

OLR Bill Analysis

sSB 281 (File 159, as amended by Senate “A” and “B”)*

AN ACT CONCERNING CAPTIVE INSURANCE COMPANIES.

SUMMARY:

This bill permits a captive insurance company (“captive”) to be licensed and domiciled (have its principal place of business) in Connecticut to transact life insurance, annuity, health insurance, and commercial risk insurance business if it meets specified requirements concerning formation, capital and surplus, local office presence, ability to meet policy obligations, payment of certain fees and premium taxes, and annual reporting, among other things. The captive may form as a pure captive, an association captive, an industrial insured captive, or a risk retention group (RRG). (By law, an RRG can already domicile in Connecticut, and RRGs domiciled in other states can transact business in Connecticut if they register with the Insurance Department.)

The bill requires the insurance commissioner to regulate captives and examine each at least once every five years. It also authorizes him to suspend, revoke, or refuse to renew a captive's license or impose a fine up to \$ 10,000 for cause. It applies some, but not all, insurance laws to captives.

It authorizes the insurance commissioner to use the money in the Insurance Department's Utilization Review Fund as necessary to implement the bill. Current law requires him to use that fund exclusively to regulate utilization review companies. (By law, utilization review companies must each pay the department \$ 2,500 annually to maintain their operating licenses. The department deposits these fees in the Utilization Review Fund.)

The bill prohibits a captive from joining or contributing to the state insolvency guaranty funds. It also prohibits a captive and its insureds and their affiliates from receiving benefits from the guaranty funds if the captive becomes impaired or insolvent.

*Senate Amendment “A” (1) increases the license application filing fee to \$ 800 from \$ 200 and (2) authorizes the insurance commissioner to use the Insurance Department's Utilization Review Fund as necessary to implement the bill.

*Senate Amendment "B" removes a provision that prohibits captives from providing workers' compensation benefits and makes changes in the provisions relating to a captive's reinsurance activities. Specifically, it (1) limits a captive's ability to assume reinsurance risks to risks it may write directly; (2) eliminates the premium tax on captives' reinsurance premiums; (3) removes a provision that permits captives to credit, as assets or liability deductions in their financial statements, reinsurance risks ceded to certain pools, exchanges, or associations; and (4) makes technical changes.

EFFECTIVE DATE: January 1, 2009, except for the provision authorizing the insurance commissioner to use the Insurance Department's Utilization Review Fund as necessary to implement the bill, which is effective October 1, 2008.

§ 1 — CAPTIVE DEFINITION

A captive insurance company domiciled in Connecticut can be a pure captive, an association captive, an industrial insured captive, or an RRG. A pure captive insures risks of its parent and affiliated companies or controlled unaffiliated businesses. An association captive insures risks of its member organizations and their affiliated companies.

An industrial insured captive insures risks of the insureds comprising the industrial insured group and their affiliated companies. An industrial insured is business that (1) obtains insurance through a full-time employee insurance manager, (2) has total annual insurance premiums of at least \$ 25,000, and (3) has at least 25 full-time employees. An industrial insured group is any group of industrial insureds that together (1) own or control all outstanding voting securities of a captive formed as a stock insurer, (2) have complete voting control over a captive formed as a mutual insurer, or (3) are all of the subscribers of the captive formed as a reciprocal insurer.

An RRG is a captive organized under state law pursuant to the 1986 federal Liability Risk Retention Act (see BACKGROUND).

§§ 2, 9, 18 — LICENSE

Application, Fees, Issuance, Renewal

A captive cannot engage in any insurance business in Connecticut until it obtains a license from the Insurance Department. To request a license, a captive must send the insurance commissioner (1) organizational documents; (2) a financial condition

statement; and (3) a coverage description, including deductibles, limits, and rates. A captive must inform the commissioner of any material change in rates within 30 days of adopting the change.

It must maintain certain capital and surplus (see CAPITAL AND SURPLUS below) and send evidence of (1) asset liquidity relative to its assumed risk; (2) adequate management expertise, experience, and character; (3) a sound operation plan; and (4) the adequacy of its insureds' loss prevention program. It must also pay an \$ 800 application fee plus reasonable legal, financial, and examination expenses that the commissioner incurs when retaining outside application review services.

The information provided is confidential and can be made public only with the captive's written consent, with two exceptions. The information is discoverable in a civil action in which the captive is a party if (1) relevant; (2) necessary; (3) unavailable elsewhere; and (4) for non-RRG captives, is the subject of a subpoena that a judicial or administrative judge issues. The commissioner can also give another state's public officials with insurance regulation jurisdiction the information if they agree in writing to keep it confidential and that state's laws require confidentiality.

If the commissioner approves the application, the captive is issued a license. The captive must pay a \$ 300 initial license fee. The license expires on the next April 1, and the captive can annually renew it by paying a \$ 300 fee.

Civil Immunity

The commissioner may outsource the application review. As under current law for other insurers, no cause of action can be brought or any liability imposed against him, his authorized representatives, or appointed examiners for (1) any good faith statements or conduct in connection with the review or (2) communicating or delivering information in good faith and without fraudulent or deceptive intent. All common law and statutory privileges or immunity remain. The commissioner, representative, or examiner can receive attorney's fees and costs if they prevail in a libel, slander, or any other relevant tort case if the moving party did not have a reasonable basis in law or fact for initiating it.

Suspension and Revocation

The commissioner may, for cause, (1) suspend, revoke, or refuse to renew a captive's license or (2) in addition to, or instead of, license suspension or revocation and after notice and hearing, fine the captive up to \$ 10,000. A captive may appeal the

commissioner's action to the New Britain Superior Court.

§§ 4 & 5 — CAPITAL AND SURPLUS

To receive or retain a license, a captive must maintain unimpaired paid-in capital and surplus of at least (1) \$ 250,000 if a pure captive, (2) \$ 500,000 if an industrial insured, (3) \$ 750,000 if an association captive, or (4) \$ 1 million if an RRG. The commissioner may adopt regulations for additional capital and surplus requirements based on the type, volume, and nature of insurance transacted. The required capital and surplus can be cash or an irrevocable bank-issued and commissioner-approved letter of credit.

A captive may not pay dividends from, or other distributions with respect to, capital and surplus without the commissioner's prior approval. His approval of an ongoing distribution plan must be conditioned on the captive keeping, when it makes each payment, capital and surplus levels above those approved.

§§ 2, 3, 6 — CAPTIVE FORMATION

Organizational Structure and Company Name

A pure captive can form as a stock insurer, nonprofit corporation, or a manager-managed limited liability company (LLC). An association captive, industrial insured captive, or RRG can be an LLC or a stock, mutual, or reciprocal insurer. A captive, if a stock insurer, may authorize capital stock with no par value. Each captive must have at least three incorporators or organizers, one of whom must be a state resident. A corporation's articles of incorporation or bylaws and a reciprocal insurer's organizing documents can permit a quorum of least one-third of the directors or members.

A captive's name cannot be the same as, or similar to, that of an existing registered business.

Certificate of General Good

A captive formed as a corporation, reciprocal insurer, or LLC must ask the insurance commissioner for a certificate finding that the proposed company or association will promote the state's general good. To make this finding, the commissioner must consider (1) each incorporator's character, reputation, financial standing, and purposes; (2) each officer's and director's character, reputation, financial responsibility, insurance experience, and business qualifications; and (3) other things he deems advisable.

A captive formed as a corporation must give this certificate, along with its articles of incorporation and organization fee, to the secretary of the state. The bill does not specify what a reciprocal insurer or LLC needs to do with its certificate, if anything. But an LLC must request a certificate before filing articles of incorporation with the secretary of the state.

Insurance Transacted

A captive can (1) provide annuities and life, health, and commercial-risk insurance; (2) reinsure a parent's or affiliated company's qualified self-insured workers' compensation plan, unless prohibited by federal law; and (3) accept or cede reinsurance, but only as the bill specifies (see REINSURANCE below). It cannot provide private passenger motor vehicle or homeowners' insurance.

§§ 2 & 6 — LOCAL OFFICE PRESENCE

A state-domiciled captive must have (1) its principal place of business and one annual management meeting in Connecticut; (2) at least one resident incorporator or organizer; (3) at least one resident corporation board member, reciprocal insurer advisory committee member, or LLC manager; and (4) a resident agent for service of process.

§§ 6 & 16 — MERGERS AND CONVERSIONS

The bill specifies that state laws concerning mergers, consolidations, and conversions that apply to insurers generally also apply to captives.

It authorizes an association captive, RRG, or industrial insured captive formed as a stock or mutual corporation to convert to, or merge with and into, a reciprocal insurer. The transaction must provide a fair and equitable plan (1) for purchasing, retiring, or extinguishing stockholders' or members' and policyholders' interests and (2) that provides rights and remedies for dissenting stockholders, members, or policyholders.

The commissioner must approve articles of merger or a conversion plan if he finds the transaction promotes the general good of the state. To make this finding, the commissioner must consider (1) each incorporator's character, reputation, financial standing, and purposes; (2) each officer's and director's character, reputation, financial responsibility, insurance experience, and business qualifications; and (3) other things he deems advisable.

Mergers

Under the bill, a reciprocal insurer's advisory committee is equivalent to a stock or mutual insurer's board of directors. Its subscribers are equivalent to a mutual insurer's policyholders. If the advisory committee does not have a president or secretary, its officers with equivalent duties are the president and secretary.

The commissioner can permit the formation of, without surplus, a captive organized as a reciprocal insurer, into which an existing captive can merge, except there can be only one authorized surviving insurer.

The bill allows an alien insurer (chartered outside the United States) to be party to a merger, subject to the insurance laws applying to mergers of domestic and foreign insurers. (A foreign insurer is organized under the laws of another U. S. state or territory.) In this instance, the alien insurer is treated as the foreign insurer.

If the commissioner approves the merger, the surviving insurer must give the articles of merger to the secretary of the state.

Conversions

A conversion to a reciprocal captive insurer must take place in accordance with a plan that the commissioner approves. He can approve a plan only if, in addition to meeting the above other requirements, it (1) notifies affected people of a hearing to be held at their request concerning the plan; (2) includes a fair and equitable plan for converting stockholder, member, or policyholder interests into substantially proportionate subscriber interests; (3) does not prevent the resulting reciprocal insurer from applying underwriting criteria that could affect ongoing ownership interests; and (4) was approved by a majority of voting interests at a meeting with a quorum.

If the commissioner approves the conversion, he must amend the converting insurer's certificate of authority to reflect it. The conversion is effective when the commissioner issues the amended certificate to the company's attorney. The converting insurer's corporate existence ceases on that day, and the resulting reciprocal insurer must inform the secretary of the state of the conversion.

§ 7 — ANNUAL FINANCIAL REPORT

A captive must give the insurance commissioner a financial report prepared under two executive officers' oaths by March 1 each year. The report must be prepared using generally accepted accounting principles, unless the commissioner approves the use of

statutory accounting principles, and any modifications or adaptations he requires or approves, depending on the insurer and type of insurance.

An association captive and RRG must prepare its report based on the National Association of Insurance Commissioners' (NAIC's) annual statement instructions. The commissioner may adopt regulations on how pure and industrial insured captives must report.

A pure or industrial insured captive can ask in writing for the commissioner's permission to file the report at its fiscal year end instead of March 1. If he agrees, (1) the report is due by 60 days after fiscal year end and (2) the captive must give him information that supports its premium tax return under two executives' oaths by March 1 each year.

Any supplemental compensation exhibit or stockholder information reported is kept confidential if filed by a nonprofit with fewer than 150 employees, except for information related to the company's three most highly compensated officers.

§ 8 — EXAMINATIONS

The commissioner or his designee must visit and examine each captive at least once every five years or more often as he determines prudent. The examination must determine the captive's (1) financial condition, (2) ability to fulfill its obligations, and (3) compliance with this bill and any applicable insurance code provisions. The commissioner, when determining the scope and frequency of examinations, and examiners must follow the guidelines and procedures in the NAIC's examiner's handbook for financial examinations, which they also follow when examining other insurance companies. The commissioner may also adopt other guidelines or procedures he deems appropriate.

The commissioner may appoint examiners and engage the services of attorneys, appraisers, actuaries, accountants, and other professionals as examiners. A captive that refuses to be examined or does not comply with any reasonable written request of the examiners may be subject to license suspension, refusal, or nonrenewal.

In general, a captive must pay the costs associated with an examination. But a domestic captive does not have to pay the portion of examination costs associated with Insurance Department examiners' salaries, fringe benefits, traveling, and maintenance expenses if it is required to pay the statutory assessment that funds the department's operations. However, it must pay the examiners' traveling and maintenance expenses when the

exam occurs out-of-state.

The commissioner and examiners have immunity for their statements or conduct when performing their examination responsibilities in good faith.

Examiners must issue an examination report within 60 days after the exam concludes, and the captive has 30 days to respond to the report. The commissioner then has 30 days to (1) consider the report and response and (2) issue an order adopting the report, rejecting it with direction to the examiners, or calling for an investigatory hearing to obtain additional information and testimony. If he adopts a report that shows the captive violated any law, he may order the captive to take necessary and appropriate action to cure the violation. The bill establishes procedures for investigatory hearings. The commissioner's findings, conclusions, and orders are subject to a further hearing and court appeal.

Examination working papers, recorded information, and documents are confidential, not subject to subpoena, and cannot be made public. But it appears that the commissioner may give the NAIC access to the information if it agrees in writing to keep it confidential (although the bill reads “unless” it agrees in writing).

The commissioner also has the authority to (1) use and, if appropriate, make public any final or preliminary examination report, any examiner or company work papers or other documents, or other information discovered or developed during the course of the examination in any legal or regulatory action; (2) publish examination results or reports in Connecticut newspapers if he deems it in the public interest; and (3) disclose examination results and reports to another state's or country's public officials with insurance regulation jurisdiction or state and federal law enforcement officers if they agree in writing to keep the information confidential.

§ 11 — REINSURANCE

A captive can reinsure another insurer's risks, but only those risks that the captive is authorized to insure directly. It can also take credit as an asset or deduction from liability for ceding risks to a reinsurer that is:

1. a state-licensed insurer or reinsurer;
2. a state-accredited reinsurer;
3. domiciled and licensed in, or if a U. S. branch of an alien reinsurer, conducts

business through a state with reinsurance standards similar to Connecticut's; or

4. maintaining a trust fund in accordance with state law for U. S. policyholders' and ceding insurers' claim payments.

If the reinsurer does not meet any of these criteria, the captive can still reduce its liability if the reinsurer holds securities in an amount adequate to cover claims that could arise under the reinsurance contract. It can also take credit if the reinsurance is on risks located in a jurisdiction that requires such reinsurance by law or regulation.

A captive can take credit for ceding risks to a reinsurer that is not state-licensed or accredited if the reinsurer agrees that, if it fails to meet its financial obligations and at the request of the ceding insurer, it will:

1. submit to the jurisdiction of any U. S. court,
2. comply with requirements necessary to give such a court jurisdiction,
3. abide by the court's final decision, and
4. appoint the commissioner or an attorney as agent for service of process in any lawsuit instituted against it by the ceding insurer.

A captive's insurance of its parent's or affiliate's qualified self-insured workers' compensation plan is deemed to be reinsurance.

§ 12 — RATING ORGANIZATION

A captive is not required to join a rating organization.

§ 13 — GUARANTY FUND

A captive is prohibited from joining or contributing to the state insolvency guaranty funds. And if the captive becomes impaired or insolvent, it and its insureds and their affiliates are prohibited from receiving benefits from the funds.

§§ 14 & 19 — PREMIUM TAXES

A captive licensed under the bill must pay premium taxes on its direct-written

premiums to the revenue services commissioner annually in February. It must pay at least \$ 7,500, but no more than \$ 200,000, based on the calculation described below. For policies issued on a multiyear basis, premiums are prorated to determine the annual tax liability. No other taxes may be levied on or collected from a captive, except taxes on real and personal property used to produce income.

Two or more captives under common ownership and control are taxed as though they were a single captive. Common ownership and control means the direct or indirect ownership of 80% or more (1) of the outstanding voting stock of two or more corporations by the same shareholders in the case of a stock corporation or (2) of the surplus and the voting power of two or more corporations by the same members in the case of a mutual or nonprofit corporation.

Current law subjects RRGs to a 4% premium tax rate. The bill exempts captives formed under its provisions (i. e. , domiciled in Connecticut) from this tax. Thus, RRGs domiciled outside of Connecticut must still pay the 4% premium tax.

Premium Tax Calculation

A captive must pay premium tax on its direct-written premiums minus any premiums returned to policyholders, including dividends paid and deposits returned or credited. No tax is due on money received for an annuity.

The tax owed is 0. 38% of the first \$ 20 million of direct-written premiums collected or contracted for in the preceding calendar year plus 0. 285% of the next \$ 20 million, plus 0. 19% of the next \$ 20 million, plus 0. 072% of each additional dollar.

Failure to Pay Tax

A captive that files a tax return but does not pay the premium tax it owes on time is subject to a penalty of 10% of the unpaid tax due or \$ 50, whichever is greater, plus 1% interest for each full or partial month that the tax remains unpaid.

If a captive does not file a tax return within three months of its being due, the revenue services commissioner may make the return based on the best information available. In addition to the tax due, the captive must pay a penalty of 10% of the tax due or \$ 50, whichever is greater. Interest of 1% on the tax due accrues for each full or partial month that it remains unpaid.

§ 17 — CONTROLLED UNAFFILIATED BUSINESS

The commissioner may adopt regulations establishing standards for a pure captive's parent or affiliated company to control the risk management functions of a controlled unaffiliated business insured by the captive. Until such regulations exist, he can approve a pure captive's coverage of such risks.

§§ 2, 6, 10, 15 — OTHER APPLICABLE LAWS

In addition to its provisions, the bill applies certain other laws to captives.

A captive transacting life insurance, annuity, or health insurance business must comply with all applicable state and federal laws.

Unless the bill conflicts, captives formed as:

1. corporations, except for LLCs and nonprofits, are subject to state corporation laws;
2. LLCs are subject to the Connecticut Limited Liability Company Act;
3. nonprofits are subject to applicable provisions of state corporation laws; and
4. reciprocal insurers are subject to state insurance laws.

Association captives and RRGs are subject to state insurance company investment laws. Pure and industrial insured captives are not subject to investment restrictions, except the commissioner can limit or prohibit any investment that threatens the company's solvency or liquidity.

A pure captive cannot loan or invest in a parent company or affiliate without the commissioner's prior written approval of the transaction and documented evidence of approval. The captive is prohibited from loaning any minimum required capital and surplus funds.

The bill makes the following, but not other, insurance statutes apply to captives:

1. § 38a-16 (investigations by the insurance commissioner);
2. § 38a-17 (commissioner's authority when business is improperly conducted);

3. § 38a-54 (audited reports);
4. § 38a-55 (hypothecation of assets (using them as collateral));
5. § 38a-56 (false returns to the commissioner);
6. § 38a-57 (retention of records and assets in Connecticut);
7. § 38a-59 (change of domestic insurance company's name);
8. § 38a-69a (confidentiality of financial work papers and operating and financial condition reports);
9. §§ 38a-250 through 38a-266 (risk retention groups);
10. §§ 38a-903 through 38a-961 (Insurers Rehabilitation and Liquidation Act); and
11. §§ 38a-962 to 38a-962j (commissioner's administrative supervision).

BACKGROUND

Domicile

A company's domicile is the jurisdiction under whose laws the company is organized and in which it has its principal place of business.

Risk Retention Group

An RRG domiciled in Connecticut must comply with all state insurance laws and must submit a plan of operation or feasibility study to the commissioner. However, because of federal law, Connecticut cannot require an RRG to become licensed in the state before it does business here.

Connecticut has limited regulatory authority over RRGs licensed in other states. Such an RRG must provide the commissioner information on its domicile licensure, its plan of operation, and a registration statement designating the commissioner as the agent for service of legal process in the state. It must also submit its financial statement and a copy of each financial examination and audit performed on it.

All RRGs, whether domiciled in Connecticut or another state, must pay premium taxes on business written in the state and give insureds notice that insurance insolvency guaranty funds are not available should the company fail. Any RRG that does not comply with Connecticut's RRG requirements is subject to fines and penalties, including revocation of its license and its right to conduct business in the state.

Stock, Mutual, and Reciprocal Insurers

A stock insurer is an insurance company conducted for profit that its stockholders own and controls. A mutual insurer is an insurance company that its policyholders own. A reciprocal insurer is an unincorporated association organized to write insurance for its subscribers, who each agree to be liable for a proportionate share of total liabilities and can be assessed for any needed additional funds.

Reinsurance

Reinsurance is a transaction between two insurers to apportion risk so that a large loss does not fall on one company. The insurer transferring part of its risk to another is the ceding insurer. The insurer accepting part of the risk is the assuming insurer or reinsurer.

Related Bill

SB 277 (File 70), which the Insurance and Real Estate Committee reported, requires a Division of Risk Management in the Insurance Department to regulate captive insurance companies.

COMMITTEE ACTION

Insurance and Real Estate Committee

Joint Favorable

Yea 18 Nay 0 (03/06/2008)

Judiciary Committee

Joint Favorable

Yea 28 Nay 0 (04/11/2008)

Government Administration and Elections Committee

Joint Favorable

Yea 11 Nay 1 (04/23/2008)