

SENATE BILL REPORT

SB 6331

As Reported by Senate Committee On:
Financial Institutions, Economic Development & Trade, February 6, 2020
Ways & Means, March 2, 2020

Title: An act relating to captive insurers.

Brief Description: Concerning captive insurers. [**Revised for 2nd Substitute:** Concerning captive insurance.]

Sponsors: Senators Mullet and Wilson, L.

Brief History:

Committee Activity: Financial Institutions, Economic Development & Trade: 1/30/20, 2/06/20 [DPS-WM, w/oRec].
Ways & Means: 2/20/20, 3/02/20 [DP2S, w/oRec].

Brief Summary of Second Substitute Bill

- Requires captive insurance companies to register with the Office of the Insurance Commissioner (OIC) and pay a tax on insurance premiums on their Washington state risk.
- Requires foreign captive insurance companies to register with the OIC and pay a tax on insurance premiums on their Washington state risk.

SENATE COMMITTEE ON FINANCIAL INSTITUTIONS, ECONOMIC DEVELOPMENT & TRADE

Majority Report: That Substitute Senate Bill No. 6331 be substituted therefor, and the substitute bill do pass and be referred to Committee on Ways & Means.

Signed by Senators Mullet, Chair; Wilson, L., Ranking Member; Braun, Ericksen and Hobbs.

Minority Report: That it be referred without recommendation.

Signed by Senators Hasegawa, Vice Chair; Das.

Staff: Kellee Gunn (786-7429)

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: That Second Substitute Senate Bill No. 6331 be substituted therefor, and the second substitute bill do pass.

Signed by Senators Rolfes, Chair; Frockt, Vice Chair, Operating, Capital Lead; Mullet, Capital Budget Cabinet; Brown, Assistant Ranking Member, Operating; Becker, Billig, Carlyle, Conway, Darneille, Dhingra, Hasegawa, Hunt, Keiser, Liias, Muzzall, Pedersen, Schoesler, Van De Wege, Wagoner and Wilson, L..

Minority Report: That it be referred without recommendation.

Signed by Senators Braun, Ranking Member; Honeyford, Assistant Ranking Member, Capital; Warnick.

Staff: Sandy Stith (786-7710)

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 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.

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 (Second Substitute): Washington Captive Insurers. A Washington captive insurer (captive) is an insurance company that:

- is wholly 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;
- has total assets worth at least \$25 million as verified by independent certified accountants; 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, or within 120 days after issuing its first policy, a captive 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. Captives must share their methodology and analysis on determining their Washington risk with the OIC. 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.

Taxes may not be imposed on Washington captive insurance companies' premiums for any period prior to January 1, 2010. Beginning January 1, 2020, 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.

Washington captive insurers are deemed to have paid B&O tax for any period preceding the effective date of this act.

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

- is wholly owned by a corporation having its principal place of business in in another state or territory of the United States other than this state, or the District of Columbia, and is not itself an insurer;
- insures risks of the parent corporation, the parent corporation's other affiliates, or both;

- has total assets worth at least \$25 million as verified by independent certified accountants; and
- is licensed as a captive insurer by the jurisdiction in which it is domiciled.

The same requirements and fees that pertain to Washington captive insurers pertain to foreign captive insurers that insure risk in Washington. A 2 percent tax on premiums for insurance directly procured by and provided to its parent or affiliate for Washington risks is due by foreign captive insurers on March 1st. Taxes on premiums may not be imposed or collected on a foreign captive insurer for any period before January 1, 2010, and all taxes must be limited to a foreign captive insurer's.

Washington Risk. For periods beginning January 1, 2020, a registered foreign captive insurer is subject to certain sanctions.

Institutions of Higher Education. Institutions of higher education, who independently procure insurance, are exempt from the requirements on exempt commercial purchasers. Institutions of higher education may have a Washington captive insurance company and must register their captive but are exempt from the tax on premiums and certain other requirements imposed on captives.

Other. This bill contains a severability clause. The exclusion of captives and exempt commercial purchasers from certain laws regarding the premiums tax, insurance licensing requirements, unauthorized insurance, and B&O tax applies both retroactively and prospectively.

EFFECT OF CHANGES MADE BY WAYS & MEANS COMMITTEE (Second Substitute):

- Removes language pertaining to exempt commercial purchasers who independently procure insurance.
- Clarifies which sections do not apply to higher education institutions with captives.
- Defines a foreign captive insurer.
- Requires a foreign captive insurer to register, pay an annual fee, and pay a 2 percent tax on premiums attributable to Washington risks.
- Amends the intent section.

EFFECT OF CHANGES MADE BY FINANCIAL INSTITUTIONS, ECONOMIC DEVELOPMENT & TRADE COMMITTEE (First Substitute):

- Requires a Washington captive insurer to have total assets worth at least \$25 million as verified by independent certified accountants.
- Makes clarifying changes regarding the exemption of Washington captive insurers in sections pertaining to exempt commercial purchasers.
- Establishes when a new Washington captive insurer must register with the OIC.
- Requires Washington captive insurers to share their methodology and analysis on determining their Washington risk with the OIC.
- Exempts Washington captive insurers from certain fees and penalties.

- Establishes that any taxes for Washington captive insurers may not be imposed or collected on any period prior to January 1, 2010.
- Removes retroactivity of the exemption on Washington captive insurers' 2 percent premiums tax on authorized insurers.
- Establishes that Washington captive insurers are deemed to have paid B&O tax for any period preceding the effective date of this act.
- Exempts B&O tax from being imposed on premiums paid by exempt commercial purchasers.

Appropriation: None.

Fiscal Note: Available.

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 (Financial Institutions, Economic Development & Trade): *The committee recommended a different version of the bill than what was heard.* 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 (Financial Institutions, Economic Development & Trade): 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 (Financial Institutions, Economic Development & Trade): No one.

Staff Summary of Public Testimony on First Substitute (Ways & Means): *The committee recommended a different version of the bill than what was heard.* PRO: This bill brings in

revenue for Washington. It may not be at the level included in the fiscal note. This is a complicated concept. Some large Washington companies set up these captive companies as a way to mitigate risk. They can put aside money they anticipate they may incur for things such as workers compensation through captive insurance, or they can book this on their balance sheets. This bill is not only an attempt to get revenue for the state of Washington, but to provide Washington businesses with the mechanism they prefer to use to insure their risk. The use of captives is good for customers, employees, shareholders and companies. The use of captives ensures that a company's reserves for future anticipated losses are in a safe, regulated, reliable, wholly owned subsidiary. Large companies do not have to use captives under accounting and IRS rules. These funds may be kept on the balance sheets. The challenge is that last year the OIC called into question whether current state law allows for the use of captives. This bill establishes two things: allows companies to use captive insurance and establishes an appropriate level of taxation through the 2 percent premium tax on Washington State risk insured by our captives. We believe this is an equitable level of taxation. This legislation is critical for our company. If this bill is not passed it would have devastating impact to our company and our ability to proceed with doing business in Washington. Approximately 55,000 Washingtonians are employed through our company. Approximately 800,000 people are employed through our company across the country. Inside Washington, we use the state fund for workers compensation. Outside Washington, we self insure. The OIC called into question an ambiguity in the law about whether out-of-state premiums should be taxed. Taxing as originally proposed by the OIC, retroactively for 20 years, with interest and penalties, would devastate our company. We would be forced to layoff staff. And, if the only justification is that we are domiciled in Washington, we would be forced to leave Washington and domicile in another state with more mature captive laws. We ask for a fair system of taxation.

OTHER: We agree that there needs to be a legal framework. Where we may not be in total agreement is taxing framework. We understand that some of the large companies are buying indemnity products. If a company is indemnifying its nationwide risk and is domiciled in Washington, then when that policy pays off, the Washington company collects. That would leave Washington as the state with the right to make the tax determination. We want to draw your attention to Section 8. This section discusses risk. In this section, captives get to determine how to define risk. It is highly unusual for a company that is regulated to tell the regulator how to define risk. We have been working with the OIC since last summer. We have concerns with independent procurement. This is separate from the captive language. We want to continue to work with stakeholders to continue on protections for independent lines. We recognize that captives are important to Washington business. Surplus line brokers are responsible for the 2 percent premium tax. There were \$1.1 billion in premiums last year. The language on independent procurement does not have enough consumer protection and could lead to unintended consequences. We are working with both House and Senate staff on amendments.

Persons Testifying (Ways & Means): PRO: Senator Mark Mullet, Prime Sponsor; Denny Eliason, Responsible Employer Coalition; Garrett Ferencz, True Blue.

OTHER: Lonnie Johns-Brown, Office of the Insurance Commissioner; Tom Parker, Surplus Line Association of Washington; Robert Hope, Surplus Line Association of Washington.

Persons Signed In To Testify But Not Testifying (Ways & Means): No one.