

# SENATE BILL REPORT

## SB 6331

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As of January 31, 2020

**Title:** An act relating to captive insurers.

**Brief Description:** Concerning captive insurers.

**Sponsors:** Senators Mullet and Wilson, L.

**Brief History:**

**Committee Activity:** Financial Institutions, Economic Development & Trade: 1/30/20.

**Brief Summary of Bill**

- Limits the ability to independently procure insurance in this state to exempt commercial purchasers and captive insurance companies.
- Requires exempt commercial purchasers who independently procure insurance to file with the Office of the Insurance Commissioner (OIC) and pay a tax on property and casualty insurance premiums.
- Requires captive insurance companies to register with the OIC and pay a tax on insurance premiums on their Washington state risk.

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**SENATE COMMITTEE ON FINANCIAL INSTITUTIONS, ECONOMIC DEVELOPMENT & TRADE**

**Staff:** Kellee Gunn (786-7429)

**Background:** Captive Insurance. A captive insurance company (captive) is a wholly owned subsidiary formed by an entity to provide insurance to its non-insurance parent company. Captives are established to meet the risk-management needs of the parent company and are generally considered a form of self-insurance. They may be formed to supplement commercial insurance, or to provide insurance for risk they are unable to cover with commercial insurance. Once established, the captive operates like any commercial insurer in that it issues policies, collects premiums and pays claims, but it does not offer insurance to the public. It is regulated as a captive, rather than as a traditional insurer, and some states have enacted separate regulatory schemes for these types of insurance companies. The primary oversight of a captive insurer is where it is domiciled. Certain tax advantages exist

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with respect to a captive. Premiums paid to a captive insurance company by a parent company qualifies as an ordinary business expense and may be deducted from federal income tax.

Insurance Regulation and Taxation in Washington State. An authorized insurer, also known as an admitted insurer, is an insurer licensed to do business in the state. To be licensed, an insurer must provide certain information on rates and policies to the OIC. Surplus lines insurance, a kind of unauthorized insurance, is allowable if registered with the OIC. A surplus lines policy may only be sold if:

- a diligent effort has been made to purchase insurance in the authorized market;
- the purpose of buying the coverage is not to secure a lower premium rate than would be accepted by any authorized insurer; and
- the insurance is purchased through a licensed surplus line broker.

All net premiums collected and received by authorized insurers and surplus lines insurance are subject to the insurance premiums tax except for title insurers and fraternal benefit societies. The insurance premiums tax rate is 2 percent, except for ocean marine and foreign trade who pay 0.95 percent. For property and casualty insurance, if Washington is the insured's home state, the tax is computed upon the entire premium regardless of whether the policy covers risks or exposures that are in this state. For all other lines of insurance, the tax is computed upon the proportion of the premium that is properly allocable to the risks or exposures located in this state.

Exempt Commercial Purchasers. A person is an exempt commercial purchaser if:

- they employ or retain a qualified risk manager to negotiate insurance coverage;
- have paid aggregate commercial property and casualty insurance premiums exceeding \$100,000 in the previous year; and
- meet one of the following criteria:
  - possess a net worth in excess of \$20 million;
  - generate revenues of at least \$50 million;
  - employ 500 full-time equivalent employees;
  - are a nonprofit or public entity with at least \$30 million in annual budgeted expenditures; or
  - are a municipality in excess of 50,000 people.

The term exempt commercial purchaser refers to the fact that they are exempt from needing to buy insurance on the commercial insurance market and can buy from a surplus line broker if certain criteria are met.

**Summary of Bill:** The bill as referred to committee not considered.

**Summary of Bill (Proposed Substitute):** The ability to independently procure insurance in this state is limited to an exempt commercial purchaser or an affiliate of a Washington captive insurer.

Exempt Commercial Purchasers Who Independently Procure Insurance. An exempt commercial purchaser must file a form with the OIC within 60 days after the effective date of the insurance. The form must include general details on the policy, and additional pertinent

information required by the OIC. Independently procured insurance is limited to property or general casualty insurance. On March 1st, an exempt commercial purchaser must provide the OIC a verified statement providing an aggregate of net premiums and any additional information as required.

A 2 percent tax on independently procured insurance premiums is due to the OIC on March 1st. When Washington is the exempt commercial purchaser's home state, the tax is on the entire premium of its property and casualty insurance risks or exposure in the United States and its territories. Any premium paid for risks and exposures outside the United States is exempt from the tax on premiums.

Failure to file a report is a \$1,000 fine, and failure to file an annual statement or pay the premium tax on independently procured insurance will result in the same penalties and interest under current law for delinquent insurers and taxpayers. Taxes and fees must be credited to the state general fund.

Washington Captive Insurers. A Washington captive insurer is an insurance company that:

- is owned by a corporation having its principal place of business in Washington and is not itself an insurer;
- insures risks of the parent corporation, the parent corporation's other affiliates, or both; and
- is licensed as a captive insurer by the jurisdiction in which it is domiciled.

An affiliate of a captive is an entity under its common control or a person that holds an insured interest because of either employment or a sales contract. A captive may provide insurance to a parent corporation having its principal place of business in this state, to the parent corporation's affiliates, or both, and insure or reinsure risks in Washington.

Within 120 days after enactment of this bill, a Washington captive insurer must register with the OIC. The captive must pay \$2,500 and show evidence of good standing in its state of domicile to the OIC in order to receive a certificate of captive authority. A certificate may be renewed annually at no more than \$2,500 per year.

A 2 percent tax on premiums for insurance directly procured by and provided to its parent or affiliate for Washington risks is due on March 1st. Washington risks are defined as the share of risk covered by the premiums attributed to this state, based upon where the underlying risks are located or the losses or injuries giving rise to covered claims arise. The captive insurer may use any reasonable method of determining such an allocation, including actuarial analysis or use of a proxy such as sales, property value, or payroll. Whether it is paid directly or is paid as a reimbursement through an indemnity policy does not change the determination of Washington risk. Washington risks do not include any risks covered under workers compensation.

Failure to pay the premium tax will result in the same penalties and interest under current law for delinquent insurers and taxpayers. Taxes and fees must be credited to the state general fund.

Public and Nonprofit Entities Exemption. Nonprofit organizations or public entities in Washington, including higher education institutions, who independently procure insurance are exempt from the requirements on exempt commercial purchasers.

Other. This bill contains a severability clause. The exclusion for captives and exempt commercial purchasers from laws regarding the premiums tax and unauthorized insurance applies both retroactively and prospectively.

**Appropriation:** None.

**Fiscal Note:** Requested on January 29, 2020.

**Creates Committee/Commission/Task Force that includes Legislative members:** No.

**Effective Date:** The bill contains an emergency clause and takes effect immediately.

**Staff Summary of Public Testimony on Proposed Substitute:** PRO: There is uncertainty in this market. This bill clarifies the uncertainty. Companies rely on law and case law. Please consider a compromise. This compromise bill is the only constitutional solution. Captive insurance is self-insurance and needs no consumer protection. Innovative companies have risks that admitted insurance cannot handle. Companies may also be in situations where there is a high deductible on admitted insurance. These situations require captive insurance. Captive insurance is not defined in current statute, and any definition currently in statute would not cover these types of insurance. Captives ensure funds are available when needed. We believe this bill should apply retroactively and prospectively. The Nonadmitted and Reinsurance Reform Act makes clear that industrial insurance or workers compensation is separate from this.

CON: There may be unintended consequences to surplus lines, and other insurance products. This issue was brought to the OIC by the business community. Captives are valuable and important to businesses. Without them they would have to go to the admitted market, to surplus lines, or keep money in an account. Keeping money in an account is not something businesses want to do. B&O tax is charged on the business's total receipts and premium tax is exempt from B&O tax. Premiums are exempt on certain types of taxation.

**Persons Testifying:** PRO: Senator Mark Mullet, Prime Sponsor; Dan Coyne, Responsible Employer Coalition; Grace Yuan, K&L Gates.

CON: Anna Lisa Gellerman, Office of the Insurance Commissioner.

**Persons Signed In To Testify But Not Testifying:** No one.