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Senate Bills 1061 and 1062 (as enacted)

PUBLIC ACTS 29 & 30 of 2008

Sponsor: Senator Alan Sanborn
Senate Committee: Banking and Financial Institutions
House Committee: Insurance

Date Completed: 8-14-08

RATIONALE

A number of states and other jurisdictions have laws 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 handling 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 was 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 added Chapter 46 (Captive Insurance Companies), Chapter 47 (Special Purpose Financial Captives), and Chapter 48 (Protected Cell Insurance Companies) to the Insurance Code.

Chapter 46 does the following:

- **Requires captive insurance companies to obtain a limited certificate of authority from the Commissioner of the Office of Financial and Insurance Regulation (OFIR).**
- **Requires applicants to pay a $10,000 processing fees, as well as examination fees and expenses; and allows OFIR to retain outside services or use internal resources to investigate applicants.**
- **Prescribes annual renewal fees ranging from $5,000 to $100,000 based on a company's volume of insurance premiums received.**
- **Provides for the confidentiality of information submitted to OFIR and reports, records, and work papers of OFIR.**
- **Requires captive insurers to have and maintain paid in capital and retained earnings in specified amounts.**
- **Provides for different types of captive insurers, and allows them to be organized or incorporated in various forms.**
- **Permits the Commissioner to revoke or suspend a limited certificate of authority for various reasons.**
- **Allows the formation of sponsored captive insurers; and permits them to**

establish protected cells to insure risks of participants, whose recovery is limited to the assets of the protected cells.

-- Provides that the assets of a protected cell may not be charged with liabilities arising out of any other business of the insurer.

-- Provides that captive insurers are not required to contribute to a guaranty fund.

-- Creates the "Captive Insurance Regulatory and Supervision Fund", and allocates to it all fees, assessments, fines, and administrative penalties collected under Chapters 46 and 47.

Chapter 47 does the following:

-- Allows insurers to apply to the Commissioner for a limited certificate of authority to transact business as a special purpose financial captive (SPFC).

-- Requires SPFCs to pay application fees, examination fees and expenses, and annual renewal fees (in the same amounts as prescribed in Chapter 46).

-- Establishes capitalization requirements for SPFCs.

-- Allows SPFCs to be established as various types of entities.

-- Authorizes 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).

-- Allows 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.

-- Permits SPFCs to issue securities.

-- Provides for SPFC contracts with counterparties.

-- Provides for the rehabilitation, conservation, or liquidation of SPFCs.

-- Provides for the confidentiality of information and documents.

Chapter 48 does the following:

-- Allows protected cell companies to establish protected cells upon the Commissioner's approval of a plan of operation or amendments.

-- Requires 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.

-- Requires 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.

-- Limits creditors' access to protected cell assets and provides that those assets may not be charged with liabilities arising from any other business of the company.

-- Provides that protected cell companies are not required to contribute to a guaranty fund.

<u>Senate Bill 1062</u> amended 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).

The bills took effect on March 13, 2008.

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

<u>Chapter 46: Captive Insurance Companies</u>

<u>Definitions</u>. Chapter 46 defines "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 must be a pure captive insurance company with respect to operations in Michigan, unless otherwise permitted by the Commissioner.

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

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

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

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

An "industrial insured captive insurance company" is a company that insures risks of the industrial insureds that comprise the industrial group and their affiliated companies. "Industrial insured" means an insured that meets all of the following:

- It procures 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 total at least $25,000.
- It has at least 25 full-time employees.

"Insured industrial group" means either 1) a group of industrial insureds that collectively own, control, or hold all of the outstanding voting securities of an industrial insured captive insurer incorporated as a stock insurer or an LLC or have complete voting control over an industrial insured captive insurance company incorporated as a mutual insurer; or 2) a group created under the Federal 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>Limited Certificate of Authority</u>. A captive insurance company, if permitted by its organizational documents, may apply to the Commissioner for a limited certificate of authority to do any and all insurance authorized by the Code, except workers' compensation insurance, long-term care insurance, personal automobile insurance, or homeowners insurance. A captive insurance company is subject to limitations on the risks that it may insure, and may not accept or cede reinsurance except as provided below.

To conduct business in this State, a captive insurance company must obtain a limited 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 registered agent.

Before granting a limited certificate of authority, the Commissioner must require the captive insurance company to submit organizational documents containing information described in Chapter 46. This information includes the amount and value of capital stock, if any, and each share of authorized capital stock must have a value of at least $1.

Before the documents are effective, they must be submitted to the Office of the Attorney General for examination, and the applicant must pay the Attorney General the $25 examination fee required under the Code. If the documents comply with Chapter 46, the Office must certify that to the Commissioner.

Before granting a limited certificate of authority, the Commissioner also must 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. The Commissioner must issue a limited certificate of authority if he or she finds that documents and statements filed by the applicant comply with Chapter 46, the applicant meets the standards of Chapter 46 and will promote the general good of the State, and all required fees have been paid.

Processing & Investigation Fees. An applicant must pay OFIR a nonrefundable $10,000 fee for processing its application for a limited certificate of authority. The Commissioner may retain legal, financial, and examination services from outside OFIR to examine and investigate the application, or may use internal resources to examine and investigate the application for a $2,700 fee.

Renewal Fees. A captive insurer must pay an annual renewal fee by March 1. The fee must be calculated based upon the annual volume of insurance or reinsurance premiums received by the insurer, as shown in Table 1.

Table 1

Annual Premiums		Fee
Equal to or more than	Less than	
	$5.0 million	$5,000
$5.0 million	$10.0 million	$10,000
$10.0 million	$15.0 million	$15,000
$15.0 million	$25.0 million	$25,000
$25.0 million	$40.0 million	$40,000
$40.0 million	$55.0 million	$50,000
$55.0 million	$75.0 million	$75,000
$75.0 million		$100,000

Document Fees. The Office may charge a $15 fee for any document requiring certification of authenticity or the signature of the Commissioner. The payment must be deposited into the Captive Insurance Regulatory and Supervision Fund.

The Office also may charge a $25 fee payable to the Attorney General for the examination of any amendment to organizational documents.

Foreign Captive Insurer. Upon the Commissioner's approval, a foreign captive insurer may become a 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. A foreign captive insurer redomesticating into this State need not merge, consolidate, transfer assets, or otherwise engage in any other reorganization.

"Foreign captive insurer" means an insurer formed under the laws of the District of Columbia, or some state, commonwealth, territory, or possession of the United States, other than Michigan.

Confidentiality. Information and testimony submitted or furnished to OFIR pursuant to Chapter 46, examination reports, and OFIR's work papers, correspondence, reports, records, and other written or oral information related to an examination report or an investigation are confidential, are not subject to subpoena, and may not be divulged to any person, except as provided in Chapter 46 or with the company's written consent. If assurances of confidentiality are provided, the Commissioner may 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.

These confidentiality requirements do not apply in any proceeding or action brought against or by a captive insurer under the Code or any applicable act of this State, any other state, or the United States.

The confidentiality provisions also do not extend to final examination reports procured by the Commissioner in inspecting or examining a captive insurer formed as a risk retention group under the Federal Liability Risk Retention Act.

Capitalization; Security; Dividends. The Commissioner may not issue a limited certificate of authority to a captive insurance company unless it possesses and maintains 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 does not assume any risk, the risks insured by the protected cells are homogeneous, and there are not more than 10 cells.
-- An amount determined by the Commissioner for a special purpose captive insurance company.

The Commissioner may not issue a limited certificate of authority to a captive insurance company incorporated as a nonprofit corporation unless it possesses and maintains 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 may 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 must 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 may 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 may 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 may 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 is elected by the member organizations of its association.

The Code's provisions pertaining to mergers, consolidations, conversions, mutualizations, and redomestications 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.

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

By March 1 of each year, a captive insurer must submit to the Commissioner a report of its financial condition. The Commissioner may require interim reporting on any or all of a captive insurer's business.

A branch captive insurer must 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 is formed.

The Commissioner may address inquires to any captive insurer concerning its activities or conditions or any other matter connected with its transactions. The insurer must reply in writing to each inquiry within 30 days of receiving it.

Each captive insurer that fails to file a required report, or fails to reply within 30 days to an inquiry of the Commissioner, is subject to a civil penalty of not less than $1,000 or more than $5,000 per occurrence, and an additional $50 per day that the insurer fails to file or reply. The insurer also is subject to proceedings for suspension or revocation of its limited certificate of authority.

Reserves. A captive insurance company annually must submit to the Commissioner the opinion of a qualified actuary as to whether the reserves and related actuarial items held in support of them are computer appropriately, are based on assumptions that satisfy contractual provisions, are consistent with prior reported amounts, and comply with applicable laws of the State.

A sponsored captive insurance company may discount its loss and loss adjustment expense reserves at the lesser of Treasury rates or the insurer's actual rate of return applied to the applicable payments projected through the use of the expected payment pattern associated with the reserves.

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

The expenses and charges of a captive insurance company examination must be paid to the State by the captive insurer examined, and OFIR must issue warrants for the proper charges incurred in all exams. The payments must be deposited into the Captive Insurance Regulatory and Supervision Fund.

Suspension or Revocation of Certificate. The Commissioner may suspend or revoke the limited certificate of authority of a captive insurance company for reasons listed in Chapter 46, 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 render 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 for an unreasonable period to pay any final judgment rendered against the insurer in this State on any policy, bond, recognizance, or undertaking issued or guaranteed by it.
-- 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.

If the Commissioner finds, upon examination, hearing, or other evidence, that a captive insurer has committed any of the acts listed in Chapter 46, the Commissioner may suspend or revoke the insurer's limited certificate of authority if he or she considers it in the best interest of the public and the policyholders of the insurer.

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

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

Only a pure captive insurer may 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 may be combined for purposes of investment upon written agreement of the participants. This combination may not be construed as defeating the segregation of those assets for accounting or other purposes.

Sponsored captive insurers must comply with the Code's investment requirements, as applicable.

Reinsurance. A captive insurance company may provide reinsurance, as authorized by the Code and with the Commissioner's prior approval, on risks ceded by any other insurer. A captive insurer may 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 may 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, may not receive a benefit from a plan, pool, association, or guaranty or insolvency fund for claims arising out of the operations of the company.

Commissioner Rules, Regulations, & Orders. The Commissioner may 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.

Also, by rule, regulation, or order, the Commissioner may establish standards to ensure that a parent or affiliated company is able to exercise control of the risk management function of any controlled unaffiliated business to be insured by a pure captive insurer. Until the standards are established, the Commissioner may temporarily authorize a pure captive insurer to insure risks.

Application of Chapter 81. Except as otherwise provided, the terms and conditions of Chapter 81 of the Code pertaining to administrative supervision, conservation, rehabilitation, receivership, and liquidation apply in full to captive insurers authorized under Chapter 46.

Sponsored Captive Insurer. One or more sponsors may form a sponsored captive insurance company. (A "sponsor" is an entity that is 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 may establish and maintain one or more protected cells to insure risks of one or more participants. ("Participant" means an entity, and any of its affiliates, that is insured by a sponsored captive insurer, where the recovery of the participant is limited through a participant contract to the assets of a protected cell.) The shareholders of the insurer must be limited to its participants and sponsors, and each protected cell must be accounted for separately on the records of the insurer.

The assets of a protected cell may not be chargeable with liabilities arising out of any other insurance business the sponsored captive insurer conducts. The insurer may 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 may be made from a protected cell to a sponsor or participant unless the insurer has given the Commissioner written notice at least 30 days, or less as the Commissioner allows, before the transaction, and the Commissioner has not disapproved the transaction during that period.

No dividend or distribution may be made from a protected cell to a sponsor or participant without the Commissioner's approval, and approval may not be given if the dividend or distribution would result in insolvency or impairment with respect to a protected cell.

No participant contract may 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 also require the Commissioner's prior written approval.

Both of the following apply to a sponsored captive insurer:

-- The assets of the protected cell may 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 must be available to pay expenses of or claims against the insurer and may not be used to pay expenses or claims attributable to a protected cell.

A sponsor must be an insurer authorized under the laws of a state or the District of Columbia (D.C.), an insurance holding company that controls an insurer authorized under the laws of a state or 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 D.C., or a captive insurance company authorized under Chapter 46. A risk retention group may not be a sponsor or a participant.

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

-- Fronted by an insurance company authorized under the laws of any state or any jurisdiction if that company is a wholly owned subsidiary of an insurance company authorized pursuant to the laws of 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 may be a participant in a sponsored captive insurer. A sponsor also may be a participant. A participant need not be a shareholder of the sponsored captive insurer or an affiliate of the company. A participant may 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 apply in full to a sponsored captive insurer, except as otherwise provided in Chapter 46.

<u>Regulatory & Supervision Fund</u>

Chapter 46 creates the Captive Insurance Regulatory and Supervision Fund within the State Treasury. The State Treasurer may receive money or other assets from any source for deposit into the Fund. All fees and assessments received by the Department of Treasury or OFIR pursuant to the administration of Chapters 46 and 47 must be credited to the Fund. All fees received by the Department from reinsurers that assume risk only from captive insurers also must be deposited into the Fund. In addition, all fines and administrative penalties ordered under Chapter 46 or 47 must be deposited into the Fund.

The State Treasurer must direct the investment of the Fund, and credit to it interest and earnings from Fund investments. Money in the Fund at the close of the fiscal year must remain in the Fund.

The Commissioner must be the administrator of the Fund for auditing purposes. Upon appropriation, the Commissioner must spend money in the Fund for the purpose of administering Chapters 18, 46, and 47 and for reasonable expenses incurred in promoting the captive insurance industry in this State. (Chapter 18 governs risk retention groups.)

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

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

"Captive LLC" means 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" means any corporation, LLC, partnership, or individual that owns, controls, or holds with power to vote more than 50% of the outstanding voting securities of an SPFC. "Counterparty" means 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" means a contract between the SPFC and the counterparty pursuant to which the SPFC agrees to provide insurance or reinsurance protection to the counterparty for risks associated with the counterparty's insurance or reinsurance business.

"Insurance securitization" means a package of related risk transfer instruments, capital market offerings, and facilitating administrative agreements by which all of the following apply:

-- The proceeds of the sale of SPFC securities are obtained, in a transaction that complies with the applicable securities laws, 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.
-- The proceeds of the issuance of the SPFC securities secure the obligations of the SPFC under one or more SPFC contracts with a counterparty.
-- The obligation to the holders of the securities is 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 apply to an SPFC. Specified sections and Chapter 45 (Insurance Fraud) apply to SPFCs. (The specified sections, among other things, provide for the examination of insurers, 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.)

By rule, regulation, or order, the Commissioner may exempt an SPFC or its protected cells, on a case-by-case basis, from provisions of Chapter 47 that he or she determines to be inappropriate given the nature of the risks to be insured. ("Protected cell" means a segregated account established and maintained by an SPFC for one or more SPFC contracts that are part of a single securitization transaction, as further provided in Chapter 48.)

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

To transact business in this State, an SPFC must do the following:

-- Obtain a limited 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 limited certificate of authority, the Commissioner must require the applicant to submit organizational documents containing information specified in Chapter 47. This information includes the amount and value of capital stock, if any, and each share of authorized capital stock must have a value of at least $1.

The organizational documents must be submitted to the Office of the Attorney General for examination before they become effective. If the documents are found to comply with Chapter 47, the Office must certify that to the Commissioner. Each applicant must pay the Attorney General the $25 examination fee required under the Code.

Before granting a limited certificate of authority, the Commissioner also must require, consider, and review various items listed in Chapter 47, including evidence of the amount and liquidity of assets relative to the risks to be assumed, a plan of operation containing required information, and an affidavit verifying specified matters. If a protected cell is used, the applicant also must file a business plan, contracts between the SPFC and any counterparty or captive LLC related to each protected cell, and other items.

The Commissioner may grant a limited certificate of authority authorizing the applicant to transact insurance or reinsurance business as an SPFC in this State upon finding all of the following:

-- The proposed plan of operation provides a reasonable and expected successful operation.
-- The terms of the SPFC contract and related transactions comply with Chapter 47.
-- All required fees have been paid.

The limited certificate of authority must be renewed annually upon payment of the renewal fee.

Fees. To transact insurance or reinsurance business in this State, an SPFC is subject to the following provisions.

For an applicant not authorized under Chapter 46 and not filing a concurrent application under that chapter, Chapter 47 imposes a nonrefundable processing fee of $10,000. The Commissioner may retain legal, financial, actuarial, and examination services from outside OFIR to examine and investigate the application, and the reasonable cost may be charged against the applicant, or the Commissioner may use internal resources to examine and investigate the applicant for a fee of $2,700, payable when the application is filed.

An SPFC must pay an annual renewal fee by March 1. The fee must be calculated based upon the annual volume of insurance or reinsurance premiums received by the insurer, in the same amounts as specified in Chapter 46.

The renewal fee under Chapter 47 does not apply to an SPFC that is authorized under both Chapter 46 and Chapter 47 and pays the renewal fee provided for in Chapter 46.

Foreign Captive. Upon the Commissioner's approval, a foreign captive may become an SPFC by complying with Chapter 47. It is not necessary for a foreign captive redomesticating into this State to merge, consolidate, transfer assets, or otherwise engage in another reorganization.

Form of Organization. An SPFC may 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 apply in a determination of the procedures to be followed by an SPFC in carrying out any of those transactions.

Capitalization Requirements. An SPFC must 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 must be in the forms described in the bill. Additional capitalization must be determined, if required, by the Commissioner.

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

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

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

An SPFC may 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 may 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 may 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 must be accounted for separately on the books of the SPFC.

All attributions of assets and liabilities between a protected cell and the general account must be in accordance with the plan of operation submitted to the Commissioner. The SPFC must 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 may 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 may be attributed to a protected cell as long as those contracts are intended to be, and ultimately are, part of a single securitization transaction.

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

An SPFC contract with or attributable to a protected cell will not take effect without the Commissioner's prior written approval. The Commissioner may retain legal, financial, and examination services from outside OFIR to examine and investigate the application for a protected cell, and the reasonable cost of the services may be charged against the applicant, and/or the Commissioner may use internal resources to examine and investigate the application, and the reasonable cost may be charged against the applicant up to $1,200.

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

Chapter 47 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 must file with OFIR accounting statements and financial reports containing information specified in Chapter 47.

SPFC Securities. An SPFC may 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 may issue SPFC securities and any other securities necessary to implement the insurance securitization. Chapter 47 governs the issuance of preferred securities; accounting for the SPFC securities as surplus; interest and principal payments; and asset management agreements.

SPFC Contracts. At any given time, an SPFC may enter into and effectuate an SPFC contract with a counterparty, provided that the contract complies with the plan of operation, obligates the SPFC to indemnify the counterparty for losses, and provides that contingent obligations of the SPFC under the contract are securitized and are funded and secured with assets held in trust for the benefit of the counterparty and are invested in a manner meeting criteria under Chapter 47.

An SPFC also may 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 must 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 are under the control of the counterparty and may be withdrawn by the counterparty at any time and used only for specified purposes.

Requirements for an SPFC. An SPFC must adhere to various requirements, and ensure that contracts obligating other parties to perform certain functions incident to its operations are 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 is 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 is not funded by proceeds from an SPFC insurance securitization meeting the provisions of Chapter 47.

An SPFC also may 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. Chapter 47 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 must be deposited; withdrawal of trust assets by the counterparty; and establishment of the trust agreement, which must provide for the trustee to take certain actions.

When a trust agreement is established in conjunction with an SPFC contract, the agreement or contract may require the counterparty to use and apply any amounts drawn upon the trust account only for specified purposes. The counterparty is subject to provisions concerning assets deposited or withdrawn by the counterparty.

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

The management of the SPFC may declare the dividends if they do 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. An SPFC may make material changes to its plan of operation, whether or not through a protected cell, as specified in Chapter 47.

Within five months after the fiscal year end of an SPFC, it must file with the Commissioner audited financial statements of the SPFC and the trust accounts. The Commissioner may address inquiries to any captive insurer concerning its activities or conditions, or any matter connected with its transactions. The insurer must reply in writing within 30 days of receiving an inquiry.

By March 1 each year, an SPFC must file a statement of operations, which must include items described in Chapter 47.

An SPFC that is authorized as an insurer other than solely under Chapters 46 and 47, or that is reinsuring risk of a counterparty that is authorized as an insurer under the Code, must file annual reports pursuant to other sections of the Code. The Commissioner may require interim reporting on any or all of the SPFC's business.

An SPFC that fails to file a required report, or fails to reply within 30 days to an inquiry of the Commissioner, is subject to a civil penalty of not less than $1,000 or more than $5,000 per occurrence, and an additional $50 for every day that the SPFC fails to file or reply. The SPFC also is subject to proceedings for the suspension or revocation of its limited certificate of authority.

As a rule, all original books, records, documents, accounts, and vouchers must preserved and kept available in this State for the purpose of examination. An SPFC must 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 OFIR's work papers and records.

Prohibited Transactions & Activities. Chapter 47 prohibits an SPFC from entering into any of the following transactions or engaging in any of the following activities unless it has given the Commissioner written notice of its intention to do so at least 30 days, or a shorter period as the Commissioner allows, before entering into the transaction or activity, and the Commissioner has not disapproved of it within that period:

-- A sale, exchange, or other transfer of assets made by the SPFC between or among any of its protected cells.
-- Any third party management contract or arrangement that does not meet requirements concerning the payment of remuneration, expenses, and compensation from protected cell assets.
-- Any material change to the SPFC's plan of operation except those specifically listed.
-- A sale, exchange, or transfer of assets from a protected cell to a counterparty, captive LLC, or parent or affiliated company of the SPFC, except as otherwise contemplated in the SPFC contract and/or related insurance securitization documents.

Exam Expenses; Document Fees. The expenses and charges of a captive insurance company exam must be paid to the State by the company examined. The payments must be deposited into the Captive Insurance Regulatory and Supervision Fund.

The Office may charge a $15 fee for any document requiring certification of authenticity or the signature of the Commissioner. The payment must be deposited into the Fund.

The Office also may charge a $25 fee payable to the Attorney General for the examination of any amendment to organizational documents.

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 will expire or, for retiring and surviving protected cells, will be modified. The SPFC will no longer be authorized to conduct activities unless and until a new or modified limited certificate of authority is issued.

The Commissioner may suspend or revoke an SPFC's limited certificate of authority for certain reasons, including insolvency, failure to meet capitalization requirements, the use of financial methods and practices that render further transaction of insurance hazardous to the public, the holders of securities, or counterparties, failure to respond within 30 days to an inquiry from the Commissioner, failure to submit to examination, refusal or failure to pay the costs of examination, failure to pay a final judgment rendered against the insurer for an unreasonable period, and failure to remove or discharge an officer or director as requested by the Commissioner. For certain violations, the Commissioner also may impose penalties under the Code if he or she considers it in the best interest of the public, the holders of the securities, and the policyholders of the SPFC.

Unless the grounds for suspension or revocation relate only to the financial condition or soundness of the SPFC or to a deficiency in its assets, the Commissioner must give the SPFC at least 30 days' notice before revoking its authority to do business in this State, and must specify in the notice the particulars of the alleged violation or grounds for revocation, and the SPFC must be given the opportunity to be heard.

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 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 may 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 may 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).

A receiver appointed pursuant to an order of conservation, rehabilitation, or liquidation must do the following:

-- For an SPFC subject to the order, manage the assets and liabilities of the SPFC pursuant to Chapter 47.
-- For a protected cell or cells subject to the order, manage the assets and liabilities of the protected cell or cells pursuant to Chapter 47 and the SPFC contract.
-- Ensure that the assets of one protected cell are not used to satisfy the liabilities of another or of the SPFC generally.

With respect to amounts recoverable under an SPFC contract, the amount recoverable by the receiver, including all expenses of taking possession of the SPFC or one or more of its protected cells, may 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 govern situations involving receiverships, insolvency, conservation, or rehabilitation.

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

The Commissioner may suspend, revoke, or modify a limited certificate of authority issued to an SPFC or an order made in connection with such a certificate of authority in compliance with these standards and criteria or in conformance with provisions for the suspension or revocation of an SPFC's limited certificate of authority (as described above).

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

Chapter 48: Protected Cell Insurance Companies

Definitions. Chapter 48 defines "protected cell company" as a domestic insurer or captive insurer that has one or more protected cells. "Protected cell" means 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" means the issuance of debt instruments, whose proceeds support 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 is contingent upon the occurrence or nonoccurrence of an event with respect to which the company is exposed to loss under insurance or reinsurance contracts it has issued.

Establishment of Protected Cell. A protected cell company may 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 may 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 must 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 must 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 must be in accordance with the approved plan of operation.

The creation of a protected cell does 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 are owned by the company, which may not be a trustee with respect to those protected cell assets of that protected cell account. The company may 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 may 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 expenses and compensation of the third party advisor or manager are payable from those assets and not from the assets of other protected cells or of the company's general account.

A protected cell company must 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 must 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 are violated, the remedy of tracing will 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 may not be charged with liabilities arising out of any other business the protected cell company conducts. All contracts or other documentation reflecting protected cell liabilities must indicate clearly that only the protected cell assets are available for the satisfaction of those protected cell liabilities.

The income, and gains and losses, from protected cell assets and liabilities must 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 may attribute to a protected cell account only the insurance obligations relating to the company's general account. A protected cell may 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 apply to the investment and valuation of protected cell assets.

Securitization. A protected cell company with respect to any of its protected cells must 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 is nonindemnity triggered will qualify under Chapter 48 only after the Commissioner, by rule, regulation, or order, addresses the methods of funding the portion of this risk that is not indemnity based, and addressing accounting, disclosure, risk-based capital treatment, and risks associated with such securitizations. A protected cell company insurance securitization that is not fully funded, whether indemnity triggered or nonindemnity triggered, is prohibited. Protected cell assets may be used to pay interest or other consideration on any outstanding debt or other obligation attributable to that cell.

("Indemnity trigger" means a transaction term by which relief of the issuer's obligation to repay investors is triggered by its incurring a specified level of losses under its insurance or reinsurance contracts. "Nonindemnity trigger" means a transaction term by which relief of the issuer's obligation to repay investors is 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 is not, and may not be considered to be, an insurance or reinsurance contract. An investor in such a securitization, solely by means of the investment, is not 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 are not conducting an insurance or reinsurance agency, brokerage, intermediary, advisory, or consulting business by virtue of their activities in connection with that business.

<u>Creditors & Obligations of a Company</u>. Protected cell assets are available only to the creditors of the protected cell company that are creditors for that protected cell and are entitled, under Chapter 48, to have recourse to the protected cell assets attributable to that cell. Creditors for a protected cell are not 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 will be available to creditors of a protected cell company only after all protected cell liabilities have been extinguished or otherwise provided for according to the plan of operation relating to that protected cell.

Specific limitations apply when an obligation of a protected cell company to a person arises from a transaction, or otherwise is imposed, with respect to a protected cell, and when an obligation of a protected cell company relates solely to the general account.

<u>Guaranty Funds & Associations</u>. The activities, assets, and obligations relating to a protected cell are not 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 may 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 do not affect the activities or obligations of an insurer's general account.

<u>Conservation, Rehabilitation, & Liquidation</u>. Upon an order of conservation, rehabilitation, or liquidation of a protected cell company, the receiver must 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 may 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.

<u>Commissioner Regulations</u>. The Commissioner may issue rules, regulations, or orders necessary to effectuate the purposes of Chapter 48.

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

<u>ARGUMENTS</u>

(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.)

<u>Supporting Argument</u>

Although captive insurance companies will 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 makes the State an attractive domicile for insurance companies. The legislation also will benefit noninsurance Michigan-based businesses, which will 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 may foster the development of 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 might create many jobs that pay well. Reportedly, if insurance companies like Jackson National Life use SPFCs to facilitate acquisitions, they potentially might hire thousands of employees with average annual salaries ranging from $30,000 for customer service associates, to $83,000 for managers and other professionals.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bills increase the responsibilities of the Office of Financial and Insurance Regulation within the Department of Labor and Economic Growth (DLEG), the Department of Treasury, and the Attorney General. The impact on State revenue and expenses is discussed below.

Administrative Impact

Senate Bill 1061 adds significant responsibilities to OFIR to regulate captive insurance companies, special purpose financial captives, and protected cell insurance companies, increasing the expenses of the office. Fees established by the bill for application for a limited certificate of authority, investigation of applicants, annual renewal documents, and examinations, will offset these expenses. The amount of expenses and fee revenue will depend on the number of companies seeking to organize under the statute and is unknown.

The Captive Insurance Regulatory and Supervision Fund is created in the State Treasury and will be administered by the OFIR Commissioner. Money in the Fund may be spent pursuant to appropriation. Permissible uses of the Fund include administering the 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 is permitted to incur reasonable expenses for promoting the captive insurance industry within the State. The Fund will receive fees paid by captive insurance companies and special purpose financial captives. In addition, fees received by the Department of Treasury from certain reinsurers will be deposited into the Fund. Fines and administrative penalties levied on captive insurance companies pursuant to the bill also will be deposited into the Captive Insurance Regulatory and Supervision Fund. Money in the Fund at the end of the fiscal year will carry forward into the subsequent fiscal year. The amount of contributions to the Fund will depend on activity by insurance companies and is unknown. The DLEG budget for FY 2008-09 in Public Act 251 of 2008 appropriates $232,500 from the Captive Insurance Regulatory and Supervision Fund to OFIR for administrative expenses.

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

<u>Taxation</u>

These bills exempt captive insurance companies from the Michigan business tax, which assesses a tax on insurance companies equal to 1.25% of the direct premiums written for property or risk located in Michigan. Instead, under these bills, captive insurance companies will be assessed an annual fee ranging from $5,000 for captive insurance companies with annual premiums of less than $5.0 million, to $100,000 for captive insurance companies with annual premiums in excess of $75.0 million. Under the annual fee schedule, captive insurance companies with annual premiums in excess of $400,000 will pay less under the annual fee than they would have had to pay under the Michigan business tax, and captive insurance companies with annual premiums totaling less than $400,000 will pay more under the annual fee than they would have paid under the Michigan business tax. For example, a captive insurance company with premiums totaling $100.0 million will pay an annual fee of $100,000, but would have paid $1.25 million under the Michigan business tax. On the other hand, a captive insurance company with annual premiums totaling $300,000 will pay an annual fee of $5,000, but would have paid only $3,750 under the Michigan business tax.

It is estimated that these bills will generate an overall reduction in the amount of revenue, whether from taxes or fees, the State will receive from insurance companies; however, there is no way to know how many captive insurance companies will be created in Michigan or what their annual premiums will be, so there is not enough information available on which to base a reasonable dollar estimate of this negative fiscal impact. Given that the revenue from the insurance tax assessed under the Michigan business tax goes to the General Fund and the new annual fee will go to the Captive Insurance Regulatory and Supervision Fund, these bills will have a negative impact on the General Fund and a positive impact on the Captive Insurance Regulatory and Supervision Fund. These bills will have no direct impact on local government.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.