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BILL ANALYSIS

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Senate Bills 1061 and 1062 (as reported without amendment)
Sponsor: Senator Alan Sanborn
Committee: Banking and Financial Institutions

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RATIONALE

Unlike a number of other states, Michigan does not have a law providing for captive insurance companies. In its simplest form, this type of insurer is a subsidiary created only to insure some or all of the risks of its parent company. A captive insurance company might be established by a single business or insurer, a trade association, or a group of companies in a particular industry. This approach to handing risk represents an alternative to the traditional method, in which businesses and organizations either transfer risk by purchasing an insurance policy from a company that insures disparate types of entities, or retain the risk and allocate funds to meet expected losses through self-insurance. Another development in the insurance industry involves special purpose financial captives, which an insurance company might form to securitize insurance or annuity contracts in order to obtain a source of relatively low-cost capital. (Securitization, generally speaking, is a process in which assets are pooled and then marketed as a financial instrument, or security, to investors.)

It has been suggested that a Michigan law providing for the creation of captive insurance companies would make this State an attractive place for insurers to domicile, and would allow both insurers and noninsurance businesses to form captive insurance companies without going to other states.

CONTENT

Senate Bill 1061 would add Chapter 46 (Captive Insurance Companies), Chapter 47 (Special Purpose Financial Captives), and Chapter 48 (Protected Cell Insurance Companies) to the Insurance Code.

Chapter 46 would do the following:

-- Require captive insurance companies to obtain a certificate of authority from the Commissioner of the Office of Financial and Insurance Services (OFIS).
-- Require captive insurers to pay application fees, examination fees and expenses, and annual renewal fees; and allow OFIS to retain outside services or use internal resources to investigate applicants.
-- Provide for the confidentiality of information submitted to OFIS and reports, records, and work papers of OFIS.
-- Require captive insurers to have and maintain paid in capital and retained earnings in specified amounts.
-- Provide for different types of captive insurers, and allow them to be organized or incorporated in various forms.
-- Permit the Commissioner to revoke or suspend a certificate of authority for various reasons.
-- Impose a tax on captive insurers' direct premiums written and reinsurance premiums.
-- Allow the formation of sponsored captive insurers; and allow them to establish protected cells to insure risks of participants, whose recovery would be limited to the assets of the protected cells.
-- Provide that the assets of a protected cell could not be charged with

-- liabilities arising out of any other business of the insurer.
-- Provide that captive insurers would not be required to contribute to a guaranty fund.
-- Create the "Captive Insurance Regulatory and Supervision Fund", which would receive 20% of taxes collected under Chapters 46 and 47, and all fees and assessments received by OFIS and the Department of Treasury under those chapters.

Chapter 47 would do the following:

-- Allow insurers to apply to the Commissioner for a certificate of authority to transact business as a special purpose financial captive (SPFC).
-- Require SPFCs to pay application fees, examination fees and expenses, and annual renewal and review fees.
-- Establish capitalization requirements for SPFCs.
-- Allow SPFCs to be established as various types of entities.
-- Impose a tax on SPFCs' reinsurance premiums.
-- Authorize an SPFC to insure or reinsure only the risks insured or reinsured by a counterparty (the SPFC's parent or affiliated company or an approved nonaffiliated company).
-- Allow an SPFC to establish protected cells for the purpose of isolating and identifying the assets and liabilities attributable to the risk ceded to the SPFC by a counterparty and the assets and liabilities arising from related insurance securitization.
-- Permit SPFCs to issue securities.
-- Provide for SPFC contracts with counterparties.
-- Provide for the rehabilitation, conservation, or liquidation of SPFCs.
-- Provide for the confidentiality of information and documents.

Chapter 48 would do the following:

-- Allow protected cell companies to establish protected cells upon the Commissioner's approval of a plan of operation or amendments.
-- Require the assets and liabilities of a protected cell to be kept separate and separately identifiable from the assets and liabilities of the company's general account and of other protected cells.
-- Require a protected cell company with respect to a protected cell to engage in insurance securitization in order to support the exposures of that protected cell.
-- Limit creditors' access to protected cell assets and provide that those assets could not be charged with liabilities arising from any other business of the company.
-- Provide that protected cell companies would not be required to contribute to a guaranty fund.

<u>Senate Bill 1062</u> would amend the Michigan Business Tax Act to exempt an insurance company authorized under Chapter 46 or 47 of the Insurance Code from the Act and from the tax it imposes on insurance companies (1.25% of gross direct premiums written on property or risk located or residing in this State).

Senate Bill 1062 is tie-barred to Senate Bill 1061, which is described below.

<u>Chapter 48: Captive Insurance Companies</u>

<u>Definitions</u>. The bill would define "captive insurance company" as a pure captive insurance company, association captive insurance company, sponsored captive insurance company, special purpose captive insurance company, or industrial insured captive insurance company authorized under Chapter 46. A branch captive insurance company would have to be a pure captive insurance company with respect to operations in Michigan, unless otherwise permitted by the Commissioner.

"Pure captive insurance company" would mean a company that insured risks of its parent, affiliated companies, controlled unaffiliated companies, or a combination of those entities.

An "association captive insurance company" would be a company that insured risks of the member organizations of the association and their affiliated companies. "Association" would mean a legal group of individuals, corporations, limited liability companies (LLCs), partnerships, political subdivisions, or groups that had been in continuous existence for at least one year and that owned, controlled, or held, or whose membership organization owned, controlled, or held, all of the outstanding voting securities of an association captive insurance company incorporated as a stock insurer or organized as an LLC; or had complete voting control over an association captive insurance company organized as a mutual insurer.

"Sponsored captive insurance company" would mean a captive insurance company in which the minimum capital and retained earnings required by applicable law were provided by one or more sponsors, that insured the risks of separate participants through the contract, and segregated each participant's liability through one or more protected cells (i.e., segregated accounts).

A "special purpose captive insurance company" would be a captive insurer that was authorized under Chapters 46 and 47 and that did not meet the definition of any other type of captive insurance company.

An "industrial insured captive insurance company" would be a company that insured risks of the industrial insureds that comprised the industrial group and their affiliated companies. "Industrial insured" would mean an insured that met all of the following:

-- It procured insurance by use of the services of a full-time employee acting as a risk manager or insurance manager or using the services of a regularly and continuously qualified insurance consultant.
-- Its aggregate annual premiums for insurance on all risks totaled at least $25,000.
-- It had at least 25 full-time employees.

"Insured industrial group" would mean either 1) a group of industrial insureds that collectively owned, controlled, or held all of the outstanding voting securities of an industrial insured captive insurer incorporated as a stock insurer or an LLC or had complete voting control over an industrial insured captive insurance company incorporated as a mutual insurer; or 2) a group created under the Federal Product Liability Risk Retention Act as a corporation or other limited liability association taxable as a stock insurance company or a mutual insurer under Chapter 46.

<u>Certificate of Authority</u>. A captive insurance company, if permitted by its articles of incorporation, articles of organization, operating agreement, or charter, could apply to the Commissioner for a certificate of authority to do any and all insurance authorized by the Code, except workers' compensation insurance, personal automobile insurance, or homeowners insurance. A captive insurance company would be subject to limitations on the risks that it could insure, and could not accept or cede reinsurance except as provided below.

To conduct business in this State, a captive insurance company would have to obtain a certificate of authority; maintain its principal place of business in Michigan or, for a branch captive insurer, maintain the principal place of business for its branch operations in Michigan; and file with the Commissioner the name and address of a resident agent.

Before granting a certificate of authority, the Commissioner would have to require the captive insurance company to submit organizational documents containing information described in the bill. Before the documents could be effective, they would have to be submitted to the Office of the Attorney General for examination, and the applicant would have to pay the Attorney General the $25 examination fee required under the Code. If the documents complied with Chapter 46, the Office would have to certify that to the Commissioner.

Before granting a certificate of authority, the Commissioner also would have to require, consider, and review various documents, including a plan of operation and, if applicable, a business plan; evidence of the source and form of the minimum capitalization to be contributed to the company; evidence of the amount and liquidity of the assets relative to the risks to be assumed; and evidence of the adequacy of the loss prevention programs of the company's parent, member organization, or industrial insureds, as applicable. If the Commissioner found that the company met the standards of Chapter 46 and would promote the general good of the State, he or she would have to issue a certificate of authority.

Fees. A captive insurance company would have to pay OFIS a nonrefundable $200 fee for processing its application for a certificate of authority. The Commissioner could retain legal, financial, and examination services from outside OFIS to examine and investigate the company, or could use internal resources to examine and investigate the application for a $2,700 fee. A captive insurance company also would have to pay a $500 annual renewal fee.

Domestic Captive Insurer. Upon the Commissioner's approval, a captive insurance company not domiciled in Michigan could become a domestic captive insurance company by complying with all of the requirements of law relative to the authorization of such an insurer of the same or equivalent type in this State.

Confidentiality. Information and testimony submitted or furnished to OFIS pursuant to Chapter 46, examination reports, and OFIS's work papers, correspondence, reports, records, and other written or oral information related to an examination report or an investigation would be confidential, would not be subject to subpoena, and could not be divulged to any person, except as provided in the bill or with the company's written consent. If assurances of confidentiality were provided, the Commissioner could disclose confidential information to the Governor, the Attorney General, a relevant regulatory agency, law enforcement officials, people authorized by the Ingham County Circuit Court, and people entitled to receive the information in order to discharge duties provided for in the Code, and in connection with an enforcement action.

Confidential information would be discoverable by a party in a civil action or contested case to which the submitting captive insurer was a party, if the party seeking discovery showed that the information was relevant and necessary, the information was unavailable from nonconfidential sources, and a subpoena had been submitted to the Commissioner.

Security Requirements. The Commissioner could not issue a certificate of authority to a captive insurance company or renew a certificate unless the company possessed and maintained paid in capital and retained earnings, in the following minimum amounts:

-- $150,000 for a pure captive insurance company.
-- $400,000 for an association captive insurance company incorporated as a stock insurer or organized as an LLC.
-- $750,000 for an association captive insurance company incorporated as a mutual insurer.
-- $300,000 for an industrial captive insurance company incorporated as a stock insurer or organized as an LLC.
-- $500,000 for a sponsored captive insurance company, or $150,000 if it did not assume any risk, the risks insured by the protected cells were homogeneous, and there were not more than 10 cells.
-- An amount determined by the Commissioner for a special purpose captive insurance company.

The Commissioner could not issue a certificate of authority to a captive insurance company incorporated as a nonprofit corporation unless it possessed and maintained unencumbered equity as follows:

-- At least $250,000 for a pure captive insurance company.
-- An amount determined by the Commissioner for a special purpose captive insurance company.

The Commissioner could prescribe additional capital based on the type, volume, and nature of insurance business to be transacted.

For a branch captive insurance company, as security for the payment of liabilities attributable to branch operations, the Commissioner would have to require that a trust fund be established and maintained in the United States for the benefit of U.S. policyholders and U.S. ceding insurers under insurance policies issued or reinsurance contracts issued or assumed, by the branch captive insurer through its branch operations.

A captive insurance company could not pay a dividend out of, or other distribution with respect to, capital or retained earnings, in excess of the limitations set forth in Section 1343 of the Code, without the Commissioner's prior approval. (That section governs the payment of shareholder dividends by domestic insurers.)

Incorporation or Organization of Captive Insurers. A pure captive insurance company or a sponsored captive insurance company could be any of the following:

-- Incorporated as a stock insurer with its capital divided into shares and held by the stockholders.
-- Incorporated as a public benefit, mutual benefit, or religious nonprofit corporation with members in accordance with the Michigan Nonprofit Corporation Act.
-- Organized as an LLC with its capital divided into capital accounts and held by its members.

An association captive insurance company or an industrial insured captive insurance company could be any of the following:

-- Incorporated as a stock insurer with its capital divided into shares and held by the stockholders.
-- Organized as an LLC with its capital divided into capital accounts and held by its members.
-- Incorporated as a mutual insurer without capital stock, whose governing body was elected by the member organizations of its association.

The Code's provisions pertaining to mergers, consolidations, conversions, mutualizations, and redomestications would apply in a determination of the procedures to be followed by a captive insurance company in carrying out any of the transactions described in those provisions, although the Commissioner could waive or modify the requirements for public notice and hearing.

Annual Report. A captive insurance company could not be required to make an annual report except as provided in Chapter 46.

By March 1 of each year, a captive insurer would have to submit to the Commissioner a report of its financial condition.

A branch captive insurer would have to file with the Commissioner, 60 days after the fiscal year end, a copy of all reports and statements required to be filed under the laws of the jurisdiction in which the alien captive insurer was formed.

Sponsored Captive's Reserves. A sponsored captive insurance company could discount its loss and loss adjustment expense reserves at Treasury rates applied to the applicable payments projected through the use of the expected payment pattern associated with the reserves. The company annually would have to submit to the Commissioner the opinion of a qualified actuary as to matters described in the bill.

Insurer Examination. Chapter 2 of the Code (which governs the Commissioner and OFIS) would apply to captive insurance companies authorized under Chapter 46, to the extent that the provisions of Chapter 2 did not contradict the provisions of Chapter 46.

The confidentiality provisions of Chapter 46 would not extend to final exam reports produced by the Commissioner in inspecting or examining a captive insurer formed as a risk retention group under the Federal Product Liability Risk Retention Act.

Section 222 of the Code (which governs the examination of insurers) would apply to all business written by a captive insurance company. The examination for a branch captive insurer, however, would be of branch business and branch operations only, as long as the company annually gave the Commissioner a certificate of compliance issued by or filed with the licensing authority of the jurisdiction in which the company was formed, and demonstrated that it was operating in sound financial condition.

A captive insurance company that was examined would have to pay to the State the expenses and charges of a captive insurer exam, and OFIS would have to issue the warrants for the proper charges incurred in all exams.

Suspension or Revocation of Certificate. The Commissioner could suspend or revoke the certificate of authority of a captive insurance company for reasons listed in the bill, including the following:

-- Insolvency or impairment of capital or retained earnings.
-- Failure to meet the paid in capital and retained earnings requirements.
-- Refusal or failure to submit an annual report or other required report.
-- Failure to submit to an examination or to pay the cost of an exam.

-- The use of financial methods and practices that rendered further transaction of insurance hazardous to policyholders, creditors, or the public.
-- The suspension or revocation of the certificate of authority or equivalent authorization of a branch captive insurer in the jurisdiction where it was formed.
-- Failure to remove or discharge an officer or director, after request by the Commissioner.
-- Failure to pay taxes, fees, assessments, or expenses required by the Code, within 30 days after notice of delinquency.

Investments. An association captive insurance company and an industrial insured captive insurance company insuring the risks of an industrial insured group would have to comply with the investment requirements of the Code. The Commissioner could approve the use of alternative reliable methods of valuation and rating.

A pure captive insurance company and a special purpose captive insurance company would not be subject to any restrictions on allowable investments contained in the Code, although the Commissioner could request a written investment plan and could prohibit or limit an investment that threatened the company's solvency or liquidity.

Only a pure captive insurer could make loans to its parent company or affiliates, and only upon the Commissioner's prior written approval.

The assets of two or more protected cells could be combined for purposes of investment, and this combination could not be construed as defeating the segregation of those assets for accounting or other purposes.

Sponsored captive insurers would have to comply with the Code's investment requirements, as applicable.

Reinsurance. A captive insurance company could provide reinsurance, as authorized by the Code, on risks ceded by any other insurer. A captive insurer could take credit for reserves on risks ceded to reinsurers complying with Sections 1103 and 1105 (which prescribe conditions under which a ceding insurer may be allowed credit for reinsurance as an asset or liability or a reduction from liability on account of reinsurance).

Rating Organization; Guaranty Fund. A captive insurance company would not be required to join a rating organization, or to join or contribute financially to a plan, pool, association, or guaranty or insolvency fund in the State. A captive insurer, its insured, its parent, or any affiliated company or any member organization of its association, could not receive a benefit from a plan, pool, association, or guaranty or insolvency fund for claims arising out of the operations of the company.

Tax on Premiums. Each captive insurance company would have to pay a tax on the direct premiums written or contracted for on policies or contracts of insurance written during the tax year less the amounts paid to policyholders as return premiums, which would include dividends on unabsorbed premiums, and premium deposits returned or credited to policyholders. The tax would have to be calculated by multiplying the amount of the direct premiums written or contracted for, after deducting the amounts paid to policyholders and premium deposits returned or credited to policyholders, by the following rates:

-- 0.4% for the first $20 million.
-- 0.3% for every dollar over $20 million.

In addition, each captive insurer would have to pay a tax on reinsurance premiums, excluding premiums for risks subject to the tax described above or receipt of assets in exchange for the assumption of loss reserves and other liabilities of another insurer or other funding mechanism under common ownership and control if the transaction were part of a plan to discontinue the operations related to the loss reserves and other liabilities being assumed of the other insurer or funding mechanism and if the parties to the transaction intended to renew or maintain business with the captive insurer. This tax would have to be calculated by multiplying the amount of reinsurance premiums by the following rates:

-- 0.225% for the first $20 million.
-- 0.15% for the next $20 million.
-- 0.05% for the next $20 million.
-- 0.025% for every dollar over $60 million.

The aggregate amount of the tax imposed on premiums and reinsurance premiums could not exceed $100,000 for any single tax year. If the aggregate amount imposed on a captive insurer were less than $5,000 for that tax year, however, the insurer would have to pay a minimum tax of $5,000 unless it were the first year in which the insurer was issued a certificate of authority. For a captive insurer that had been issued a certificate of authority for a year or less during the tax year for which the minimum tax was to be imposed, the minimum tax would have to be prorated according to the quarter in which the insurer was issued a certificate, as follows:

-- $5,000 in the first quarter.
-- $3,750 in the second quarter.
-- $2,500 in the third quarter.
-- $1,250 in the fourth quarter.

Regardless of whether two more captive insurers were under common ownership and control, each would be subject to the tax on premiums and reinsurance premiums.

The Department of Treasury would have to administer the tax, and promulgate rules to implement these provisions. The Department would have to prescribe forms for taxpayers' use, and could promulgate rules for taxpayers' maintenance of records, books, and accounts, and for the computation of the tax, the making of returns, and the ascertainment, assessment, and collection of the tax.

An annual return would have to be filed by the first day of the third month after the end of a captive insurer's tax year.

<u>Commissioner Rules, Regulations, & Orders</u>. The Commissioner could promulgate rules, and issue regulations and orders relating to captive insurance companies as necessary to enable him or her to carry out the provisions of Chapter 46.

The Commissioner would be required to promulgate rules establishing standards to ensure that a parent or affiliated company was able to exercise control of the risk management function of any controlled unaffiliated business to be insured by a pure captive insurer. Until the rules were promulgated, the Commissioner could temporarily authorize a pure captive insurer to insure risks.

<u>Application of the Code or Chapter</u>. Except as specifically provided, no provisions of the Code would apply to captive insurance companies. If a conflict occurred between a provision of the Code and a provision of Chapter 46, the chapter would control.

The Commissioner could exempt special purpose captive insurers, on a case-by-case basis, from provisions of Chapter 46 that he or she determined to be inappropriate given the nature of the risks to be insured.

Except as otherwise provided, the terms and conditions of the Code pertaining to insurance reorganizations, receiverships, and injunctions would apply in full to captive insurers authorized under Chapter 46.

<u>Sponsored Captive Insurer</u>. One or more sponsors could form a sponsored captive insurance company. (A "sponsor" would be an entity that was approved by the Commissioner to provide all or part of the capital and retained earnings required by applicable law and to organize and operate a sponsored captive insurance company.)

A sponsored captive insurer could establish and maintain one or more protected cells to insure risks of one or more participants. ("Participant" would mean an entity, and any of its affiliates, that were insured by a sponsored captive insurer, where the recovery of the participant was limited through a participant contract to the assets of a protected cell.) The shareholders of the insurer would be limited to its participants and sponsors, and each protected cell would have to be accounted for separately on the records of the insurer.

The assets of a protected cell could not be chargeable with liabilities arising out of any other insurance business the sponsored captive insurer conducted. The insurer could not make any sale, exchange, or other transfer of assets between or among any of its protected cells without their consent. No sale, exchange, transfer of assets, dividend, or distribution could be made from a protected cell to a sponsor or participant without the Commissioner's approval.

No participant contract could take effect without the Commissioner's prior written approval. The addition of each new protected cell and the withdrawal of any participant of any existing protected cell would constitute a change in the business plan requiring prior approval.

Both of the following would apply to a sponsored captive insurer:

-- The assets of the protected cell could not be used to pay expenses or claims other than those attributable to the protected cell.
-- The capital and surplus of the sponsored captive insurer at all times would have to be available to pay expenses of or claims against the insurer and could not be used to pay expenses or claims attributable to a protected cell.

A sponsor would have to be an insurer authorized under the laws of a state or the District of Columbia (D.C.), an insurance holding company that controlled an insurer authorized under the laws of a state or the D.C. and subject to registration pursuant to the insurance holding company system laws of the insurer's state of domicile, a reinsurer authorized or approved pursuant to the laws of a state or the D.C., or a captive insurance company authorized under Chapter 46. A risk retention group could not be a sponsor or a participant.

The business written by a sponsored captive insurance company with respect to each protected cell would have to be one of the following:

-- Fronted by an insurance company authorized under the laws of any state or any jurisdiction if that company were a wholly owned subsidiary of an insurance company authorized pursuant to the laws or any state or jurisdiction.
-- Reinsured by a reinsurer authorized or approved by this State.
-- Secured by a trust fund in the United States for the benefit of the policyholders and claimants.

An association, corporation, LLC, partnership, trust, or other business entity could be a participant in a sponsored captive insurer. A sponsor also could be a participant. A participant would not have to be a shareholder of the sponsored captive insurer or an affiliate of the company. A participant could insure only its own risks through a sponsored captive insurer, unless otherwise approved by the Commissioner.

The terms and conditions provided in Chapter 48 relating to a protected cell insurer would apply in full to a sponsored captive insurer, except as otherwise provided in Chapter 46.

<u>Regulatory & Supervision Fund</u>

The Captive Insurance Regulatory and Supervision Fund would be a separate fund administered by the Commissioner for the purpose of administering Chapter 18 (Risk Retention Groups) and Chapters 46 and 47, and for reasonable expenses incurred in promoting the captive insurance industry in Michigan.

The Fund would have to be credited with 20% of the taxes collected under Chapters 46 and 47, and all fees and assessments received by the Department of Treasury or OFIS pursuant to the administration of Chapters 46 and 47. All fees received by the Department from reinsurers that assumed risk only from captive insurers also would have to be deposited into the Fund.

Money in the Fund would not revert to the General Fund at the close of the fiscal year, but would remain in the Captive Insurance Regulatory and Supervision Fund.

All fines and administrative penalties would have to be deposited directly into the General Fund.

<u>Chapter 47: Special Purpose Financial Captives</u>

<u>Definitions.</u> The bill would define "special purpose financial captive" or "SPFC" as a captive insurance company, a captive LLC, or a company otherwise qualified as an authorized insurer that had received a certificate of authority from the Commissioner for the limited purposes provided for in Chapter 47.

A captive LLC would be a limited liability company established by a parent, counterparty, affiliated company, or SPFC for the purpose of issuing SPFC securities, entering into an SPFC contract with a counterparty, or otherwise facilitating an insurance securitization.

"Parent" would mean any corporation, LLC, partnership, or individual that owned, controlled, or held with power to vote more than 50% of the outstanding voting securities of an SPFC. "Counterparty" would mean an SPFC's parent or affiliated company or, subject to the Commissioner's prior approval, a nonaffiliated company as ceding insurer to the SPFC contract.

"SPFC contract" would mean a contract between the SPFC and the counterparty pursuant to which the SPFC agreed to provide insurance or reinsurance protection to the counterparty for risks associated with the counterparty's insurance or reinsurance business.

"Insurance securitization" would mean a package of related risk transfer instruments, capital market offerings, and facilitating administrative agreements by which proceeds of the sale of SPFC securities were obtained by an SPFC directly by the issuance of the SPFC securities by the SPFC or indirectly through the issuance of preferred securities by the SPFC in exchange for some or all of the proceeds of the sale of SPFC securities by the SPFC's parent, an affiliated company of the SPFC, a counterparty, or a captive LLC, in transactions that complied with applicable securities laws and in which the proceeds of the issuance of the SPFC securities secured the obligations of the SPFC under one or more SPFC contracts with a counterparty and the obligation to the holders of the securities was secured by assets obtained with proceeds of the securities in accordance with the transaction terms.

Application of the Code. Except as referred to in Chapter 47, no provisions of the Code would apply to an SPFC. Specified sections and Chapter 45 (Insurance Fraud) would apply. (The specified sections, among other things, provide for the examination of insurers; require a $500 fee for examination, investigation, and processing; provide for judicial review, investigations by the Commissioner, and cease and desist orders; and prohibit misrepresentation of an insurer's identity, maintaining an unlicensed office, and making false reports.)

The Commissioner could exempt an SPFC or its protected cells, on a case-by-case basis, from provisions of Chapter 47 that he or she determined to be inappropriate given the nature of the risks to be insured. ("Protected cell" would mean a segregated account established and maintained by an SPFC for one or more SPFC contracts that were part of a single securitization transaction, as further provided in Chapter 48.)

Certificate of Authority. A captive insurance company, a captive LLC, or a company otherwise qualified as an authorized insurer could apply to the Commissioner for a certificate of authority to transact insurance or reinsurance business as authorized by Chapter 47. An SPFC could only insurer or reinsure the risks of its counterparty. An SPFC could purchase reinsurance to cede the risks assumed under the SPFC contract as approved by the Commissioner.

To transact business in this State, an SPFC would have to do the following:

-- Obtain a certificate of authority from the Commissioner.
-- Maintain its principal place of business in Michigan.
-- File with the Commissioner the name and address of a resident registered agent.
-- Provide documentation of the insurance securitization as requested by the Commissioner immediately upon the closing of the securitization transaction.
-- Give the Commissioner a complete set of documentation of the securitization shortly after the closing.

Before granting a certificate of authority, the Commissioner would have to require the applicant to submit organizational documents containing information specified in the bill. The documents would have to be submitted to the Office of the Attorney General for examination before they became effective. If the documents were found to comply with Chapter 47, the Office would have to certify that to the Commissioner. Each applicant would have to pay the Attorney General the $25 examination fee required under the Code.

Before granting a certificate of authority, the Commissioner also would have to require, consider, and review various items listed in the bill, including evidence of the amount and liquidity of assets relative to the risks to be assumed, a plan of operation containing information described in the bill, and an affidavit verifying specified matters. If a protected cell were used, the applicant also would have to file a business plan, contracts between the SPFC and any counterparty or captive LLC related to each protected cell, and other items.

A certificate of authority could be renewed if the Commissioner made certain findings.

Fees. To transact insurance or reinsurance business in this State, an SPFC would have to pay OFIS a nonrefundable fee of $200 for processing its application for a certificate of authority. The Commissioner could retain legal, financial, actuarial, and examination services from outside OFIS to examine and investigate the application, and the reasonable cost could be charged against the applicant, or the Commissioner could use internal resources to examine and investigate the applicant for a fee of $1,500; of that fee, $600 would be payable when the application was filed and the remainder would be payable when the applicant received its certificate of authority.

An SPFC also would have to pay a $500 annual renewal fee, as well as a $2,400 annual review fee or the actual cost as determined by the Commissioner if the costs of the annual review were higher than $2,400.

Form of Organization. An SPFC could be established as a stock corporation, LLC, mutual, partnership, or other form of organization approved by the Commissioner.

The provisions of the Code pertaining to mergers, consolidations, conversions, mutualizations, and redomestications would apply in a determination of the procedures to be followed by an SPFC in carrying out any of those transactions, although the Commissioner could modify or waive requirements for public notice and hearing.

Capitalization Requirements. An SPFC would have to possess initially and then maintain minimum capitalization of at least $250,000 in cash. Other funds of the SPFC in excess of the minimum initial capitalization would have to be in the forms described in the bill. Additional capitalization would have to be determined, if required, by the Commissioner.

An SPFC that was authorized as an insurer other than solely under Chapters 46 and 47 would have to possess initially and then maintain minimum capital and surplus in compliance with Sections 408 and 410, and would have to maintain deposits as specified in Section 411. (Section 408 contains a schedule of paid-in capital or surplus or asset amounts. Section 410 prescribes required amounts of unimpaired capital and surplus. Section 411 requires an insurer to deposit specified amounts with the State Treasurer.)

An SPFC annually would have to submit to the Commissioner the opinion of a qualified actuary regarding its reserves and related actuarial items held in support of its reserves.

Risks; Contracts. An SPFC could insure or reinsure only the risks insured or reinsured by a counterparty. An SPFC could not issue a contract for assumption of risk or indemnification of loss other than an SPFC contract, but could cede risks assumed through an SPFC contract to third party reinsurers through the purchase of reinsurance or retrocession protection.

An SPFC could enter into contracts and conduct other commercial activities related or incidental to and necessary to fulfill the purposes of the SPFC contract, insurance securitization, and Chapter 47.

Protected Cells. An SPFC could establish and maintain one or more protected cells with the Commissioner's prior written approval, subject to compliance with the applicable provisions of Chapter 47 and specified requirements.

A protected cell could be established only for the purpose of isolating and identifying the assets and liabilities attributable to the risk ceded to the SPFC by the counterparty pursuant to one or more SPFC contracts and the assets and liabilities of the SPFC arising out of the related insurance securitization. Each protected cell would have to be accounted for separately on the books of the SPFC.

All attributions of assets and liabilities between a protected cell and the general account would have to be in accordance with the plan of operation submitted to the Commissioner. The SPFC would have to attribute all insurance obligations, assets, and liabilities relating to an SPFC contract and all obligations, assets, and liabilities of the SPFC arising out of the related insurance securitization transaction to a particular protected cell.

The assets of a protected cell could not be chargeable with liabilities arising out of an SPFC contract related to or associated with another protected cell, although one or more SPFC contracts could be attributed to a protected cell as long as those contracts were intended to be, and ultimately were, part of a single securitization transaction.

An SPFC could not sell, exchange, or transfer assets between or among any of its protected cells without the approval of the Commissioner, the counterparty, and each protected cell.

An SPFC contract with or attributable to a protected cell would not take effect without the Commissioner's prior written approval, and the addition of each new protected cell would constitute a change in the business plan requiring prior written approval. The Commissioner could retain legal, financial, and examination services from outside OFIS to examine and investigate the application for a protected cell, and the reasonable cost of the services could be charged against the applicant, or the Commissioner could use internal resources to examine and investigate the application, and the reasonable cost could be charged against the applicant up to $1,200.

An SPFC using protected cells would have to possess minimum capitalization for each protected cell separate from the capitalization required for the SPFC.

The bill contains various provisions governing the legal nature of a protected cell, the use of its assets to pay claims, the obligation of the SPFC, and the attachment of a security interest to a protected cell; requirements to keep protected cell assets and liabilities separate and separately identifiable; and the income, and gains and losses, from protected cell assets and liabilities.

An SPFC with protected calls annually would have to file with OFIS accounting statements and financial reports containing information specified in the bill.

<u>SPFC Securities</u>. An SPFC could issue securities subject to applicable law, the SPFC's plan of operation, and its organizational documents. An SPFC, its parent or an affiliated company, its counterparty, or a captive LLC could issue SPFC securities and any other securities necessary to implement the insurance securitization. The issuance of securities would be governed by provisions of the bill.

Securities issued pursuant to an insurance securitization would not be insurance or reinsurance contracts.

<u>SPFC Contracts</u>. At any given time, an SPFC could enter into and effectuate an SPFC contract with a counterparty, provided that the contract complied with the plan of operation, obligated the SPFC to indemnify the counterparty for losses, and provided that contingent obligations of the SPFC under the contract were securitized and were funded and secured with assets held in trust for the benefit of the counterparty and were invested in a manner meeting criteria under the bill.

An SPFC also could enter into agreements with affiliated companies and third parties and conduct business necessary to fulfill its obligations and administrative duties incidental to the insurance securitization and the SPFC contract.

An SPFC contract would have to contain various provisions, including a requirement for a trust agreement; a stipulation regarding the valuation of assets deposited in the trust account; a requirement for the SPFC to execute assignments or transfer title to the trustee; and a stipulation that the assets in the trust account were under the control of the counterparty and could be withdrawn by the counterparty at any time and used only for specified purposes.

<u>Requirements for an SPFC</u>. An SPFC would have to adhere to various requirements, and ensure that contracts obligating other parties to perform certain functions incident to its operations were substantively and materially consistent with those requirements.

The requirements pertain to the preservation and administration of SPFC assets; the valuation of assets held by an SPFC in trust; the deposit of proceeds from the sale of SPFC securities pursuant to the insurance securitization; and other matters.

Except as approved by the Commissioner, an SPFC would be prohibited from issuing or administering primary insurance policies; entering into an SPFC contract with an unlicensed or unauthorized person; or assuming or retaining exposure to insurance or reinsurance losses for its own account that was not funded by proceeds from an SPFC insurance securitization meeting the provisions of Chapter 47.

An SPFC also could not have any direct obligation to the policyholders or reinsureds of the counterparty, or engage in certain transactions with particular individuals, including someone convicted of a felony or an offense involving the conversion or misappropriation of fiduciary funds.

Assets of an SPFC; Trust Agreement. The bill contains provisions pertaining to assets of an SPFC held in trust to secure obligations of the SPFC; the creation of trust accounts into which all pledged assets would be deposited; withdrawal of trust assets by the counterparty; and establishment of the trust agreement, which would have to provide for the trustee to take certain actions.

When a trust agreement was established in conjunction with an SPFC contract, the agreement or contract could provide that the counterparty would have to use and apply any amounts drawn upon the trust account only for specified purposes. The counterparty would be subject to provisions concerning assets deposited or withdrawn by the counterparty.

Dividends. An SPFC could not declare or pay dividends in any form to its owners except in accordance with the insurance securitization transaction agreements. In no event could the dividends decrease the capital of the SPFC below $250,000. After giving effect to the dividends, the assets of the SPFC would have to be sufficient to satisfy the Commissioner that it could meet its obligations.

The management of the SPFC could declare the dividends if they did not violate Chapter 47 or jeopardize the fulfillment of the obligations of the SPFC or the trustee pursuant to the securitization agreements, the SPFC contract, or any related transaction.

Plan of Operation; Reports; Confidentiality. Any material change of an SPFC's plan of operation would require prior approval of the Commissioner, with certain exceptions.

Within five months after the fiscal year end of an SPFC, it would have to file with the Commissioner an audit of the financial statements of the SPFC and the trust accounts. By March 1, an SPFC would have to file a statement of operations, which would have to include items described in the bill.

An SPFC that was authorized as an insurer other than solely under Chapters 46 and 47 would have to file annual reports pursuant to other sections of the Code.

As a rule, all original books, records, documents, accounts, and vouchers would have to preserved and kept available in this State for the purpose of examination. An SPFC would have to pay the expenses of an examination.

As provided in Chapter 46, Chapter 47 contains provisions for the confidentiality and disclosure of information and testimony, examination reports or results, and OFIS's work papers and records, and provides that the information would be discoverable in a civil action.

Cessation; Suspension or Revocation. At the cessation of business of an SPFC following termination or cancellation of an SPFC contract and the redemption of any related SPFC securities issued in connection with it, the authority granted by the Commissioner would expire or, for retiring and surviving protected cells, would be modified.

The Commissioner could suspend or revoke an SPFC's certificate of authority for certain reasons, including insolvency, failure to meet specified provisions, the use of financial methods and practices that rendered further transaction of insurance hazardous to the public, the holders of securities, or counterparties, and failure to remove or discharge an officer or director as requested by the Commissioner. The Commissioner also could impose penalties under the Code under certain circumstances.

Tax on Reinsurance Premiums. Each SPFC would have to pay a tax on reinsurance premiums, except as otherwise provided. Reinsurance premiums would not include receipt of assets in exchange for the assumption of loss reserves and other liabilities of another insurer or other funding mechanism under common ownership and control, if the transaction were part of a plan to discontinue the operations related to the loss reserves and other liability being assumed of the other insurer or funding mechanism, and if the parties to the transaction intended to renew or maintain business with the SPFC. The tax would have to be calculated by multiplying the amount of reinsurance premiums by the following rates:

-- 0.225% for the first $20 million.
-- 0.15% for the next $20 million.
-- 0.05% for the next $20 million.
-- 0.025% for every dollar over $60 million.

The amount of the tax imposed on any SPFC could not exceed $100,000 for any single tax year. If the aggregate amount imposed on an SPFC were less than $5,000 for that tax year, however, the insurer would have to pay a minimum tax of $5,000 unless it were the first year in which the SPFC was issued a certificate of authority. For an SPFC that had been issued a certificate of authority for a year or less during the tax year for which the minimum tax was to be imposed, the minimum tax would have to be prorated according to the quarter in which the insurer was issued a certificate (as provided in Chapter 46).

Any tax incurred by an SPFC with respect to an SPFC contract would have to be accounted for by allocation to the associated protected cell, but no protected cell could be taxed as if it were a separate SPFC.

The Department of Treasury would have to administer the tax and promulgate rules to implement these provisions. The Department would have to prescribe forms for taxpayers to use and could promulgate rules for taxpayers to maintain records, books, and accounts, and for the computation of the tax, the making of returns, and the ascertainment, assessment, and collection of the tax.

An annual return would have to be filed with the Department by the first day of the third month after the end of the insurer's tax year.

Credit for Ceded Insurance. A domestic insurer ceding business to an SPFC under an SPFC contract would have to be granted credit for the reinsurance ceded, as an asset or reduction from liability, under Section 1105 (which otherwise governs this issue). The credit would be limited to the fair value of the assets in trust or irrevocable letters of credit held for the benefit of the counterparty under the SPFC contract; the assets would have to be held in trust under Chapter 47; and other conditions would have to be met.

Suspension, Rehabilitation, & Liquidation. Except as otherwise provided, the terms and conditions under Chapter 81 (Suspension, Rehabilitation, and Liquidation) pertaining to administrative supervision, conservation, rehabilitation, receivership, and liquidation of insurers would apply in full to SPFCs or each of an SPFC's protected cells, individually or in combination, without causing an administrative supervision, conservation, rehabilitation, receivership, or liquidation of the SPFC or another protected cell.

Without causing or otherwise affecting the conservation or rehabilitation of an otherwise solvent protected cell, the Commissioner could petition the circuit court for an order authorizing him or her to conserve, rehabilitate, or liquidate an SPFC domiciled in this State on specified grounds (e.g., embezzlement of the assets intended to be used to pay amounts owed to the counterparty, or insolvency of the SPFC).

The Commissioner also could petition the court for an order authorizing him or her to conserve, rehabilitate, or liquidate one or more of an SPFC's protected cells, independently, without causing a conservation, rehabilitation, receivership, or liquidation of the SPFC generally or another of its protected cells, on specified grounds (e.g., embezzlement of assets of the SPFC attributable to the affected protected cell, or insolvency of the protected cell).

Upon any order of conservation, rehabilitation, or liquidation of an SPFC, or one or more protected cells, the receiver would have to manage the assets and liabilities of the SPFC pursuant to Chapter 47. The receiver would have to ensure that the assets linked to one protected cell were not applied to the liabilities linked to another or to the SPFC generally, unless an asset or liability were linked to more than one protected cell; in that case, the receiver would have to deal with the asset or liability according to the terms of any relevant governing instrument or contract.

The amount recoverable by the receiver under an SPFC contract could not be reduced as a result of the entry of an order of conservation, rehabilitation, or liquidation with respect to the counterparty, notwithstanding any other provision in the contracts or documentation governing the SPFC insurance securitization.

Additional provisions of Chapter 47 would govern situations involving receiverships, insolvency, conservation, or rehabilitation.

Third Party Contested Case. A contested care brought by a third party based on a decision of the Commissioner under Chapter 47 would be governed by applicable Michigan law, except that the third party would have to prove its case by clear and convincing evidence, demonstrate irreparable harm to the SPFC and/or its counterparty, show that there was no adequate remedy at law, and post a bond sufficient to protect the interests of the holders of the SPFC securities and policyholders.

If the Commissioner suspended, revoked, or modified a certificate of authority previously issued to an SPFC or an order made in connection with such a certificate of authority, the action would have to comply with these standards and criteria (except as described above regarding suspension or revocation of an SPFC's certificate of authority).

Commissioner Regulations. The Commissioner could issue regulations necessary to effectuate the purposes of Chapter 47. These regulations would not affect an SPFC insurance securitization in effect at the time they were issued.

Chapter 48: Protected Cell Insurance Companies

Definitions. "Protected cell company" would mean a domestic insurer or captive insurer that had one or more protected cells. "Protected cell" would mean an identified pool of assets and liabilities of a protected cell company segregated and insulated by means of Chapter 48 from the remainder of the company's assets and liabilities.

"Protected cell company insurance securitization" would mean the issuance of debt instruments, whose proceeds supported the exposures attributable to the protected cell, by a protected cell company where repayment of principal and/or interest to investors pursuant to the transaction terms was contingent upon the occurrence or nonoccurrence of an event with respect to which the company was exposed to loss under insurance or reinsurance contracts it had issued.

Establishment of Protected Cell. A protected cell company could establish one or more protected cells with the Commissioner's prior written approval of a plan of operation or amendments submitted by the company with respect to each protected cell in connection with an insurance securitization. Upon the Commissioner's approval of the plan, the company could attribute to the protected cell insurance obligations for its insurance business and obligations relating to the insurance securitization and assets to fund the obligations. The company would have to transfer all assets attributable to a protected cell to one or more separately established and identified protected cell accounts bearing the name of that cell. Protected cell assets would have to be held in the accounts for the purpose of satisfying the obligations of that cell.

All attributions of assets and liabilities between a protected cell and the general account would have to be in accordance with the approved plan of operation.

The creation of a protected cell would not create, with respect to that cell, a legal person separate from the protected cell company. Amounts attributed to a protected cell under Chapter 48 would be owned by the company, which would not be a trustee with respect to those protected cell assets of that protected cell account. The company could allow for a security interest to attach to protected cell assets or a protected cell account in favor of a creditor of the protected cell and as otherwise allowed under applicable law.

Chapter 48 could not be construed to prohibit a protected cell company from contracting with an investment advisor, commodity trading advisor, or other third party to manage the assets of a protected cell, if all compensation of the third party advisor or manager were payable from those assets and not from the assets of other protected cells or of the company's general account.

A protected cell company would have to establish administrative and accounting procedures necessary to identify properly its protected cell or cells and the protected cell assets and liabilities attributable to them. The company directors would have to keep protected cell assets and liabilities separate and separately identifiable from the assets and liabilities of the company's general account and attributable to one protected cell separate and separately identifiable from assets and liabilities attributable to other protected cells. If these requirements were violated, the remedy of tracing would apply to protected cell assets when commingled with assets of other protected cells or of the company's general account.

Liability; Income. The assets of a protected cell could not be charged with liabilities arising out of any other business the protected cell company conducted. All contracts or other documentation reflecting protected cell liabilities would have to indicate clearly that only the protected cell assets were available for the satisfaction of those protected cell liabilities.

The income, and gains and losses, from protected cell assets and liabilities would have to be credited to or charged against the protected cell without regard to other income and gains or losses of the protected cell company, including income and gains or losses of other protected cells.

A protected cell company could attribute to a protected cell account only the insurance obligations relating to the company's general account. A protected cell could not be authorized to issue insurance or reinsurance contracts directly to policyholders or reinsureds or have any obligation to the policyholders or reinsureds of the company's general account.

Additional provisions would apply to the investment and valuation of protected cell assets.

Securitization. A protected cell company with respect to any of its protected cells would have to engage in fully funded indemnity triggered insurance securitization to support in full the protected cell exposures attributable to that cell. A protected cell company insurance securitization that was nonindemnity triggered would qualify under Chapter 48 only after the Commissioner promulgated applicable rules. A protected cell company insurance securitization that was not fully funded, whether indemnity triggered or nonindemnity triggered, would be prohibited. Protected cell assets could be used to pay interest or other consideration on any outstanding debt or other obligation attributable to that cell.

("Indemnity trigger" would mean a transaction term by which relief of the issuer's obligation to repay investors was triggered by its incurring a specified level of losses under its insurance or reinsurance contracts. "Nonindemnity trigger" would mean a transaction term by which relief of the issuer's obligation to repay investors was triggered solely by some event or condition other than the individual protected cell company's incurring a specified level of losses under its insurance or reinsurance contracts.)

A protected cell company insurance securitization would not be, and could not be considered to be, an insurance or reinsurance contract. An investor in such a securitization, solely by means of the investment, would not be conducting an insurance business in Michigan. The underwriters or selling agents and their partners, directors, officers, members, managers, employees, agents, representatives, and advisors involved in a protected cell company insurance securitization would not be conducting an insurance or reinsurance agency, brokerage, intermediary, advisory, or consulting business by virtue of their activities in connection with that business.

Creditors & Obligations of a Company. Protected cell assets would be available only to the creditors of the protected cell company that were creditors for that protected cell and were entitled, under Chapter 48, to have recourse to the protected cell assets attributable to that cell. Creditors for a protected cell would not be entitled to have recourse against the protected cell assets of other protected cells or the assets of the company's general account. Protected cell assets would be available to creditors of a protected cell company only after all protected cell liabilities had been extinguished or otherwise provided for according to the plan of operation relating to that protected cell.

Specific limitations would apply when an obligation of a protected cell company to a person arose from a transaction, or otherwise was imposed, with respect to a protected cell, and when an obligation of a protected cell company related solely to the general account.

Guaranty Funds & Associations. The activities, assets, and obligations relating to a protected cell would not be subject to the provisions of Chapters 77 and 79 (the Michigan Life and Health Insurance Guaranty Association Act and the Property and Casualty Guaranty Association Act, respectively). Neither a protected cell nor a protected cell company could be assessed by, or otherwise be required to contribute to, any guaranty fund or guaranty association in this State with respect to the activities, assets, or obligations of a protected cell. These provisions would not affect the activities or obligations of an insurer's general account.

Conservation, Rehabilitation, & Liquidation. Upon an order of conservation, rehabilitation, or liquidation of a protected cell company, the receiver would have to deal with the company's assets and liabilities, including protected cell assets and liabilities, according to Chapter 48.

The amount recoverable by the receiver under a protected cell company insurance securitization could not be reduced or diminished as a result of the entry of an order of conservation, rehabilitation, or liquidation with respect to the protected cell company, notwithstanding any other provision to the contrary in the contracts or other documentation governing the securitization.

Commissioner Regulations. The Commissioner could issue regulations necessary to effectuate the purposes of Chapter 48.

Proposed MCL 500.4601-500.4813
(S.B. 1061)
MCL 208.235 (S.B. 1062)

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Although captive insurance companies would be new to Michigan, the growth of this industry can be traced to the mid-1900s and the movement by parent companies to establish captives off-shore. In 1981, Vermont enacted the first significant captive law in the United States, and now over 1,250 captive insurance companies are domiciled in 20-some states. Five states (Delaware, Missouri, Nebraska, South Carolina, and Vermont) and the District of Columbia authorize captives to transact business as SPFCs. Clearly, there already are many jurisdictions in which companies may establish captive insurers. By allowing the formation of these entities in Michigan, as well, this legislation would make the State an attractive domicile for insurance companies, and would benefit noninsurance Michigan-based businesses, which would not have to go to another state in order to establish a captive insurance company.

There are various reasons that businesses—both insurance and noninsurance companies—might wish to form a captive insurer. Since captives essentially are insurance vehicles created by their owners, they provide considerable risk management flexibility as well as affordability. Sometimes, a company may find that commercial liability insurance has become unreasonably expensive, if not unavailable, and therefore chooses to form a captive insurance company to handle its own risk. In other cases, a group of companies might have a good historical loss experience but be in an industry experiencing unacceptable insurance premium increases. The companies then may opt to form a captive to insure the risks of the group.

Forming a captive insurance company enables a business or group of businesses to save the cost of the premiums that commercial insurers charge for their acquisition expenses, overhead, and profit. A captive allows the parent company to retain the profit within the group, and may help reduce insurance costs by charging a premium that more accurately reflects the parent's loss experience. In addition, a captive can focus on the risk management and risk financing practices of its parent, resulting in recognizable profits. A company also might use a captive to gain access to the reinsurance market, allowing the buyer to determine its own retention levels more easily and structure its programs with greater flexibility than it could otherwise.

Some insurers might wish to form special purpose financial captives in order to securitize insurance or annuity contracts and gain access to alternative sources of low-cost capital. A life insurance company, for example, might create an SPFC to reinsure a block of its policies, and will pay a premium to the SPFC. A life insurer also might form an affiliated finance company to issue debt securities to investors based on income streams created by the block of policies reinsured by the SPFC. The finance company then will remit to the SPFC the proceeds from the sale of the securities, which can serve as a source of capital for the life insurance company.

By allowing the creation of captive insurance companies, the bills could foster the development an industry built around the formation and regulation of captives, and help to diversify Michigan's economy. Vermont, which is the leading domicile for captive insurers in the U.S., has seen its captive business increase significantly, rising from 230 captives in 1992 to over 560 by 2002. Reportedly, this growth has created over 1,500 jobs servicing captive insurers in that state.

The formation of special purpose financial captives also could create many well-paying jobs. Reportedly, if insurance companies like Jackson National Life used SPFCs to facilitate acquisitions, they potentially could hire thousands of employees with average annual salaries ranging from $30,000 for customer service associates, to $83,000 for managers and other professionals.

Response: The Office of Financial and Insurance Services has raised several concerns about Senate Bill 1061. First, it is not clear at this point whether the legislation would have a negative impact on accreditation standards. Evidently, the National Association of Insurance Commissioners (NAIC) is considering a policy governing captive insurance companies, and it is important for any Michigan law on the subject to be consistent with the standards NAIC adopts. It also is not clear whether the bill contains proper enforcement and monitoring tools to enable OFIS to regulate captive insurers. In addition, enforcement and monitoring would require adequate staff and staff training; OFIS either would need to bring its personnel up to speed or retain outside assistance. Reportedly, another state was overwhelmed by the rapid growth of the industry and faced a backlog of applications. Finally, OFIS has pointed out that it could be necessary to involve other State agencies, such as the Michigan Economic Development Corporation, if this legislation is considered an economic development tool.

In addition, since the bills would exempt captive insurers from taxation under the Michigan Business Tax (MBT) Act and impose taxes on them under the proposed chapters of the Insurance Code, the Department of Treasury would incur the costs of creating and implementing an entirely new tax structure. It would be more economical to leave these entitles under the MBT Act and create a credit that would make their tax liability equivalent to what it would be under this legislation.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bills would increase the responsibilities of the Office of Financial and Insurance Services within the Department of Labor and Economic Growth, the Department of Treasury, and the Attorney General. They also would provide for taxation of captive insurance companies and special purpose financial captives. The impact on State revenue and expenses is discussed below.

Administrative Impact

Senate Bill 1061 would add significant responsibilities to OFIS to regulate captive insurance companies, special purpose financial companies, and protected cell insurance companies, increasing the expenses of the office. Fees that would be established by the bill for application for a certificate of authority, investigation of applicants, and annual renewal would offset these expenses. The amount of expenses and fee revenue would depend on the number of companies seeking to organize under the proposed statute and is unknown.

The proposed Captive Insurance Regulatory and Supervision Fund would be administered by the OFIS Commissioner. Permissible uses of the Fund would include administering the proposed regulation of captive insurance companies and special purpose financial captives pursuant to the bill, and of risk retention groups (which are regulated currently). The Fund also would be permitted to incur reasonable expenses for promoting the captive insurance industry within the State. The Fund would receive 20% of the revenue from the proposed tax on captive insurance company direct premiums and reinsurance premiums, and 20% of the revenue from the proposed tax on special purpose financial captive reinsurance premiums. In addition, fees received by the Department of Treasury from certain reinsurers would be deposited into the Fund. Money in the Fund at the end of the fiscal year would carry forward into the subsequent fiscal year. The amount of contributions to the Fund would depend on activity by insurance companies and is unknown.

Other State departments would be affected by the bill. The Department of Treasury would incur administrative costs for promulgating administrative rules and implementing other provisions of the bill. The extent of these costs is unknown but could be substantial. The Attorney General would be required to review organizational documents for proposed captive insurance companies and special purpose financial captives and would receive a fee from each applicant.

Fines and administrative penalties levied on captive insurance companies pursuant to the bill would be deposited into the General Fund.

Taxation

As mentioned above, the bills would establish a new tax that would apply to captive insurance companies and special purpose financial captives. The tax rate would be applied to insurance and reinsurance premiums of these companies with maximum and minimum payments established for each tax-paying company. Premiums collected or contracted for by these companies would be exempt from the Michigan Business Tax Act. The tax rate that Senate Bill 1061 would establish is less than the rate that applies to insurance premiums under the MBT Act. Under the proposal, General Fund tax collections would be lower than if the premiums were taxed under the MBT Act. To the extent that premiums were taxed pursuant to this proposal instead of under the Act, there would be a significant reduction in the tax rate applied to eligible premiums, resulting in a loss of revenue to the General Fund. The number of eligible companies that would be established and the amount of tax that would be paid under the bills are unknown.

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