

HOUSE BILL REPORT

HB 2493

As Reported by House Committee On:
Consumer Protection & Business

Title: An act relating to captive insurers.

Brief Description: Concerning captive insurers.

Sponsors: Representatives Kirby, Vick and Walen.

Brief History:

Committee Activity:

Consumer Protection & Business: 2/4/20, 2/7/20 [DPS].

Brief Summary of Substitute Bill

- Limits the ability to independently procure insurance in this state to exempt commercial purchasers and captive insurance companies (captives).
- 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 a captive to register with the OIC and pay a tax on insurance premiums on their Washington risk.

HOUSE COMMITTEE ON CONSUMER PROTECTION & BUSINESS

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 13 members: Representatives Kirby, Chair; Vick, Ranking Minority Member; Hoff, Assistant Ranking Minority Member; Barkis, Blake, Duerr, Dufault, Johnson, J., Ryu, Santos, Volz, Walen and Ybarra.

Staff: Robbi Kesler (786-7153).

Background:

Captive Insurance. A captive insurance company (captive) is a wholly owned subsidiary formed by an entity to provide insurance to its noninsurance parent company. Captives are

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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 by a parent company qualify as an ordinary business expense and may be deducted from federal income tax.

Insurance Regulation. 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 Office of the Insurance Commissioner (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.

Insurance Taxation in Washington. 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.

Exempt commercial purchasers are exempt from the requirement if they buy insurance on the commercial insurance market and may instead buy from a surplus line broker if certain criteria are met.

Summary of Substitute Bill:

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 1, 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 1. 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.

The Business and Occupations (B&O) tax may not be imposed on premiums paid by exempt commercial purchasers.

Washington Captive Insurers. A Washington captive insurer 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 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.

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.

Public Institutions of Higher Education. Public 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 and must register their captive, but are exempt from the tax on premiums and certain other requirements imposed on captives.

Substitute Bill Compared to Original Bill:

The substitute bill requires a Washington captive insurer to have total assets worth at least \$25 million as verified by independent certified accountants. Institutions of higher education may have a Washington captive and must register their captive, but are exempt from the tax on premiums and certain other requirements. 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 1 and requires Washington captive insurers to share their methodology and analysis on determining their Washington risk with the OIC. This bill establishes that any taxes for Washington captive insurers may not be imposed or collected on any period prior to January 1, 2010, and removes retroactivity of the exemption on Washington captive insurers' 2 percent premiums. It also establishes that Washington captive insurers are deemed to have paid B&O tax for any period preceding the effective date of this act.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill contains an emergency clause and takes effect immediately.

Staff Summary of Public Testimony:

(In support) A framework for regulation captive insurance needs to be addressed this session. Captive insurance is self-insurance and needs no consumer protection. Large companies have risks that admitted insurance cannot handle. Insurers require businesses to retain large amounts of risk, and typically the business must finance the risk. Many of these policies do not involve businesses or claims in Washington. Because of the need to self-insure, the company must maintain a balance sheet reserve, which is unfunded, or create a captive insurance structure to ensure the risk is funded. 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. The use of a captive protects employees, customers, and the company. Offering some certainty to this issue provides independent oversight by the state regulator instead of forcing business out of state or making a business begin to fully self-insure, which may lead to more risks.

(Opposed) None.

(Other) There may be unintended consequences to surplus lines and other insurance products. Taxation could bring in revenue, but not taxing could create market instability, and the OIC is required to look after the market stabilization.

Persons Testifying: (In support) Representative Kirby, prime sponsor; Dan Coyne and David Beyer, Alaska Airlines; Steve Legg, Starbucks; and Garrett Forencz, True Blue.

(Other) Tom Parker, Surplus Lines Association of Washington; and Lonnie Johns-Brown and AnnaLisa Gellerman, Office of the Insurance Commissioner.

Persons Signed In To Testify But Not Testifying: None.