**SUBJECT:** Captive Insurance

**DATE:** April 12, 2013                      **REVISED:** \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Burgess</u>	<u>Burgess</u>	<u>BI</u>	<u>Fav/CS</u>
2.	<u>Siples</u>	<u>Hrdlicka</u>	<u>CM</u>	<u>Pre-meeting</u>
3.	_____	_____	<u>AP</u>	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

**Please see Section VIII. for Additional Information:**

A. COMMITTEE SUBSTITUTE.....  Statement of Substantial Changes

B. AMENDMENTS.....  Technical amendments were recommended

Amendments were recommended

Significant amendments were recommended

**I. Summary:**

CS/SB 1408 strikes the reference to “satisfactory non-approved reinsurer” from the definition of a qualifying reinsurer parent company, and replaces it with a reference to “trusteed reinsurer,” as being considered a qualifying reinsurer parent company. The bill removes the current allowance for a qualifying reinsurer parent company to hold a letter of eligibility as an acceptable alternative to holding a certificate of authority.

The bill allows 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 insurance company. The bill allows an industrial insured captive insurance company with unencumbered capital and surplus of at least \$20 million to be licensed to provide workers’ compensation and employer’s liability insurance in excess of \$25 million in the annual aggregate.

The bill exempts captive insurance company from the statutory trust deposit required under s. 624.411, F.S., as a condition of obtaining a certificate of authority to transact insurance. A pure captive insurance company must submit to the Office of Insurance Regulation its standards to ensure a parent or affiliated company is able to exercise control of the risk management

function of any controlled unaffiliated business that is to be insured by the pure captive insurance company. The bill deletes the current authorization for the Financial Services Commission to adopt rules establishing such standards.

This bill substantially amends the following ss. 628.901, 628.905, 628.907, 628.909, 628.9142, 628.915, 628.917, and 628.919, F.S.

## II. Present Situation:

A captive insurance company is one that is created to insure the risks of its owners.<sup>1</sup> A captive insurance company acts similarly to a commercial insurer in that it will issue an insurance policy and in exchange, the insured entity will pay an insurance premium.<sup>2</sup>

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, or 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>3</sup> meaning that the captive is a wholly-owned subsidiary that insures the risks of its parent and affiliates.<sup>4</sup>

An “industrial insured captive insurance company”<sup>5</sup> is defined as a captive insurance company that provides insurance only to industrial insureds<sup>6</sup> 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, and 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.

A “captive reinsurance company”<sup>7</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”<sup>8</sup> is defined as a reinsurer that:

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<sup>1</sup> Insurance Information Institute, *Captives and Other Risk Financing Options* (April 2013), available at [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 visited Apr. 12, 2013).

<sup>2</sup> Theriault, Patrick. *What to Consider When Establishing and Operating Captives*, 3 (2008), available at <http://www.captive.com/service/WilmingtonTrust/images%20and%20pdf/captive101whitepaper.pdf> (last visited Apr. 12, 2013).

<sup>3</sup> *Id* at 9.

<sup>4</sup> Section 628.901(12), F.S.

<sup>5</sup> Section 628.901(9), F.S.

<sup>6</sup> Section 628.901(8), F.S., defines an industrial insured as an insured that has gross assets in excess of \$50 million, procures insurance through a full-time employee of the insured who acts as an insurance manager or buyer or through a person licensed as a property and casualty insurance agent, broker or consultant, has at least 100 full-time employees, and pays annual premiums in excess of specified amounts.

<sup>7</sup> Section 628.901(3), F.S.

<sup>8</sup> Section 628.901(13), F.S.

- 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 insurance company, and the coverages involved. Some benefits of captive insurance may include:

- Lower insurance cost.<sup>9</sup> 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 insurance company would not need to factor these elements into the premium it charges.
- Potential tax savings.<sup>10</sup> 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 insurance company's income from the collected premium may not be recognized as taxable. Further, a captive insurance company 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.<sup>11</sup> A captive insurance company 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.<sup>12</sup> Forming a captive insurance company 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 complicated when a captive is involved. Regulatory compliance is an additional component that may impose added administrative costs.
- Long-term Financial Risks.<sup>13</sup> The formation of a captive insurance company is a long-term investment with benefits that often are not realized immediately. Captive insurance companies may also expose a company to increased risk and exposure to volatile capital and reinsurance markets. The financial commitment to a captive insurance company is less flexible than the simple purchase of an annual policy through a commercial insurer.

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<sup>9</sup> Captive.com, *Reasons to Form a Captive*, available at <http://captive.com/service/SCG/ProsAndCons.html> (last visited Apr. 12, 2013).

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

<sup>11</sup> Captive Insurance Council of the District of Columbia, *Frequently Asked Questions*, available at <http://www.dccaptives.org/i4a/pages/index.cfm?pageid=3382> (last visited Apr. 12, 2013).

<sup>12</sup> *Reasons to Form a Captive*.

<sup>13</sup> *Id.*

In 2012, the Legislature passed and the Governor signed CS/CS/HB 1101 into law,<sup>14</sup> 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;
- Allowed the formation and incorporation of different varieties of captive insurance and reinsurance companies;
- Substantially reduced the capital and surplus requirements for industrial insured and pure captive insurance companies;
- Established new procedures for licensure of captive insurance or reinsurance companies by the OIR;
- Fixed annual reporting requirements applicable to captive insurance companies;
- Provided net asset requirements for nonprofit captive insurance companies formed as pure captive and special purpose captive insurance companies;
- 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 insurance company; and
- Restricted the allowable coverage a captive insurance or reinsurance company may provide. Prior to CS/CS/HB 1101, an industrial insured captive insurance company 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. This provision negatively affected the ability of at least one currently existing captive insurance company 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 revise the definition of "qualifying reinsurer parent company" by replacing "satisfactory non-approved" reinsurer with "trusteed" insurer as an entity that is considered to be a qualifying reinsurer parent company. The bill also removes the current allowance for a qualifying reinsurer parent company to hold a letter of eligibility as an acceptable alternative to holding a certificate of authority.

**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 insurance company. The bill also allows an industrial insured captive insurance company with unencumbered capital and surplus of at least \$20 million to be licensed to provide workers' compensation and employer's liability insurance in excess of \$25 million in the annual aggregate. Such firms must maintain unencumbered capital and surplus of at least \$20 million to continue writing excess workers' compensation insurance.

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<sup>14</sup> Sections 19 – 34, ch. 2012-151, L.O.F.

**Section 4** amends s. 628.909, F.S., to exempt captive insurance companies from the statutory trust deposit required under s. 624.411, F.S., as a condition of obtaining a certificate of authority to transact insurance.

**Sections 3, 5, 6, and 7** conform language in and make technical amendments language to ss. 628.907, 628.9142, 628.915, and 628.917, F.S., related to captive insurance companies.

**Section 8** amends s. 628.919, F.S., to remove the authority of the Financial Services Commission to adopt rules establishing the standards for risk management control. The bill requires a pure captive insurance company to submit standards to the Office of Insurance Regulation that ensure that a parent or affiliated company is able to exercise control of the risk management function of any controlled unaffiliated business that is to be insured by the pure captive insurance company.

**Section 9** 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:

None.

C. Government Sector Impact:

None.

**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.)

**CS by Banking and Insurance on April 9, 2013:**

The CS removes the original bill's redefinition of "captive insurance company," and the bill's new definitions for "incorporated protected cell," "participant," "protected cell," "incorporated protected cell, and" "protected cell subsidiary company."

The CS removes the original bill's provision to allow that a protected cell subsidiary company can insure or reinsure risks.

The CS removes the original bill's provision to provide that a protected cell subsidiary company must possess and maintain unimpaired paid-in capital of at least \$200,000 and unimpaired surplus of at least \$300,000.

The CS removes the original bill's provision to make conforming changes to add protected cell subsidiary companies to the applicability of specific provisions of the Insurance Code.

The CS removes the original bill's provision 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.

The CS removes the original bill's provision 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.

The CS removes the original bill's provision 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.

The CS removes the original bill's creation of new s. 628.921, F.S., governing the establishment of protected cells, the formation of and requirements for protected cell subsidiary companies, defining the term "incorporated protected cell," and establishing provisions for the formation of and requirements for incorporated protected cells.

The CS amends the definition of "qualifying reinsurer parent company," to delete a reference to a "satisfactory non-approved reinsurer," and replace it with a reference to "trusteed reinsurer."

The CS removes the current allowance for a qualifying reinsurer parent company to hold a letter of eligibility as an acceptable alternative to holding a certificate of authority.

The CS requires that an industrial insured captive insurer must have unencumbered capital and surplus of at least \$20 million to provide workers' compensation and employer's liability insurance in excess of \$25 million in the annual aggregate.

The CS exempts captive insurers from the statutory trust deposit required as a condition of obtaining a certificate of authority to transact insurance.

The CS requires a pure captive insurance company to submit to the OIR for approval its standards to ensure a parent or affiliated company is able to exercise control of the risk management function of any controlled unaffiliated business that is to be insured by the pure captive insurance company. The CS deletes the current authorization for the Financial Services Commission to adopt rules establishing these standards.

**B. Amendments:**

None.