

# HOUSE BILL REPORT

## 2SSB 5315

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**As Passed House:**

April 9, 2021

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

**Brief Description:** Concerning captive insurance.

**Sponsors:** Senate Committee on Ways & Means (originally sponsored by Senators Mullet and Dozier).

**Brief History:**

**Committee Activity:**

Consumer Protection & Business: 3/22/21, 3/24/21 [DP];

Finance: 3/29/21, 3/31/21 [DP].

**Floor Activity:**

Passed House: 4/9/21, 96-1.

**Brief Summary of Second Substitute Bill**

- Requires eligible captive insurers to register with the Office of the Insurance Commissioner.
- Imposes insurance premiums tax on the risk covered by captive insurance premiums allocable to Washington.

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### HOUSE COMMITTEE ON CONSUMER PROTECTION & BUSINESS

**Majority Report:** Do pass. Signed by 7 members: Representatives Kirby, Chair; Walen, Vice Chair; Vick, Ranking Minority Member; Dufault, Assistant Ranking Minority Member; Corry, Ryu and Santos.

**Staff:** Serena Dolly (786-7150).

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

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## HOUSE COMMITTEE ON FINANCE

**Majority Report:** Do pass. Signed by 15 members: Representatives Frame, Chair; Berg, Vice Chair; Walen, Vice Chair; Orcutt, Ranking Minority Member; Dufault, Assistant Ranking Minority Member; Chase, Chopp, Harris-Talley, Morgan, Orwall, Ramel, Springer, Thai, Vick and Wylie.

**Minority Report:** Without recommendation. Signed by 1 member: Representative Stokesbary.

**Staff:** Tracey O'Brien (786-7152).

### **Background:**

#### Captive Insurance.

A captive insurance company (captive) is one created and wholly owned by one or more non-insurance companies to insure the risks of its owner or owners. A captive may be formed to supplement commercial insurance or to provide insurance for risk it is unable to cover with commercial insurance. Once established, a 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.

A captive is not regulated as a traditional insurer, and some states have enacted separate regulatory frameworks for captives. The primary oversight of a captive occurs where it is domiciled. Captives enjoy certain tax advantages, and premiums paid to a captive by a parent company qualify as an ordinary business expense and may be deducted from federal income tax.

No statutory framework currently exists to allow for the formation or use of captives in Washington.

#### Insurance Taxation.

All net premiums collected and received by authorized insurers are subject to the state's 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 in which 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.

### **Summary of Bill:**

A framework for registering and imposing the insurance premiums tax on eligible captives

is established.

An eligible captive is defined as an insurance company that:

- is wholly or partially owned by a corporation, company, nonprofit, or public institution of higher education;
- insures risk of its captive owner, the owner's affiliates, or both;
- has one or more insureds whose principal place of business is Washington;
- has assets that exceed its liabilities by \$1 million and can pay its debts when they come due, as verified by audited financial statements and prepared by an independent certified accountant; and
- is licensed as a captive insurer by the jurisdiction in which it is domiciled.

Eligible captives must register with the Office of the Insurance Commissioner (OIC) within 120 days of either the effective date of the act or the issuance of a policy that covers Washington risks. The initial registration fee is \$2,500, and the OIC may set a renewal fee not to exceed \$2,500 per year. Eligible captives who fail to register are subject to penalties and fines applicable to unlawful, unauthorized insurers.

Registered captives may only provide property and casualty insurance to a captive owner or to the captive owner's affiliates. Registered captives also may obtain or provide reinsurance for ceded or assumed risks regardless of location.

On or before the first day of March, registered captives must pay the 2 percent insurance premiums tax for insurance directly procured by and provided to its parent or affiliate for Washington risks during the preceding calendar year. Registered captives affiliated with public institutions of higher education are not subject to the insurance premiums tax. Insurance premiums taxes are credited to the State General Fund.

If not previously paid to the OIC, insurance premiums taxes are due from registered captives for any period after January 1, 2011, but are not subject to penalties and fees. Beginning July 1, 2021, penalties, interest, and fees may be imposed on registered captives. Penalties and fees are credited to the State General Fund.

Washington risks are defined as the share of risk covered by premiums allocable to this state, based on where underlying risks are located or where the losses or injuries giving rise to covered claims arise. Whether paid directly or by reimbursement, the timing or nature of a captive insurer's payment must not determine Washington risks. Methodology to determine Washington risks by eligible captive insurers must be shared with the OIC.

**Appropriation:** None.

**Fiscal Note:** Available.

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

**Staff Summary of Public Testimony (Consumer Protection & Business):**

(In support) This is a thoughtful agreement between the OIC and the insurance industry. Captive insurance is very similar to self-insurance. For decades, Washington businesses have used captives as a financially prudent tool, and some businesses would not be able to continue without the use of captives. However, the state's insurance code does not authorize or recognize captives. In 2018 and 2019 the OIC began enforcement actions, and some businesses suspended the use of captives. At the request of legislators, enforcement was halted to allow for a study on captive insurance, and the OIC and other stakeholders began work on this legislation. The bill authorizes the use of captives and allows for appropriate oversight and taxation. It will generate revenue for the state while ensuring businesses are not penalized for past practices that they believed were lawful. The revenue assumptions in the fiscal note may increase as businesses reinstate their captives. The use of captives by institutions of higher education saves the state millions of dollars each year.

(Opposed) None.

**Staff Summary of Public Testimony (Finance):**

(In support) Many Washington headquartered companies have moved to insure against risk by creating a captive insurance company. Essentially, it is a way to self-insure when commercial or surplus insurance policies are unavailable or unaffordable for the level of coverage required. It is a prudent financial tool that allows a company to set aside the reserves for their risk exposure. The OIC has questioned the ability for captive insurers to be formed. Stakeholders and the OIC have settled upon this legislation as the appropriate level of taxation and of regulation. It is both prospective and retrospective without punishing those companies who used captive insurance before this legislation. The legislation ensures that a captive insurer has the proper amount of reserves to reflect the potential risk. The University of Washington has been self-insured since the mid-1970s, primarily to reflect risk exposure from its hospital and other medical practices.

(Opposed) None.

**Persons Testifying (Consumer Protection & Business):** Senator Mullet, prime sponsor; Michael Walker and Ellen Range, Office of the Insurance Commissioner; Joe Dacca, University of Washington; Denny Eliason, Responsible Employer Coalition; Rob Mitchell, K&L Gates; and Garrett Ferencz, TrueBlue, Inc.

**Persons Testifying (Finance):** Senator Mullet, prime sponsor; Joe Dacca, University of Washington; Michael Walker and Ellen Range, Office of the Insurance Commissioner; and Denny Eliason, Amazon, Starbucks, and the Responsible Employer Coalition.

**Persons Signed In To Testify But Not Testifying (Consumer Protection & Business):**  
None.

**Persons Signed In To Testify But Not Testifying (Finance):** None.