HOUSE RESEARCH ORGANIZATION bill analysis | 5/15/2013 | SB 734 Carona (Smithee) (CSSB 734 by Smithee)

SUBJECT: Authorizing the formation of pure captive insurance companies

COMMITTEE: Insurance — committee substitute recommended

VOTE: 9 ayes — Smithee, Eiland, G. Bonnen, Creighton, Morrison, Muñoz, Sheets, Taylor, C. Turner

0 nays

SENATE VOTE: On final passage, April 16 — 29-0

WITNESSES: (*On companion bill, HB 2788:*)
For — Bob Digneo, AT&T Texas; Richard Marshall, R&Q Quest Management Services USA; Michael Mead, M.R. Mead & Co.; (*Registered, but did not testify:* John Marlow, ACE Group; Neftali Partida, Phillips 66; Kandice Sanaie, Texas Association of Business)

Against — None

On — (*Registered, but did not testify:* Kevin Brady, Texas Department of Insurance; Karen Snyder, State Comptroller's Office)

BACKGROUND: A captive insurance company insures the risks of its owners. A pure captive insurance company insures only its owner and its owner's affiliates. Under the pure captive model, the policyholder owns the insurer, making the insurer captive to the policyholder. A segregated captive insurance company creates separate and independent accounts, each of which insures the risks of its parent and affiliates.

Typically, pure captive insurance companies are owned by very large corporations and function as a form of self-insurance. Although there are some differences, the regulation of a pure captive is similar in many ways to the regulation of a traditional insurance carrier. Current law does not permit the formation of domestic captive insurance carriers in Texas.

DIGEST: CSSB 734 would add ch. 964 to the Insurance Code to permit the formation of a pure domestic captive insurance carrier in Texas. The chapter would define the forms of business organization under which a pure captive could operate, the minimum requirements for its board of directors, and the features of the captive's certificate of formation.

The bill would require that a pure domestic captive insurance company apply for a certificate of authority from the Texas Department of Insurance (TDI). A captive would be required to have significant operations in Texas, hold at least one meeting of its board of directors in Texas each year, and maintain its principal office and records in Texas. The bill would outline the application and approval procedures for a domestic certificate of authority. It also would allow, with commissioner of insurance approval, a foreign captive to transfer its domicile to Texas.

By adding ch. 964, the bill would authorize a captive insurance company to insure only the operational risks of the company's affiliates and would define which types of insurance policies the captive could issue. It would permit the captive to provide reinsurance to an insurer covering the captive's affiliates, such as an affiliate's employee benefit plan, liability insurance, or workers' compensation insurance, and would require the captive to provide notice to the commissioner of insurance of any reinsurance it provided.

CSSB 734 would establish a tax rate of one-half of 1 percent on a captive's taxable premium receipts and other forms of revenue from written insurance policies in a calendar year. A captive's taxable receipts would not be deducted for premiums paid for reinsurance. The annual minimum tax for a captive would be $7,500 and the annual maximum would be $200,000. A captive would not be subject to other taxes or fees, including the franchise tax, except for insurance maintenance taxes on the direct premiums on individual lines of business written by the captive.

The bill would require a captive to maintain reserves sufficient to pay all losses for which it could be liable, plus any expenses from the settlement of those losses. A captive would be required to maintain capital and surplus of at least $250,000, or a higher amount as determined by the commissioner of insurance. The insurer would use generally accepted accounting principles.

The bill would detail a captive insurance company's requirements for submitting an annual report. A captive would be able to make loans to its affiliates with the prior approval of the commissioner, who could prohibit any loan or investment that threatened the solvency of the company. The captive would not be allowed to participate in any insolvency funds or pools in Texas.

CSSB 734 would permit the commissioner of insurance to revoke or suspend the captive's certificate of authority for various infractions and would require that the captive receive notice of the disciplinary action and an opportunity for a hearing.

The general confidentiality of information provided by applicants and captives would be established by the bill, along with entities permitted to access the information when acting in an official capacity.

The bill would require that a captive register with the commissioner before receiving captive management services.

The commissioner by rule could establish standards to ensure an affiliated company was able to exercise control of the risk management function of a controlled unaffiliated business to be insured by the captive insurance company.

This bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2013. As soon as practicable after this date, but by January 1, 2014, the commissioner of insurance would be required to adopt rules necessary to implement the provisions of the bill.

SUPPORTERS SAY:

CSSB 734 would create a healthier business climate for corporations that have or would like to have a domestic captive insurance company. When a Texas-based corporation must form its captive in another state, it incurs additional expenses and administrative burdens. For example, other states often require captives to engage locally based management companies, hold a minimum number of board meetings within their jurisdiction each year, and appoint a local resident to the board.

Allowing domestic captives to form in Texas would attract new business to the state and would help retain existing Texas companies. In addition to lowered taxes for redomesticated firms, the bill would attract high paying jobs, including attorneys, accountants, actuaries, and their support personnel. It would also result in new revenue for the state through the insurance premium tax.

OPPONENTS SAY: No apparent opposition.

NOTES: The companion bill, HB 2788 by Smithee, was left pending in the House Insurance Committee following a public hearing on April 9.

CSSB 734 differs from the Senate-passed version in that the committee substitute would apply only to pure captive insurance companies and not to segregated captive insurance companies.