

BILL ANALYSIS

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AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

Captive insurance companies are often formed by large corporations for the purpose of providing insurance exclusively for the corporation. The most traditional type of captive insurance company is called a pure captive (captive), which is created as a means to self-insure risk originating from a parent company and any affiliates. Under this model, the parent company provides capital in order to adequately fund the captive and, like an admitted carrier, determines what risks it will insure and the premium charged for that risk.

Currently, over thirty states allow captive insurance companies. A captive is generally subject to different regulations than a traditional insurance carrier, and insurance commissioners typically have significant discretion to regulate and set the captive's minimum financial requirements based on the financial strength of the captive's owner, the parent company.

The Texas Insurance Code does not currently allow for the formation of captive insurance companies within the state; however, a number of large companies domiciled in Texas currently have a captive that has been formed in another state with captive enabling legislation. This creates additional expenses and administrative burdens for Texas companies because other states typically impose a number of obligations on an out-of-state company.

S.B. 734 amends the Texas Insurance Code to authorize the formation of pure captive insurance companies in Texas. The captive must be licensed with the Texas Department of Insurance. S.B. 734 also explicitly states the types of insurance and reinsurance the captive may issue and requires that the captive company obtain approval from the commissioner of insurance (commissioner) before providing reinsurance. Additionally, S.B. 734 requires an appropriate amount of initial capital, provides the commissioner the authority to conduct a detailed examination of the applicant to ensure that all statutory requirements have been met and that the applicant's business model is sufficient; requires a captive to file an annual report with the commissioner containing a statement of the company's financial condition; prohibits a captive from participating in the state guaranty fund; states the process for license suspension or revocation; and notes the captive's obligations for premium and maintenance taxes.

As proposed, S.B. 734 amends current law relating to the licensing of captive insurance companies, and authorizes fees.

RULEMAKING AUTHORITY

Rulemaking authority is expressly granted to the commissioner of insurance in SECTION 1 (Sections 964.004, 964.007, 964.008, and 964.020, Insurance Code) and SECTION 2 of this bill.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Subtitle H, Title 6, Insurance Code, by adding Chapter 964, as follows:

CHAPTER 964. CAPTIVE INSURANCE COMPANIES

Sec. 964.001. DEFINITIONS. Defines "affiliated company," "affiliate," "captive insurance company," and "operational risk" in this chapter.

Sec. 964.002. **APPLICABILITY OF OTHER LAWS.** (a) Provides that the following provisions of this code apply to a captive insurance company to the extent the provisions do not conflict with this chapter:

(1) Titles 2 (Texas Department of Insurance) and 3 (Department Funds, Fees, and Taxes);

(2) Chapter 421 (Reserves in General), unless the commissioner of insurance (commissioner) by order allows a captive insurance company to establish reserves as prescribed by generally accepted accounting principles;

(3) Subtitle C (Insurance Maintenance Taxes), Title 4 (Regulation of Solvency); and

(4) Chapter 401 (Audits and Examinations).

(b) Provides that a captive insurance company formed under this chapter is not subject to Chapter 823 (Insurance Holding Company Systems), except to the extent that the captive insurance company is part of an insurance holding company system as described by Chapter 823.

(c) Provides that a captive insurance company operating under this chapter is subject to the Texas For-Profit Corporation Law, as cited in Section 1.008 (Short Titles), Business Organizations Code, and any other provision of the Business Organizations Code that governs for-profit corporations to the extent those laws do not conflict with this chapter.

Sec. 964.003. **AUTHORITY TO WRITE BUSINESS.** (a) Authorizes a captive insurance company, except as provided by this section, to write any type of insurance, but may only insure or reinsure the operational risk of the company's affiliates.

(b) Prohibits a captive insurance company from issuing or reinsuring life insurance, annuities, accident and health insurance, title insurance, mortgage guaranty insurance, financial guaranty insurance, residential property insurance, personal automobile insurance, or workers' compensation insurance.

(c) Prohibits a captive insurance company from issuing or reinsuring a type of insurance, including automobile liability insurance, that is required, under the laws of this state or any political subdivision of this state, as a prerequisite for obtaining a license or permit if the law requires that the liability insurance be issued by an insurer authorized to engage in the business of insurance in this state.

Sec. 964.004. **AUTHORITY TO PROVIDE REINSURANCE.** (a) Authorizes a captive insurance company to only reinsure risks as described by this section.

(b) Authorizes a captive insurance company, with the commissioner's prior approval, to provide reinsurance on risks that it has authority to insure directly under Section 964.003.

(c) Requires the captive insurance company applying to provide reinsurance under Subsection (b), not later than the 60th day before the effective date of a proposed reinsurance agreement, to file with the commissioner the agreement and any other documentation and information necessary for the commissioner to determine that the agreement does not violate a law and the captive insurance company would be able to continue to operate in a sound manner.

(d) Authorizes the commissioner by rule to authorize a shorter approval period under Subsection (c).

(e) Prohibits a captive insurance company from entering into an agreement filed under Subsection (c) if the commissioner disapproves the proposed agreement during the approval period.

(f) Requires a change to a reinsurance agreement to be filed for prior approval under Subsection (c).

(g) Requires the captive insurance company, not later than the 30th day after the date a previously filed reinsurance agreement terminates, to give notice of the termination to the commissioner.

(h) Authorizes a captive insurance company to take credit for reserves on risks or portions of risks ceded to reinsurers that comply with Subtitle F (Commerce and Industrial Development), Title 4.

Sec. 964.005. **CERTIFICATE OF AUTHORITY REQUIRED.** (a) Prohibits an entity from engaging in business as a captive insurance company unless it holds a certificate of authority to act as a captive insurance company issued by the Texas Department of Insurance (TDI). Authorizes an insurance company, when permitted by its organizational document, to apply for a certificate of authority under this section.

(b) Provides that an entity does not qualify for a certificate of authority under this section unless its affiliates have significant operations in this state, as determined by the commissioner, its board of directors holds at least one meeting each year in this state, it maintains its principal office and records in this state, and it complies with Section 804.102.

Sec. 964.006. **FORMATION OF CAPTIVE INSURANCE COMPANY.** (a) Authorizes any number of persons to form a captive insurance company for the purpose of engaging in the business of insurance under this chapter.

(b) Requires each incorporator, to form a captive insurance company, to adopt and sign the articles of incorporation of the captive insurance company as provided by this section.

(c) Requires that the articles of incorporation of a captive insurance company include the name of the captive insurance company, which may not be the same as, deceptively similar to, or likely to be confused with or mistaken for any other existing business name registered in this state; the location of the captive insurance company's principal business office; the type of insurance business in which the captive insurance company proposes to engage; the number of directors of the captive insurance company; the number of authorized shares and the par value of the captive insurance company's capital stock; the amount of the captive insurance company's capital and surplus; and any other information required by the commissioner as necessary to explain the captive insurance company's objectives, management, and control.

(d) Requires the board of directors of a captive insurance company incorporated in this state to have at least three members, and requires that at least two of the members be residents of this state.

(e) Requires that the articles of incorporation or bylaws of a captive insurance company authorize a quorum of the board of directors consist of not fewer than one-third of the fixed number of directors.

Sec. 964.007. **CAPITAL AND SURPLUS REQUIREMENTS.** (a) Prohibits TDI from issuing a certificate of authority to a captive insurance company unless the company possesses and maintains unencumbered capital and surplus in an amount determined by the commissioner by rule based on the type, volume, and nature of the insurance business transacted.

(b) Prohibits the amount of capital and surplus determined by the commissioner under Subsection (a) from being less than \$250,000 or greater than \$5 million.

(c) Requires that the minimum capital and surplus required under Subsection (a) be in the form of United States currency; an irrevocable letter of credit, in a form approved by the commissioner, naming the commissioner as beneficiary for the security of the captive insurance company's policyholders and issued by a bank approved by the commissioner; bonds of this state; or bonds or other evidences of indebtedness of the United States, the principal and interest of which are guaranteed by the United States.

Sec. 964.008. APPLICATION FOR CHARTER AND CERTIFICATE OF AUTHORITY. (a) Requires the incorporators, to obtain a charter and certificate of authority for a captive insurance company, to pay to the commissioner an application fee and file with the commissioner an application for the charter and certificate of authority, which is required to include:

(1) a financial statement certified by two principal officers;

(2) a plan of operation and projections, which must include an actuarial report prepared by a qualified independent actuary;

(3) the captive insurance company's proposed articles of incorporation;

(4) an affidavit by the incorporators or officers of the captive insurance company stating that the capital and surplus are the bona fide property of the company and the articles of incorporation are true and correct; and

(5) if the application provides for the issuance of shares of stock without par value, a certificate authenticated by the incorporators or officers stating the number of shares without par value that are subscribed and the actual consideration received by the captive insurance company for those shares.

(b) Authorizes the commissioner, if the commissioner is not satisfied with the affidavit filed under Subsection (a)(4), to require that the incorporators or officers provide at their expense additional evidence as described by Subsection (a) before the commissioner takes action on the application.

(c) Provides that the application fee required under this section is \$1,500 or a greater amount set by the commissioner by rule as necessary to recover the cost of administering this chapter.

(d) Prohibits the application fee, notwithstanding Subsection (c), for a complete application filed on or before December 30, 2018, from exceeding \$1,500 unless the commissioner by rule has raised the filing fee. Provides that this subsection expires January 1, 2019.

Sec. 964.009. EXAMINATION BY COMMISSIONER. (a) Requires the commissioner, after the application and application fee for a charter and certificate of authority under Section 964.008 are filed with TDI and the applicant has complied with all legal requirements, to conduct an examination of the applicant to determine whether the minimum capital stock and surplus requirements of Section 964.007 are satisfied, the capital stock and surplus are the bona fide property of the captive insurance company, and the captive insurance company has fully complied with applicable insurance laws.

(b) Authorizes the commissioner to appoint a competent and disinterested person to conduct the examination required by this section. Requires the examiner to file

an affidavit of the examiner's findings with the commissioner. Requires the commissioner to record the affidavit.

Sec. 964.010. **ACTION ON APPLICATION.** (a) Requires the commissioner to determine whether the proposed capital structure of the applicant meets the requirements of this chapter; the proposed officers or directors of the applicant have sufficient insurance experience, ability, standing, and good record to make success of the captive insurance company probable; the applicant is acting in good faith; and the applicant otherwise satisfies the requirements of this chapter.

(b) Requires the commissioner, in evaluating the application, to consider the amount and liquidity of the applicant's assets relative to the risks to be assumed; the adequacy of the expertise, experience, and character of each individual who will manage the applicant; the overall soundness of the applicant's plan of operations and the projections contained in that plan; the adequacy of the loss prevention programs of the applicant's parent; whether the applicant's affiliates have significant operations located in this state; and any other factors the commissioner considers relevant to determine whether the proposed captive insurance company will be able to meet its policy obligations.

(c) Requires the commissioner, if the commissioner determines that the applicant has not met the standards set out by Subsection (a), to deny the application in writing, giving the reason for the denial. Requires the commissioner, on the applicant's request, to hold a hearing on a denial. Requires the commissioner, not later than the 30th day after the date the commissioner receives the applicant's request for a hearing, to set a hearing date.

(d) Requires the commissioner, if the commissioner does not deny the application under Subsection (c), to approve the application and issue to the applicant a certificate of authority to engage in business as proposed in the applicant's articles of incorporation or application, certify and file the approved documents with TDI, and issue certified copies of the charter and certificate of authority to the applicant's incorporators.

(e) Prohibits a certificate of authority issued to a captive insurance company under this section from being sold.

Sec. 964.011. **ORGANIZATION AND CORPORATE PROCEDURE.** Authorizes a captive insurance company to be incorporated as a stock insurer with its capital divided into shares and held by the stockholders.

Sec. 964.012. **ANNUAL REPORT.** (a) Provides that a captive insurance company licensed under this chapter is not required to file any report, except as provided by this section.

(b) Requires a captive insurance company that holds a certificate of authority to engage in captive insurance business in this state to file with the commissioner on or before March 1 of each year, a statement of the company's financial condition, verified by two of its executive officers and filed in the annual statement format adopted and published each year by the National Association of Insurance Commissioners (NAIC) for the lines of business written by the captive insurance company and on or before June 1 of each year, a report of its financial condition at last year-end with an independent certified public accountant's opinion of the company's financial condition.

(c) Authorizes a captive insurance company to make a written application to the commissioner for filing its annual report required under this section on a fiscal year-end. Requires the captive insurance company, if an alternative filing date is granted, to file the annual report not later than the 60th day after the date of the company's fiscal year-end; to file the report of its financial condition at last year-

end with an independent certified public accountant's opinion of the company's financial condition not later than the 150th day after the date the annual report is due; and to file its balance sheet, income statement, and statement of cash flows, verified by two of its executive officers, before March 1 of each year to provide sufficient detail to support the premium tax return.

Sec. 964.013. INVESTMENTS. (a) Provides that a captive insurance company is not subject to a restriction on allowable investments, except as provided by this section.

(b) Authorizes a captive insurance company to make loans to its affiliates with the prior approval of the commissioner. Requires that each loan be evidenced by a note approved by the commissioner. Prohibits a captive insurance company from making a loan of the minimum capital and surplus funds required by this chapter.

(c) Authorizes the commissioner to prohibit or limit an investment that threatens the solvency or liquidity of a captive insurance company.

Sec. 964.014. AMENDMENTS TO CHARTER OR ARTICLES OF INCORPORATION. Prohibits a captive insurance company from amending its charter or articles of incorporation unless the amendment has been filed with and approved by the commissioner.

Sec. 964.015. NOTICE OF DIVIDENDS. Requires a captive insurance company to notify the commissioner in writing before issuing policyholder dividends.

Sec. 964.016. PROHIBITION ON JOINING OR CONTRIBUTING TO CERTAIN ENTITIES AND FUNDS. Provides that a captive insurance company is prohibited from joining or contributing financially to any plan, pool, association, or guaranty or insolvency fund in this state, and provides that a captive insurance company, its insured, or any affiliate is not entitled to receive any benefit from a plan, pool, association, or guaranty or insolvency fund for claims arising out of the operations of the captive insurance company.

Sec. 964.017. SUSPENSION OR REVOCATION OF LICENSE. Authorizes the commissioner, after notice and an opportunity for hearing, to revoke or suspend the certificate of authority of a captive insurance company for insolvency or impairment of required capital or surplus to policyholders; failure to submit an annual report, as required by Section 964.012; failure to comply with the provisions of its own charter or bylaws; failure to submit to examination as required by Chapter 401; failure to pay the cost of examination as required by Chapter 401; failure to pay any tax or fee required by this code, removal of its principal office or records from this state; use of practices that render its operation detrimental to the public or its condition unsound; or failure to otherwise comply with laws of this state.

Sec. 964.018. CONFIDENTIALITY. (a) Provides that any information filed by an applicant or captive insurance company under this chapter, including an application filed under Section 964.008, is confidential and privileged for all purposes, including for purposes of Chapter 552 (Public Information), Government Code, a response to a subpoena, or evidence in a civil action. Prohibits the information from being disclosed, except as provided by Subsections (b), (c), and (d), without the prior written consent of the applicant or captive insurance company to which the information pertains.

(b) Authorizes the commissioner to publish all or any part of the information described by Subsection (a) in the manner that the commissioner considers appropriate if the commissioner, after notice to the applicant or captive insurance company and its affected affiliates and an opportunity for hearing, determines that the interests of the public will be served by the publication of the information.

(c) Authorizes the commissioner or another person, if the recipient of the information described by Subsection (a) has the legal authority to maintain the

confidential or privileged status of the information and verifies that authority in writing, to disclose the information to any of the following entities functioning in an official capacity: a commissioner of insurance or an insurance department of another state; an authorized law enforcement official; a district attorney of this state; the attorney general; a grand jury; members of a supervisory college described by Section 823.0145 (Supervisory Colleges); NAIC and its affiliates and subsidiaries; or another state, federal, or international insurance agency or analogous financial agency if the entity is operating in its official capacity and the applicant, captive insurance company, or corporate system to which the information relates operates in the entity's jurisdiction.

(d) Requires the commissioner to enter into written agreements with NAIC that are required to specify procedures and protocols regarding the confidentiality and security of information shared with NAIC and its affiliates and subsidiaries under this section, including procedures and protocols for sharing by NAIC with other state, federal, or international regulators; specify that ownership of information shared with NAIC and its affiliates and subsidiaries under this section remains with the commissioner, and that use of the information by NAIC is subject to the direction of the commissioner; require prompt notice to an applicant or captive insurance company whose confidential information is in the possession of NAIC under this section that the information is subject to a request or subpoena to NAIC for disclosure or production; and require NAIC and its affiliates and subsidiaries to give consent to intervention by an applicant or captive insurance company in any judicial or administrative action in which NAIC and its affiliates and subsidiaries may be required to disclose confidential information about the applicant or captive insurance company shared with NAIC and its affiliates and subsidiaries under this section.

(e) Authorizes the commissioner to use information described by Subsection (a) in the furtherance of a legal or regulatory action relating to the administration of this code.

Sec. 964.019. PREMIUM AND MAINTENANCE TAXES. (a) Provides that a captive insurance company is subject to premium taxes under Subtitle B (Reserves and Investments), Title 3, as applicable to the individual lines of business written by the captive insurance company, provided that the premium tax rate imposed on all business written by the captive insurance company is one half of one percent of the business.

(b) Prohibits the total amount of premium tax assessed each year from exceeding \$200,000.

(c) Provides that a captive insurance company is subject to maintenance taxes under Subtitle C, Title 3, as applicable to the individual lines of business written by the captive insurance company.

Sec. 964.020. RULEMAKING AUTHORITY. Authorizes the commissioner to adopt reasonable rules as necessary to implement the purposes and provisions of this chapter.

SECTION 2. Requires the commissioner, as soon as practicable after the effective date of this Act, but not later than January 1, 2014, to adopt rules and procedures necessary to implement Chapter 964, Insurance Code, as added by this Act.

SECTION 3. Effective date: upon passage or September 1, 2013.