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December 26, 2013

The Honorable Martin O'Malley
Governor
State of Maryland Executive Department
State House
Annapolis, MD 21401

The Honorable Thomas V. Mike Miller, Jr.
President of the Senate
State House, Room H-107
Annapolis, Maryland 21401

The Honorable Michael E. Busch
Speaker of the House of Delegates
State House, H-101
Annapolis, Maryland 21401

The Honorable Thomas M. Middleton
Chair, Senate Finance Committee
Miller Senate Office Building, 3 East Wing
11 Bladen Street
Annapolis, Maryland 21401

The Honorable Dereck E. Davis
Chair, House Economic Matters Committee
231 House Office Building
6 Bladen Street
Annapolis, Maryland 21401

Re: Report to Examine Methods to Establish and Properly Regulate
a Captive Insurer Industry in the State of Maryland
MSAR No. 9790

Dear Sirs,

Pursuant to Chapter 407 of the 2013 Acts of the General Assembly, the Maryland Insurance Administration is enclosing its Report to Examine Methods to Establish and Properly Regulate a Captive Insurer Industry in the State of Maryland.

Should you have any questions regarding this report, please do not hesitate to contact me.

Very truly yours,

Karen Stakem Hornig
Deputy Commissioner

Enclosure
cc: Senate Finance Committee Members
House Economic Matters Committee Members
Victoria L Gruber, Esq., Chief of Staff (President)

Kristen Jones, Esq., Chief of Staff (Speaker)
Tamela D. Burt, Committee Staff (Finance)
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Report to Examine Methods to Establish and Properly Regulate a Captive Insurer Industry in the State of Maryland

December 2013

MSAR No. 9790

For more information concerning this document, please contact:

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I. Executive Summary

Section 1, Chapter 407, 2013 Laws of Maryland (Chapter 407) requires the Maryland Insurance Administration (MIA) to examine methods to establish and properly regulate a captive insurer industry in the State and develop recommendations for whether Maryland should establish a captive insurance industry and, if so, how to establish, promote, and regulate that industry.

The purpose of this report is to provide information to the Governor, the Senate Finance Committee and the House Economic Matters Committee about the possibility of establishing a captive insurance industry in the State. In accordance with Chapter 407, the MIA was required to study:

- the models of regulation of captive insurance industries in other states, including the mechanisms for funding those regulatory models;
- the potential benefits of hosting a captive insurance industry in the State to different classes of insureds, and the associated costs of captive insurance compared with insurance procured through traditional insurance underwriting and brokerage;
- the impact on the State and the domestic insurance industry, both as to the potential expansion of the insurance industry and related professionals and activities in the State, and the effect of newly available captive insurance on existing traditional insurance underwriting and brokerage in the State;
- the need for different or additional consumer protections and financial controls for customers of captive insurers compared with customers of traditional insurers in the State;
- the effectiveness, cost, and long-term viability of alternative regulatory or market mechanisms addressing the same or similar markets that have been implemented or are being considered in other states; and
- any additional matters the MIA considers relevant to assessing the possibility of establishing a captive insurance industry in the State.

Further, Chapter 407 requires that the MIA develop recommendations for whether Maryland should establish a captive insurance industry and, if so, how to establish, promote, and regulate the industry.

The MIA recommends that the General Assembly forego captive legislation at this time because there is little demand for traditional captive insurers and because the industry has developed in ways that have caused considerable regulatory concern at the federal and state levels. To become a thriving captive domicile today, a state must be willing to relax important regulatory safeguards. Attractive new domiciles are those that have a high risk appetite, demand few hurdles to formation, have low premium taxes and fees, have minimal solvency and capital requirements, and require little in the way of reporting. Additionally, there is no evidence to support a conclusion that becoming a captive domicile would create actual economic benefit to Maryland.

If, however, the General Assembly chooses to pass captive legislation, it is recommended that the legislation be conservatively drafted to prohibit certain types of captives that are currently under scrutiny by the Internal Revenue Service and the National Association of Insurance Commissioners. Legislation should ensure that only legitimate insurance transactions are permitted and make certain that third party claimants are not put at risk.

II. Overview of the Study Process

This report includes a review of other states' legislative enactments, a review of the current captive insurance marketplace, a discussion of current regulatory issues related to the captive industry, and the costs, challenges, and potential benefits of establishing a captive domicile. As required under Chapter 407, the MIA also made recommendations to establish a captive industry including recommending draft legislation.

Chapter 407 permitted the MIA to secure the services of an independent consultant to assist with this report. After a competitive bid process completed in July 2013, a successful bidder was chosen. Pinnacle Actuarial Resources, Inc. has experience in helping to establish and evaluate captive insurers and also provide captive management services. The report developed by Pinnacle, entitled *Recommendations on the Enactment of Captive Insurance Company Legislation in Maryland* (Pinnacle Report), is included as Attachment 1.

III. Development of the Captive Insurance Industry

Captive insurance is a form of self-insurance. In its pure form, a captive insurer is a wholly owned subsidiary created to provide commercial insurance to its non-insurance parent company, which is the principal beneficiary. Originally established by large companies to provide insurance where coverage was unavailable or high-priced, a captive insurer operates like any commercial insurer: it issues policies, collects premiums, and pays claims. It does not offer insurance to the public.[1] It is not regulated like an admitted insurance carrier, but operates under relaxed rules governing the captive's formation, capitalization, and solvency.[2]

The International Association of Insurance Commissioners (IAIS) defines a captive as "an insurance or reinsurance entity created and owned, directly or indirectly, by one or more industrial, commercial or financial entities, other than an insurance or reinsurance group, the purpose of which is to provide insurance or reinsurance coverage for risks of the entity or entities to which it belongs, or for entities connected to those entities, and only a small part if any of its risk exposure is related to providing insurance or reinsurance to other parties." [3] Most Fortune 500 companies and many large non-profits use captives as a way to control insurance cost and to enjoy tax benefits resulting from deducting insurance premiums paid into a privately held insurance company.[4] Traditionally, industries with the greatest number of captives include

[1] Greg Taylor and Scott Soebel, *A Closer Look at Captive Insurance,* The CPA Journal, June 2008, at 1.
[2] Shanique Hall, *Recent Developments in the Captive Insurance Industry,* National Association of Insurance Commissioners (NAIC), January 2012 at 1.
[3] IAIS, *Issues Paper on the Regulation and Supervision of Captive Insurance Companies*, October 2006, at 4.
[4] Greg Taylor and Scott Soebel, *A Closer Look at Captive Insurance,* The CPA Journal, June 2008, at 2.

finance, real estate, construction, and manufacturing. More recently, there has been particular growth in health care, property development, and securitization for life insurers.[5]

A. History

While risk management developed for a particular business (e.g. maritime industry or textile manufacturers) or a group (e.g. religious denomination) has existed for centuries,[6] most sources credit Ohio insurance agent Frederic M. Reiss with establishing the first "captive" insurer in 1955.[7] His client, Youngstown Sheet & Tube Company (YST) owned mines that were used exclusively for YST and were referred to as "captive" mines.[8] The term was then used for the insurance company solely created to insure the mining operation. In 1958, Reiss founded American Risk Management and chose to operate offshore to avoid state regulation.[9]

Reiss founded International Risk Management Ltd. in 1962 in Bermuda, which remains the leading offshore captive domicile. In 1978, Bermuda passed the first comprehensive legislation to standardize captive licensing and oversight procedures.[10] The Cayman Islands followed and wrote captive legislation targeting the healthcare industry. Harvard's medical hospital formed one of the first pure Cayman Islands captives to supplement and control professional and medical liability risks due to increasingly expensive commercial market insurance and to improve claims and loss control.[11]

B. Current Captive Insurance Marketplace

The captive industry has grown dramatically in the last 30 years. While reports are not consistent, industry sources report that there are more than 6,000 captives that do business around the world in a variety of industries as compared with 1,000 in 1981.[12] Approximately 3,000 captives are domiciled in the Caribbean, 1,200 captives are domiciled in Europe and Asia, and the remaining captives are domiciled in the United States.[13] Numbers are estimated because

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[5] Shanique Hall, *Recent Developments in the Captive Insurance Industry,* NAIC, January 2012 at 2.

[6] William R. Vance, Handbook on the Law of Insurance 8 (Buist M. Anderson ed., 3d ed. 1951); *The Early Days,* Lloyd's Corporate History, http://www.lloyds.com/lloyds/about-us/history/corporate-history/the-early-days; FM Global History, http://www.fmglobal.com/page.aspx?id=01070000; Sharon Thatcher, *The First 100 Years of Church Mutual Insurance Company*, Church Mutual Insurance Company, https://www.churchmutual.com/87/Company-History; *About Us,* Church Insurance Company, https://www.cpg.org/global/about-us/about-cpg/church-insurance/

[7] Insurance Hall of Fame, Frederic Reiss, Induction Year 2007, http://www.insurancehalloffame.org/laureateprofile.php?laureate=135.

[8] Jenna Jones, *Staying Power*, Captive Insurance Times, Issue 23 (May 29, 2013), www.captiveinsurancetimes.com.

[9] Julian M. Burling and Kevin Lazarus editors, *Research Handbook on International Insurance Law and Regulation*, Edward Elgar Publishing., Inc. 2011, at 560.

[10] Catherine Lapsley and Andrea Dismont, *Moments In Time: The Bermuda Insurance Market*, Bermuda Insurance Institute and Bermuda Foundation for Insurance Studies, http://www.bermudayp.com/momentsintimeinsurance.

[11] *History of Captives*, http://captiveexperts.com/History_of_Captives.html.

[12] Dan Berman, *More Employers Choosing Captive Insurance,* BenefitsPro, November 25, 2013. *But see*, Shanique Hall, *Recent Developments in the Captive Insurance Industry,* NAIC, January 2012 at 1 (reporting "...that there are more than 5,000 captives worldwide.").

[13] Shanique Hall, *Recent Developments in the Captive Insurance Industry,* NAIC, January 2012, at 2-3.

not only do some domiciles place a high value on the confidentiality of captive transactions, but there is inconsistency in how numbers are counted. For example, the Pinnacle Report states that Delaware has 181 captives.[14] However, Delaware reported in August of 2013 that it "has over 550 active captives…"[15] which seems to indicate that Delaware counts each cell within microcaptives as a separate captive entity.

Off shore jurisdictions remain the most popular captive domicile, with Bermuda and the Cayman Islands the two largest. Vermont, the United States' largest captive domicile, is third. These top three domiciles account for 36% of all captives globally. Trends indicate that businesses are now more likely to form new captives in the United States or in European Union countries than in other jurisdictions.[16]

While most captives insure only the risks of its parent, variations have grown as captive managers and companies come up with new ways to use captives.[17] In addition to the traditional, single-parent captive, in which the captive insurer writes only the risk of the parent or its affiliates, there are, among others, group, association, agency and cell captives.[18] Since forming the Bureau of Captive and Financial Insurance Products in 2009, Delaware claims to be the 10th largest international captive domicile and 3rd largest in the United States, due to is specialization in microcaptives.[19]

C. Significant Regulatory Issues

While captives traditionally have been used as a risk management tool for large, often hard to insure commercial risks, the captive industry has spawned newer varieties of particular concern to federal and state regulators. "Microcaptives" are highly unregulated, private transactions that are insurance in name only and can be used to shield personal wealth from income tax. Special purpose vehicles are controversial transactions that shift life insurance reserves from a life insurance company's balance sheet, putting third party claimants at risk. There has been significant growth in the captive industry resulting from these two types of captives. The Internal Revenue Service, the Federal Insurance Office, the National Association of Insurance Commissioners (NAIC), and industry observers have raised serious concerns about these captive forms. Unlike more traditional captive forms, critics claim this new breed of risk-shifting vehicles are more like the high risk transactions that contributed to the 2008 financial crises.[20]

1. Section 831(b) "Microcaptives"

Insurance companies, other than life insurance companies, generating annual premiums of $1.2 million or less can elect to pay federal tax based only on their investment income (as

[14] Pinnacle Report, Ex. 1, at 2.
[15] Steve Kinion, *Courting Controversy*, August 2013, www.captivereview.com.
[16] Marsh Risk Management Research, *2013 Captive Benchmarking Report*, April 23, 2013, at 6.
[17] *Id.*
[18] A listing of various types of captives and their definitions are in the Pinnacle Report at page 8.
[19] Steve Kinion, *Courting Controversy*, August 2013, www.captivereview.com.
[20] New York State Department of Financial Services, *Shining a Light on Shadow Insurance,* June 2013.

opposed to the taxable income of a corporation) under § 831(b) of the IRS code. Increasingly, midsize and small companies are entering the captive marketplace by forming "microcaptives" to take advantage of the tax benefits of making a § 831(b) election. Microcaptives have been the key to growth in the newer captive domiciles of Delaware, Kentucky and Utah.[21] Microcaptives are not limited to a particular captive form, but are often formed as a type of "cell" captive.[22] Cell captives are a group of captives designed to be legally separate entities with separate assets and liabilities.[23]

The IRS is actively investigating the use of microcaptives and the aggressive marketing by some captive managers and financial advisors of § 831(b) tax benefits to high wealth individuals. Some microcaptives are taking advantage of the tax treatment of being an insurance company without meeting one or more of the basic requirements of an insurance transaction. To be a legitimate § 831(b) captive insurance company, there must be an actual insurable risk and the actual transfer of risk. The IRS is focusing on questionable pooling mechanisms used to provide risk distribution, inflated premiums, fraudulent transfer of assets out of the captive to off-shore accounts, and dubious insurance risk having a very low likelihood of resulting in a claim.[24] Currently, "the IRS has more cases pending in tax court against captives than ever before – and the growth of the sector means the IRS will be tasking more resources toward abusive practices." [25]

2. *Life Reinsurance Captives and the "Shadow Banking" Debate*

Some life insurance companies started using a type of captive for reinsurance and securitizations that is referred to as a special purpose vehicle (SPV) to distinguish it from traditional self-insurance captive insurers. SPVs developed in response to the NAIC Valuation of Life Insurance Policies Model Regulation (Model #830) adopted in February of 2001. Model #830 requires conservative assumptions and valuation methodologies for determining the level of statutory reserves for life insurers. These conservative assumptions can result in higher reserve levels than were previously maintained by insurers. For term life products, the acronym "XXX" is used to denote these reserves, and for universal life products, the acronym "AXXX" is used.

Model #830 sparked the creation of various SPVs to help companies circumvent the conservative reserving standards. Most of the securitization structures use a captive insurance company as a repository for the funds that were available from the securitization. An insurer or reinsurer ("ceding insurer") transfers the risk associated with policy liabilities to a captive reinsurer. As compensation for the assumed risk, the ceding insurer pays the capital, plus an

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[21] Pinnacle Report, at 3.
[22] Pinnacle Report, at 8; IAIS Report at 8, 36-38.
[23] IAIS Report, at 38.
[24] Richard Klumpp, *The 3 Most Common Mini-Captive Scams,* Wilmington Trust Captive Insurance Brief (January 5, 2012), http://blog.wilmingtontrustcaptiveinsurance.com/blog/bid/75823/The-3-Most-Common-Mini-Captive-Scams.
[25] Jay Adkisson, *IRS Filling The Pipeline With Captive Insurance Cases And Focusing On Dubious Practices,* Forbes (September 9, 2013), www.forbes.com/sites/jayadkisson/2013/09/22/irs-filling-the-pipeline-with-captive-insurance-cases-and-focusing-on dubious-practices.

initial economic reserve, into the captive reinsurer. In return, the SPV issues debt securities in the capital market to finance the statutory reserve requirement exceeding the economic reserves. These developments have caused significant concern among state insurance regulators as it raises the question as to whether third-party insurance risk should be undertaken by a captive insurer.[26]

In July 2012, the New York Department of Financial Services (DFS) initiated an investigation into what it called "shadow insurance."[27] (Attachment 2.) DFS investigated the use of SPVs to free up a company's reserves that were supposed to be set aside to pay claims on a block of life insurance policies. The DFS investigation pointed out that there is no actual risk transfer in these transactions, that insurers have depleted reserves available to pay policyholders, and that these transactions "could potentially put the stability of the broader financial system at greater risk."[28] As part of the DFS final recommendation, it asked for state insurance commissioners to consider an *"immediate national moratorium"* on approving additional shadow insurance transactions until further investigations could be completed.[29]

Following the DFS report and articles in The New York Times[30] and the Wall Street Journal,[31] the NAIC formed the Captive and Special Purpose Vehicle Use Subgroup under the Financial Condition (E) Committee in early 2012. The Subgroup was charged with studying, "...insurer's use of captives and special purpose vehicles to transfer insurance risk, other than self-insured risk, in relation to existing state laws and regulations...". [32]

While the Subgroup's work continues, it has identified several regulatory concerns. These concerns do not relate to the traditional captive forms but, rather, to the use of SPVs. In addition to the lack of transparency or regulation surrounding these transactions, a primary concern is that these transactions are being used to circumvent statutory accounting reserve requirements. Of particular concern is the use of letters of credit and parental guarantees to capitalize or fund the surplus of captives. Statutory accounting requirements limit the types of assets that can count as admitted assets and a letter of credit is not an admitted asset under statutory accounting for a commercial insurer. However, some states allow SPVs to count a letter of credit or a parental guarantee as an admitted asset. Thus, a life insurer can improve its balance sheet and preserve capital resources by transferring the XXX and AXXX reserves to an SPV. A final report from the NAIC Subgroup is expected in 2014 and it is expected that it will have specific recommendations involving the modification of existing NAIC model laws and the drafting of new NAIC model laws.

On December 12, 2013, the Federal Insurance Office (FIO) of the U.S. Department of the Treasury issued a report pursuant to the Dodd-Frank Wall Street Reform and Consumer

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[26] Shanique Hall, *Recent Developments in the Captive Insurance Industry*, NAIC, January 2012 at 6-7.
[27] New York State Department of Financial Services, *Shining a Light on Shadow Insurance*, June 2013.
[28] *Id.* at 1.
[29] *Id.* at 3 (emphasis in the original).
[30] Mary Williams Walsh, *Insurers Inflating Books, New York Regulator Says,* N.Y. Times, June 11, 2013.
[31] Leslie Scism and Serena Ng, *New York Probes Insurers' Dealings with Captives,* Wall St. J., August 5, 2012.
[32] NAIC, *2013 Committee Charges,* March 1, 2013, p. 37, http://www.naic.org/index_committees.html.

Protection Act.[33] The report recommends ways to modernize and improve insurance regulation in the U.S. and one topic specifically addressed is captive insurers and their impact on the life insurance industry.[34] FIO encouraged states to "develop a uniform and transparent solvency oversight regime for the transfer of risk" to SPVs.[35]

IV. MODELS OF REGULATION OF CAPTIVE INSURANCE INDUSTRIES IN OTHER STATES

In the United States, 37 states have captive legislation.[36] Over the last five years, there have been a significant number of emerging captive domiciles including Oregon, New Jersey, Connecticut, Texas, and Louisiana. In addition, current captive states such as Florida, Tennessee, Oklahoma, and Maine are all looking at captive growth in their states and strategically amending their laws to be more accommodating and attractive to captive owners.[37]

Captive legislation addresses the types of captive forms permitted, formation requirements, types of coverages allowed, capitalization requirements, premium taxes and fees, solvency regulations (i.e. surplus requirements), reporting and examination requirements, and rate and premium setting requirements. The following discussion focuses on the top ten captive domiciles in the United States - Arizona, Delaware, the District of Columbia, Hawaii, Kentucky, Montana, Nevada, South Carolina, Utah, and Vermont - and their approach to capital and surplus requirements, permitted coverages, premium tax, and accounting standards.

Capital and surplus requirements vary by state depending on the type of captive. This variety is a key element of consideration for companies shopping for a captive domicile. Typically, minimum requirements for capital and surplus are as follows:

- pure captives require $250,000;
- association captives require $500,000;
- agency captive requires from $250,000 to $600,000;
- industrial captives require $500,000; and
- sponsored captives require $500,000.[38]

For those states that allow them, the minimum capital and surplus for SPVs vary from $250,000 to $500,000 in four states, and are at the discretion of the commissioner in two other states. A table comparing the capital and surplus requirements for various types of captives in the top ten U.S. domiciles is found at Attachment 3.

Most states prohibit captives from writing direct workers' compensation insurance, personal motor vehicle insurance, and homeowner's insurance. In addition to prohibitions for

[33] Federal Insurance Office, *How To Modernize and Improve the System of Insurance Regulation in the United States,* U.S. Department of the Treasury, December 2013.
[34] *Id.* at 32-36.
[35] *Id.* at 32.
[36] Pinnacle Report at 1.
[37] Marsh Benchmarking Report. at 2.
[38] A listing of various types of captives and their definitions are in the Pinnacle Report at page 8.

certain lines of coverage, state laws also dictate to whom insurance coverage should be provided. For example, many state laws provide limitations such as "a pure captive insurer shall not insure risks other than the risks of its affiliates and controlled unaffiliated business."[39] Finally, some states require that the insurance commissioner approve certain coverages. A table comparing the permitted coverages for captives in the top ten U.S. domiciles is found at Attachment 4.

Captive premium tax rates (typically, less than 0.40%) are significantly lower than the traditional admitted market premium tax rates, which typically range from 2% to 3% nationally.[40] Maryland's premium tax rate is 2%.[41] Captive domiciles take a variety of approaches to premiums taxation of captives. A few states, like Utah and Arizona, do not tax captive premium but impose an annual fee. Delaware imposes a flat rate of 0.2% for direct premium and 0.1% for assumed premium. For the majority of the domiciles in the top ten U.S. captives, premium tax is assessed according to "banded" premium levels. A table comparing the premium tax rates in the top ten U.S. domiciles is found at Attachment 5.

All top ten captive U.S. domiciles require a statement of actuarial opinion as part of the annual financial reporting requirement. Financial examination frequency ranges from three to five years except for Arizona, which does not require financial examinations for non-risk retention group captives. Regarding accounting standards, the top ten domiciles require the use of generally accepted accounting principles (GAAP) for financial reports. Some states' law gives the insurance commissioner the authority to accept financial statements using other standards. In regulating admitted insurance carriers, state regulators require the use of the NAIC's Statutory Accounting Principles (SAP), which industry considers conservative. A table comparing the accounting standards in the top ten U.S. domiciles is found at Attachment 6.

V. ALTERNATIVE REGULATORY OR MARKET MECHANISMS ADDRESSING SIMILAR MARKETS

Risk retention groups (RRGs) and purchasing groups (PGs) formed pursuant to the federal Liability Risk Retention Act (LRRA) are two primary alternative regulatory or market mechanisms.[42] RRGs and PGs are limited by the LLRA to offering or purchasing liability coverage such as general liability, errors and omissions, directors and officers, medical malpractice, professional liability, and products liability insurance. The LRRA excludes workers compensation, property insurance or personal lines insurance. The most important difference between an RRG and a purchasing group is that an RRG is an insurer that retains risk while a PG does not, because it purchases insurance from an insurer. The LLRA relies solely on state insurance departments for its implementation.[43]

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[39] ARIZ. REV. STAT, § 20-1098.01(A)(1).
[40] NAIC, *Retaliation: A Guide to State Retaliatory Taxes, Fees, Deposits and Other Requirements*, 2013.
[41] MD. CODE ANN., INS. ART., § 6-103.
[42] 15 USC § 3902.
[43] *Id.*

Maryland law permits the formation of RRGs and PGs.[44] A RRG "has as its members only persons that have an ownership interest in the group and has as its owners only persons that are members of the group..."[45] Generally, a Maryland RRG is regulated like a traditional insurance company.[46] Maryland has 98 foreign RRGs authorized to write business in Maryland. There are currently no domestic RRGs. There are 539 PGs registered to do business in Maryland and of those nine are domiciled in Maryland.

Typically, RRGs domicile in states with captive laws, because "[t]hese laws typically provide advantages that would not be available to an RRG if it formed under the states' traditional property-casualty law, including lower capital and surplus requirements, fewer restrictions on investments, and lower premium tax rates."[47] As a result, those states that have expanded their appeal to other captive types have attracted more RRGs.[48] In 2013, there have been notable RRG failures such as those seen in Utah and Delaware.[49]

VI. Discussion of Potential Benefits and Costs of Captive Legislation

The decision whether to permit the formation of captive insurers in Maryland requires consideration of the potential benefits and possible risks and costs to the State and its citizens. In terms of costs and benefits, Chapter 407 asked the MIA to consider:

- the potential benefits of hosting a captive insurance industry in the State to different classes of insureds, and the associated costs of captive insurance compared with insurance procured through traditional insurance underwriting and brokerage;
- the impact on the State and the domestic insurance industry, both as to the potential expansion of the insurance industry and related professionals and activities in the State, and the effect of newly available captive insurance on existing traditional insurance underwriting and brokerage in the State; [and]...
- the need for different or additional consumer protections and financial controls for customers of captive insurers compared with customers of traditional insurers in the State.

A. Potential Costs and Benefits to Insureds

While captives can provide benefits to insureds, on balance, the potential benefits to insureds do not outweigh the potential costs. In a traditional captive arrangement, captive insurance companies do not sell insurance to the public. The "insured" in relation to a captive is an employee or member of an entity or group that owns the captive insurance company. Captives can provide the benefit of a financially beneficial alternative insurance vehicle for

[44] MD. CODE ANN., INS. ART., §§ 25-101 - 25-111.
[45] MD. CODE ANN., INS. ART., § 25-101(j)(6)(i).
[46] MD. CODE ANN., INS. ART., § 25-102(a).
[47] Karen Cutts, *Not All Captive States Alike For RRGs,* National Underwriter Property & Casualty (April 15, 2004), http://www.propertycasualty360.com/2004/04/15/not-all-captive-states-alike-for-rrgs.
[48] *Id.*
[49] *Industry New Article Excerpts,* Risk Retention Reporter (December 2013), http://www.rrr.com/news/.

commercial entities. Today whether a state is a successful captive domicile depends less upon the number and type of businesses that exist within a state, but rather how attractive a state can make its regulatory environment for the formation of new, riskier types of captives.

Anticipating a significant number of redomestications of existing captive insurers is unrealistic. "While the formation of new captives is trending toward onshore domiciles, large scale re-domestication is not occurring among existing captives. Of the more than 1,220 captives under management at Marsh, only 16 re-domiciled to a new jurisdiction in 2012."[50]

A potential risk to insureds comes in the form of SPVs and other captive forms involving third party claims. As discussed in section III.C.2, these transactions can shift policy liability off of a life insurance company's balance sheet. These arrangements can put at risk both the ability to cover insurance claims and the financial solvency of the underlying life insurance company.

B. Potential Costs and Benefits to the State of Maryland

1. Premium Taxes and Fees

Captive legislation generally includes a method for funding the regulation of the captive industry. In most states, captive legislation sets up a regulatory fund into which captive premium taxes, fees, and penalties are deposited and ear-marked for the regulation of the captive industry. This type of regulatory fund is used in Maryland to fund the regulation of the admitted insurance carriers.[51] Typically, captive premium tax does not impact a state's general fund. Recently some states have revised their statutes to be more attractive to captive insurance companies by reducing premium taxes and fees. For example, Oregon no longer imposes premium taxes on captives, instead charging a $5,000 annual fee.[52]

The Pinnacle Report estimates that, by year three, if 30 Maryland captives are formed, which are not microcaptives or SPVs, the estimated premium tax would be $912,000.[53] However, this analysis seems to be based upon overly optimistic assumptions. For example, New Jersey passed a captive law in 2010 and currently has only five captive insurers.[54] Furthermore, the consultant's scenario assumes a premium tax rate (.40%) that is higher than that charged by Maryland's neighboring captive jurisdictions.[55] If one makes the more realistic assumptions of only five captive insurers by year three and reduces the premium tax rate by half (i.e. .20%), the anticipated total premium tax in year three only would be $80,000.[56] Under this

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[50] *Marsh Benchmarking Report* at 6.
[51] MD. CODE. ANN., INS. ART., § 2-505.
[52] *See* Oregon Captive Insurance Division, http://www.cbs.state.or.us/external/ins/captive/taxes_fees.html.
[53] Pinnacle Report at 25.
[54] Captive Insurance Companies Association, http://www.cicaworld.com/Resources/world-map/DomicileByState.aspx?id=99.
[55] Delaware has a flat 0.2% rate to a maximum of $125,000 for direct premium. The District of Columbia has a banded tax rate for direct premium with rates ranging between 0.05% and .250%.
[56] This scenario assumes that by year three Maryland would have five captives with $8,000,000 in average premium per captive for a total captive premium volume of $40,000,000. This amount taxed at a rate of .20% would yield an estimated total premium tax of $80,000.

more realistic scenario, projected revenue would not cover the cost of staffing and marketing. *See* section IV.B.3.

2. Job Generation and Economic Benefits to the State

Job creation in a captive domicile involves primarily actuaries, lawyers, and others professionals who serve as captive managers. Captives may bring business into the state if captive legislation requires that a captive hire a captive manager, an actuary, legal consultants and other experts to assist with the formation and administration of the captive. These service providers are licensed by the domiciliary state and are generally required to have an office in the state. In addition, captives have capitalization requirements. These funds may be required to be deposited in State financial institutions. Further, collateral requirements may apply to reinsurance transactions and those funds also may be deposited in State financial institutions.

Although Vermont claims that the captive industry has created 1,400 jobs in the state, newer domiciles have not seen that level of job creation.[57] It is unlikely that Maryland would see significant job growth, even if the General Assembly decided to pass aggressive captive legislation with few regulatory limits. The MIA's research indicates that Maryland's legal and financial industry includes a number of actuaries, lawyers and managers already working in the State who have captive expertise. Furthermore, Maryland's close proximity to the District of Columbia and Delaware – domiciles with significant captive markets – may make it less likely that Maryland would attract significant numbers of captive-related firms and professionals.

An increase in hospitality and travel is often cited as a benefit to a captive domicile, if domiciles require significant business presence in the state such as annual board meetings. States are now encouraged, however, to consider limiting the statutory requirements that a captive have significant business activity in the state of domicile.[58] Requiring a captive manager to have a location in the domicile or requiring physical attendance of annual board meetings in the state makes a new captive domicile less attractive.

3. Regulatory and Marketing Costs

The State would have to provide two distinct functions for the captive industry: the regulatory function and the economic development function. Captive regulators with whom the MIA consulted confirmed that marketing a state's captive industry is a critical investment. The captive industry holds numerous meetings and conferences in popular off-shore captive domiciles and these meetings and conferences are considered important opportunities for selling a state's benefits and making important connections with captive managers and associations. A state with a new captive market must quickly recruit competent regulators and build a captive-savvy infrastructure within the insurance department at a time when states are under significant budget pressure. Because of growing competition among states, not only would Maryland have to commit to investing in experienced staff to work with companies interested in forming a captive, but must be willing to market Maryland as an attractive domicile. States spend from

[57] State of Vermont Captive Website, http://www.vermontcaptive.com/about-us/why-vermont.html.
[58] Pinnacle Report at 32.

$250,000 to $800,000 in startup costs.[59] Delaware's Captive Insurance Department suggested that Maryland budget $400,000 for marketing costs to launch a captive program. The needed growth of the MIA's budget for staffing to support the captive industry depends, in part, on the growth of the industry over time. However, the MIA estimates that a core regulatory staff of at least two individuals with a strong captive background would be required at the outset at a cost of over $225,000 for salary and benefits.

C. Potential Costs and Benefits to the Domestic Insurance Industry, Existing Traditional Insurance Underwriting, and Brokerage in the State

It is difficult to determine the likely impact of a captive law on the domestic insurance industry. If the General Assembly were to pass a fairly conservative captive law, there may be little impact on the domestic insurance industry. If, however, the General Assembly were to pass an aggressive captive law to attract small captives to Maryland, it is possible that Maryland's admitted insurance carriers, especially its small mutual insurers and the producers who work with them, could be negatively impacted. There is the risk that captives would compete with traditional insurers and reduce the need for commercial brokers/agents. It would be advisable to secure additional input from Maryland's admitted insurance carriers to gain their view on the impact on the domestic industry.

Underwriting, whether in the admitted or captive markets, should be actuarially sound taking into consideration the risk involved, premium received, and losses expected. Therefore, traditional insurance underwriting should not be impacted by captives. However, underwriting is an issue being addressed by the IRS with respect to microcaptives. The IRS has found cases in which microcaptives were charging premiums that were not actuarially justified for "dubious" insurance risks. [60]

It is also difficult to determine the impact of a captive law with respect to agents, brokers, or other professional who service the insurance industry (e.g. lawyers, lobbyists, actuaries). Captives require the use of captive managers, actuaries, lawyers, and other consultants to assist in the formation and administration of captive insurers. Currently, there are insurance professionals in Maryland who work in the captive market and additional service providers could come, in part, from the existing insurance industry.

D. Costs Associated with Captive Insurance Compared with Insurance Procured through Traditional Insurance Underwriting and Brokerage

It is difficult to compare the traditional and captive markets because of the different approaches to insurance. When an insured buys a traditional insurance product the insured does not take on the underlying risk, which is not the case with traditional captive insurance. To form

[59] Pinnacle Report at 2.

[60] Jay Adkisson, *IRS Filling The Pipeline With Captive Insurance Cases And Focusing On Dubious Practices,* Forbes (September 9, 2013), www.forbes.com/sites/jayadkisson/2013/09/22/irs-filling-the-pipeline-with-captive-insurance-cases-and-focusing-on dubious-practices.

a captive, a parent must create a subsidiary entity. There are numerous costs involved in forming that entity, capitalizing it, creating a business plan for the entity, and hiring certain managers, actuaries, and consultants to form and administer the entity. There is also the long term cost of taking on the underlying risk of loss. However, captives are promoted as having two major advantages: the tax advantages and the ability to better control the cost of insurance over the long term.

E. Impact on Consumer Protection for Customers of Captives Compared with Customers of Traditional Insurance Industry

Maryland has high standards of consumer protection for policyholders of traditional insurance products. Among other things, insurance regulation focuses on ensuring a marketplace free of discrimination, fair claims practices, protection from fraud, disclosure of actions taken by insurance companies, review and approval of rates and forms, and generally providing a certain level of transparency and equal treatment. This regulation stems from the MIA's authority to license insurers, brokers, and other insurance entities.

Under typical captive legislation, these protections do not extend to captive insurers. Captive laws do not focus on consumer protection because traditional captive forms do not sell insurance to the general public. Regulation is primarily focused on financial solvency and management competence. Because some states are allowing the growth of captives into lines of business long the exclusive purview of admitted insurance carriers, significant concern has been voiced by insurance regulators about captive insurance transactions and their impact on third-party insureds.

VII. RECOMMENDATIONS ON LEGISLATION

The MIA recommends that the General Assembly forego passage of captive legislation in the 2014 session. Because of the highly competitive environment among captive states, it is unlikely that Maryland could become an attractive captive domicile and maintain strong regulatory standards. Additionally, parts of the industry have drawn the negative attention of federal and state regulators for practices that may run afoul of applicable law. State insurance regulators are developing a strategy to deal with SPVs and their potential to destabilize the life insurance industry, and the IRS is giving unprecedented attention to microcaptives at this time.

However, if the General Assembly determines that it is in the best interest of the State to pass captive legislation, the MIA recommends that the legislation exclude microcaptives and SPVs and prohibit the use of captives for health insurance, workers compensation, personal lines, or other arrangements in which third party claims may be put at risk. A copy of a draft bill is found at Attachment 7.

The challenge for state insurance regulators is how to establish and nurture a captive insurance industry in the current "race to the bottom" regulatory environment.[61] States openly compete with one another to attract business by eliminating as many regulatory safeguards to attract business.[62] Many new captive domiciles that have experienced significant growth share certain characteristics. They have captive formation requirements that are quick and inexpensive and solvency requirements that are often described as "flexible," allowing intra-company letters of credit and loan-back arrangements. Information about captives and their transactions remain confidential, reporting requirements are minimal, and fees and premium taxes are low.

Measuring the ultimate success of a captive program will depend upon the primary reason for passing a law permitting the formation of captives. A primary goal of providing a legitimate and financially viable alternative insurance vehicle for large commercial entities could be achieved by passing a law that avoids some of the more controversial risk shifting vehicles. However, the market demand for this more traditional approach seems limited.[63]

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[61] *See* Zachary R. Mider, *Apollo-to-Goldman Embracing Insurers Spurs State Concerns,* Bloomberg Businessweek Online (April 22, 2013), http://www.businessweek.com.

[62] Mary Williams Walsh and Louise Story, *Seeking Business, States Loosen Insurance Rules,* N.Y. Times, May 8, 2011.

[63] Pinnacle Report at p. 37.

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Attachment 1

Recommendations on the Enactment of Captive Insurance Company Legislation in Maryland

Pinnacle Actuarial Resources

November 2013

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December 2, 2013

Karen Stakem Hornig
Deputy Commissioner
Maryland Insurance Administration
200 St. Paul Place, Suite 2700
Baltimore, Maryland 21202

Re: Recommendations on the Enactment of Captive Insurance Company Legislation in Maryland

Ms. Hornig,

Enclosed are copies of our report analyzing the methods of establishing and regulating a captive domicile in Maryland, as well as our recommendations regarding whether captive legislation should be pursued at this time and issues that can threaten the viability of a domicile and approaches that can increase the likelihood of success.

I am a member in good standing of the Casualty Actuarial Society (CAS) and the American Academy of Actuaries (AAA) and meet the continuing education requirements to provide this statement of actuarial opinion.

Please give me a call at your earliest convenience so that we can discuss this report. We have enjoyed working with you on this assignment and remain available to discuss any questions you may have with this report or any additional reforms that may be proposed.

Sincerely,

Robert J. Walling III, FCAS, MAAA, CERA
Principal and Consulting Actuary

Recommendations on the Enactment of Captive Insurance Company Legislation in Maryland

November 2013

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Commitment Beyond Numbers

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Recommendations on the Enactment of Captive Insurance Company Legislation in Maryland

Executive Summary [1]

The Maryland Insurance Administration ("MIA") has retained Pinnacle Actuarial Resources, Inc. ("Pinnacle") to "conduct a statutorily mandated study of methods to establish and properly regulate a captive insurer industry in the State, and to develop a report to be submitted to the MIA that includes recommendations as to whether Maryland should establish a captive insurance industry, and if so, how to establish, promote, and regulate the industry."

The last several years have seen a substantial increase in the number of states and U.S. territories that have enacted captive insurance company legislation and thus become captive domiciles. As of the publication of this report, recently enacted legislation in Florida, North Carolina and Texas brings the number of U.S. captive domiciles to 37[2]. According to Philip Giles of Artex Risk Solutions, "Ten years ago, there were only four states (Arizona, Hawaii, South Carolina, and Vermont) that could be counted as (major) onshore domiciles." This increase in the number of domiciles is being fueled by the growth in the number of captives in operation which has surpassed 2,000 in the U.S. in 2011.[3]

Pinnacle has come to a number of key conclusions regarding the opportunities and challenges faced by the state of Maryland should they choose to enact captive legislation. These conclusions are based on a review of a substantial amount of information from state captive insurance regulators, state captive insurance associations, other captive and risk management associations, captive managers, discussions with the leaders of these organizations, and Pinnacle's extensive experience in the captive industry and working with captive owners, captive regulators, and captive service providers (e.g. managers, lawyers, and auditors).

First, we find that there is little downside risk and modest start-up regulatory administrative expenses to the state of Maryland enacting captive legislation and forming a captive domicile. Two recent captive domiciles began their regulatory operations with additional budget allocations of between

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[1] Third parties receiving only this Executive Summary should recognize that the furnishing of this summary is not a substitute for their own due diligence and should place no reliance on this summary that would result in the creation of any duty or liability by Pinnacle Actuarial Resources, Inc. (Pinnacle) to the third party. Pinnacle is available to answer any questions regarding the information contained in the Executive Summary. The conclusions and findings of this executive summary are expanded upon in subsequent sections of this report.

[2] "Onshore Captive Domiciles: Contemplating Competition," Philip C. Giles, CEBS, www.artexrisk.com/resource-room/articles-and-white-papers/onshore-captive-domiciles-contemplating-competition/

[3] "Market Insights: Captive Domiciles 2012," Business Insurance, March 2012

$200,000 and $400,000. The largest incremental regulatory budget for a new captive domicile that we are aware of is $800,000. Once a captive domicile is up and running, captive premium tax revenues are typically greater than captive regulatory expenses. However, there may also be some factors limiting the growth in both the number of captives and premium that might enter a Maryland captive domicile. In the current insurance environment, a Maryland captive domicile is likely to find itself facing significant opposition to its growth from a growing number of other domiciles. It is also likely that continued challenges from the IRS and potentially elements of the NAIC will temper future captive growth somewhat. In addition, it is possible that the MIA's regulatory emphasis on consumer protection may run counter to the captive industry's desire to innovate and take risks. So while it costs relatively little to start a captive domicile, there may be several factors that might reduce the likelihood that the domicile would reach a level of critical mass necessary for long term viability.

This overall finding is based on a number of additional findings as documented in the ***Discussion and Analysis*** section of the report and the exhibits attached to the report.

The enactment of captive legislation and the formation of a captive domicile in Maryland are supported by several factors, including:

- The substantial and fast growth of other domiciles in recent years including Delaware, Kentucky, Missouri, Tennessee, and Utah,
- Captive regulatory costs appear to be less than 0.20% of premium while captive premium taxes are typically between 0.25% and 0.40% of premium for the first $20 million of premium. This means that active captive domiciles have more than sufficient revenue to cover regulatory expenses,
- The proximity of Maryland to the successful domiciles of Delaware and the District of Columbia may result in new captive opportunities in Maryland from captive managers already located in the area or captives dissatisfied with a neighboring domicile,
- The substantial benefits captive owners are realizing should continue to foster broad growth in the number and premiums in captives in the U.S., and
- Even a modestly successful captive domicile can have positive economic benefits to the state of Maryland including job creation, hospitality and travel revenue, and increased tax proceeds.

Factors that potential limit the success and long term viability of Maryland as a captive domicile if they are not addressed include:

- The current lack of a champion advocating the domicile,
- While the local economy is not typically a key factor in the success of a captive domicile, Maryland businesses and domestic insurers do not appear to present a significant opportunity for captive formations or redomestications, other than within microcaptives.

- The MIA's historical focus on consumer protection may run counter at times to the desire for innovation and risk taking by captive owners,
- Current IRS scrutiny of microcaptives, which have been the key to growth in the newer domiciles of Delaware, Kentucky and Utah, may constrain short term captive growth rates,
- Current NAIC debate over life reinsurance captives may deter some short term captive formations of these large captives,
- The level of competition between domiciles due to the proximity of Maryland to the successful domiciles of Delaware and the District of Columbia may limit opportunities presented in the state, unless Maryland's captive law or regulatory system offer a clear advantage over these established domiciles to captive managers already doing business in these domiciles,
- The additional risk of insolvency and lack of compensation, particularly to third party claimants, may conflict with MIA's mission and values focusing on consumer protection, and
- The increased reputational risk in the event of insolvencies or heightened IRS scrutiny.

Key elements of a successful captive domicile in the current U.S. captive industry include:[4]

- The willingness to license some form of segregated cell captives, such as series LLC captives (e.g. Delaware),
- Competitive captive premium taxes and fees,
- Minimum capitalization requirements and permitted types of capital that are attractive to captive owners,
- Reasonable residency requirements for captive managers,
- Coverage limitations, such as exclusions of personal lines, especially homeowners, and workers compensation on a direct basis that are consistent with Maryland's regulatory philosophy of consumer protection,
- Reasonable rules for allowing "loan backs," dividends and non-investment grade investments to captive owners under certain rules and conditions,
- Efficient and cost-effective financial reporting requirements,
- An active and engaged captive association,
- Strong leadership (i.e. a champion) from a captive regulator and/or a captive association director, and
- An experienced captive regulator.

These are all nearly prerequisites of a captive domicile that will be viable for the long run. Poor execution of any of these elements (types of permissible captives, premium taxes, capitalization,

[4] These findings are predicated on the expectation that effective legislation can be crafted in line with the stated objectives and that a regulatory framework can be implemented to carry out the legislation in an effective manner.

residency requirements, treatments of dividends, investments and loan-backs, financial reporting, captive association, and domicile promotion and leadership) can constrain domicile growth.

Scope & Background

Project Scope

The Maryland Insurance Administration ("MIA") has retained Pinnacle Actuarial Resources, Inc. ("Pinnacle") to "conduct a statutorily mandated study of methods to establish and properly regulate a captive insurer industry in the State, and to develop a report to be submitted to the MIA that includes recommendations as to whether Maryland should establish a captive insurance industry, and if so, how to establish, promote, and regulate the industry."

There were several specific areas Pinnacle was asked to address within the scope of this report. They include:

1) Background information on other captive domiciles
2) Models of regulation of the captive insurance industry
3) Estimates of the potential captive market (number and size of the captives)
4) Benefits to insureds of forming captives
5) Potential impacts on the state of Maryland and the domestic insurance market
6) Administrative and operational costs of establishing and regulating a captive domicile
7) Alternative regulatory approaches
8) The potential need for different or additional consumer protections
9) Keys to the long term viability of a captive domicile

The scope of this assignment tends to focus on design features and comparisons of U.S. (onshore) domiciles. An analysis of offshore domiciles, such as Bermuda and the Cayman Islands is outside the scope of this study.

The Maryland Insurance Market and Economy

According to 2012 insurance company financial statement data provided by the A.M. Best Company, Maryland is the sixteenth largest property casualty insurance market in the U.S. with annual premiums of approximately $10.0 billion dollars. As of June 30, 2012[5], MIA reports that there were 1,456 insurance companies licensed in the state, 901 of them property casualty insurers. In addition, there are 96 licensed risk retention groups (RRGs), 135 surplus lines insurers, 28 motor clubs, and 6 workers compensation self-insurers licensed in the state.

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[5] "Fiscal Year 2012 Annual Report of the Maryland Insurance Administration to the Maryland General Assembly Pursuant to §2-110 of The Maryland Insurance Article," November 2, 2012

According to the 2012 MIA Annual Report data, approximately 13.4% of property-casualty premium written in 2012 was written by insurance companies domiciled in Maryland. The largest domestic property-casualty insurers in Maryland are GEICO ($806 million), Medical Mutual Liability Insurance Society of Maryland ($121 million), Brethren Mutual ($69 million), Harford Mutual ($35 million), Peninsula Insurance Company (part of Donegal Mutual) ($31 million), and Frederick Mutual ($17 million). Other than Medical Mutual, these companies write mostly personal lines and small commercial lines insurance policies that are not well suited for captive insurance solutions.

Maryland also has a competitive state insurance fund, the Injured Workers' Insurance Fund (IWIF), which has recently been privatized and become Chesapeake Employers' Insurance Company. Maryland also has a domestic medical professional liability insurer, Medical Mutual Liability Insurance Society of Maryland, which focuses on providing medical professional liability to healthcare providers in the state.

According to the Maryland Department of Business & Economic Development[6], the leading industries in Maryland are the following:

Rank	Industry	Employment	Percent
1	Health care and social assistance	395,202	12%
2	State and local government	347,113	10%
3	Retail trade	335,516	10%
4	Professional and technical services	329,659	10%
5	Accommodation and food services	211,256	6%
6	Administrative and waste management services	207,286	6%
7	Construction	203,923	6%
8	Other services, except government	205,505	6%
9	Federal government, civilian	171,994	5%
10	Finance and insurance	169,775	5%
11	Real estate and rental and leasing	164,164	5%
12	Manufacturing	124,273	4%
13	Wholesale trade	94,608	3%
14	Educational services	93,328	3%
15	Transportation and warehousing	89,741	3%
16	Arts, entertainment and recreation	76,250	2%
17	Information	57,503	2%
18	Military	46,422	1%
19	Mgt. of companies and enterprises	22,094	1%

[6] The source of the data from the Maryland Department of Business & Economic Development was the U.S. Bureau of Economic Analysis, 2010. Total full-time and part-time employment. www.choosemaryland.org/factsstats/

Information technology, telecommunications, and aerospace and defense also play a leading role in the Maryland economy. In the biotechnology area, Maryland is a leader in the mapping of the human genome.

According to the Maryland Department of Business & Economic Development[7], the largest employers in the state are as follows:

Major Statewide Employers in Maryland - 2012

Employer	Employees	Product / Service
Fort George G. Meade	56,700	Military installation/intelligence
University System of Maryland	36,880	Higher education
Johns Hopkins University	27,000	Higher education
Johns Hopkins Hospital & Health System	21,620	Hospitals; health services
Wal-Mart	17,680	Consumer goods
National Institutes of Health	17,660	Federal Agency
Aberdeen Proving Ground	15,580	Military installation
MedStar Health	15,520	Hospitals; health services
University of Maryland Medical System	15,000	Hospitals; health services
Joint Base Andrews Naval Air Facility	13,500	Military installation
Giant Food	13,180	Groceries
U.S. Social Security Administration	13,000	Federal agency
U.S. Food and Drug Administration	12,200	Federal agency
Walter Reed National Military Medical Center	11,680	Hospitals; health services
Naval Air Station Patuxent River	10,960	Military installation
Northrop Grumman	10,260	Electronic systems
Marriott International	9,800	Food and lodging services
Verizon Maryland	8,920	Communications services
Lockheed Martin	8,000	Aerospace and electronics
Constellation / BGE	7,400	Energy services
Target	7,400	Consumer goods
Home Depot	7,380	Home improvement products
LifeBridge Health	7,140	Hospitals; health services
United Parcel Service (UPS)	6,600	Package delivery services
SAIC	6,500	Energy & scientific services

Notes: Largest employers exclusive of state and local governments. Employee counts are rounded.
Federal and military employers exclude contractors to the extent possible; embedded contractors may be included.
Fort George G. Meade includes employees of the National Security Agency.

The role of federal government agencies, healthcare and higher education is clear. There appear to currently be four Fortune 500 companies with their primary headquarters located in Maryland. [8]

[7] Source: Maryland Department of Business and Economic Development, 2012
www.choosemaryland.org/factsstats/Pages/MajorEmployers.aspx

It should be recognized that the domestic insurance market and economy are not primary factors in determining the success or failure of a captive domicile. Otherwise, relatively small markets such as Vermont, the Cayman Islands, and Hawaii would not have the successful captive markets they currently enjoy. However, the presence of local insurers or businesses that are willing to form or redomesticate captives into the domicile can provide a new domicile with several initial captive formations that provide:

1) A flow of premium taxes to fund the captive regulatory structure in the state,
2) An opportunity to work through the captive application process and streamline the process for future captive growth,
3) A core group of supporters of the state's captive association, and
4) Initial momentum to encourage captive managers and owners to consider the domicile.

The two most likely ways for Maryland businesses to take advantage of a Maryland captive domicile would be medical professional liability insurance captives in partnership with Medical Mutual Liability Insurance Society of Maryland and medium sized businesses forming SBUs within series LLC captives.

Captive Background

What is a captive insurance company, or a captive for short? First and foremost, it is essential to understand that a captive is an insurance company. Whatever else a captive may or may not be used for (tax advantages, generational wealth transfer, investment opportunities, etc.) a captive must be an insurance company first. More details on what this entails will be provided later on in this report.

Some sources oversimplify their definition of a captive to something akin to an insurance company that provides coverage to its owner. However, there are numerous captives that are owned by a party related to the insured, such as their insurance agency, industry association, a manufacturer of a product their business uses, but not owned by the insured. Further, in order to satisfy risk transfer requirements to be a valid insurance company, many captives also provide coverage to "related unrelated" risks such as franchisees, owner-operators, or even employees through health insurance and benefits insurance programs.

We will define a captive insurance company, or captive, as "an insurance company whose primary purpose is financing the risks of its owners or participants."[9] Oftentimes, but not always, the owner of

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[8] money.cnn.com/magazines/fortune/fortune500/2013/full_list/

[9] From the International Risk Management Institute, Inc. (IRMI) website, www.irmi.com/online/insurance-glossary/default.aspx.

the captive is also the sole or primary insured. Captives are typically regulated under different enabling legislation and regulations than traditional admitted insurance companies. Captives tend to be owned by and provide insurance to sophisticated commercial insureds that require less policyholder protection than the general public.

There are a number of different types of captive insurers. These include:

- Single Parent or Pure Captives – A captive formed, owned, controlled and insuring a company and its affiliates.
- Agency Captives – A captive formed by an insurance company or agency to provide reinsurance to their clients.
- Association Captives – A captive formed or sponsored by an industry or trade association for the purpose of insuring the risk of the association's members.
- Group Captives – A captive formed by a group of companies to provide insurance for a shared need and to pool risk. These groups may be homogeneous or heterogeneous.
- Protected Cell – A form of "rent-a-captive" that attempts to protect and insulate the capital and surplus from the owners of other cells in the captive.
- Rent-a-Captive – A captive that "rents" its facilities to other companies that may not have the resources or claims volume to form a captive of their own. The renter pays a fee to access the captive and may contractually agree to utilize services provided by the captive such as underwriting, claims or accounting.
- Risk Retention Groups (RRGs) – A risk retention group is a form of captive operating under the auspices of the Risk Retention Act (RRA) of 1986. RRGs are limited by the RRA to writing casualty (liability) insurance coverages. However, because of the RRA, RRGs have significantly reduced state regulatory requirements, particularly as it relates to filing insurance rates.
- Series LLC Captives – A form of U.S. protected cell captive that utilizes a series of limited liability companies (LLCs). Each series, or Special Business Unit (SBU), is treated as a pure captive and can take any of the other captive forms described.
- Special Purpose Vehicles (SPVs) - A special purpose captive is owned or controlled by a parent company and may only insure the risk of its parent. SPVs are frequently used by life reinsurance companies.

Captives that have premiums of less than $1.2 million annually may make a tax election under section 831(b) of the Internal Revenue Code of 1986 or other related sections of the tax code that exempt underwriting profits from federal income taxes. These small captives are sometimes referred to as 831(b)s or 831(b) captives. They are also sometimes referred to colloquially as "microcaptives." Any of the captive types listed earlier may make an 831(b) election. Therefore neither the term 831(b) captive, nor the term microcaptive describes a single type of captive according to the earlier

categories. However, hundreds of microcaptives have been formed in a variety of domiciles whose captive legislations have lower premium taxes and limited regulatory requirements, both attractive features to microcaptives. Because of this significant growth in the number of microcaptives in recent years, they are currently an important part of the U.S. captive landscape. Given their current importance in the captive industry, we will adopt the term microcaptive to refer to the growing number of small captives that are being formed and making 831(b) tax elections when we discuss them.

A wide variety of coverages are provided through captive insurance companies. Some of the more common coverages include:

- Workers compensation, typically on a deductible reimbursement basis
- Property, sometimes including flood, earthquake or terrorism coverage.
- Professional liability including:
    - Medical professional liability;
    - Hospital professional liability: and
    - Non-medical professional liability for lawyers, accountants, insurance agents, etc.
- Liability insurance, including:
    - Products Liability;
    - Pollution liability;
    - General liability;
    - General liability coverage gaps such as contractual and intellectual property liability;
    - Errors & Omissions liability (E&O);
    - Directors and Officers liability (D&O);
    - Employers professional liability (EPLI);
    - Fiduciary liability;
    - Cyber liability
    - Product recall; and
    - Garage liability.
- Automobile insurance – both liability and physical damage.
- Group health insurance and other employee benefits.
- Non-traditional, low frequency, high severity coverages such as brand rehabilitation, loss of key employee, publisher's liability or loss of contingent business income due to causes such as loss of key supplier or labor shortage.

While a more extensive discussion of the benefits of a captive to the captive owner will be provided in a later section of this report, some of the primary benefits a captive can provide include 1) greater control over the insured's insurance program and claims, 2) ownership of underwriting profits and

investment income, 3) improved coverage affordability, availability, and price stability, 4) customized and manuscripted coverages, and 5) improved cash flow and tax benefits.

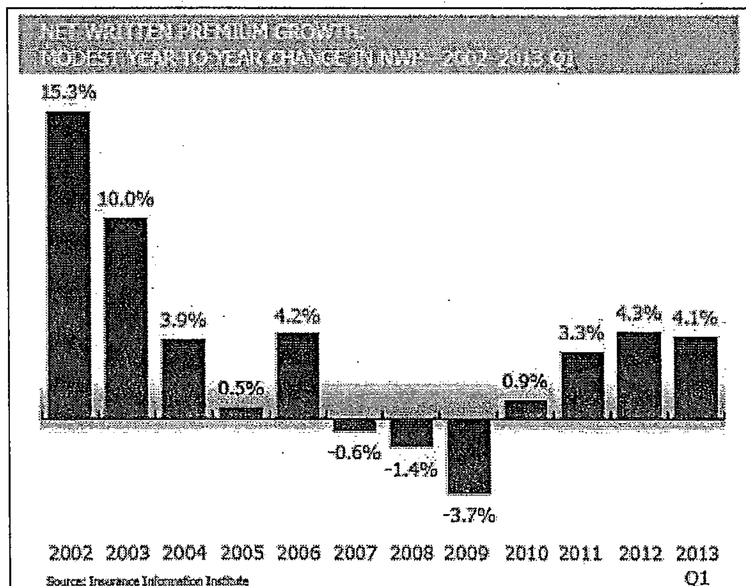
There are potentially numerous ways a state can benefit from becoming a captive domicile. Captive insurance companies generate economic benefits to the domicile state in a variety of ways:

- Increased premium taxes,
- Increased hospitality revenues and taxes related to captive board meetings, captive association meetings, educational conferences and other activities in the state, and
- Employment of captive service providers, captive managers, accountants, lawyers, actuaries, and claims administrators in the state producing state income taxes, sales taxes, etc.

These benefits are realized for both businesses located in the state and for captive owners from other jurisdictions that the domiciliary state attracts to its domicile.

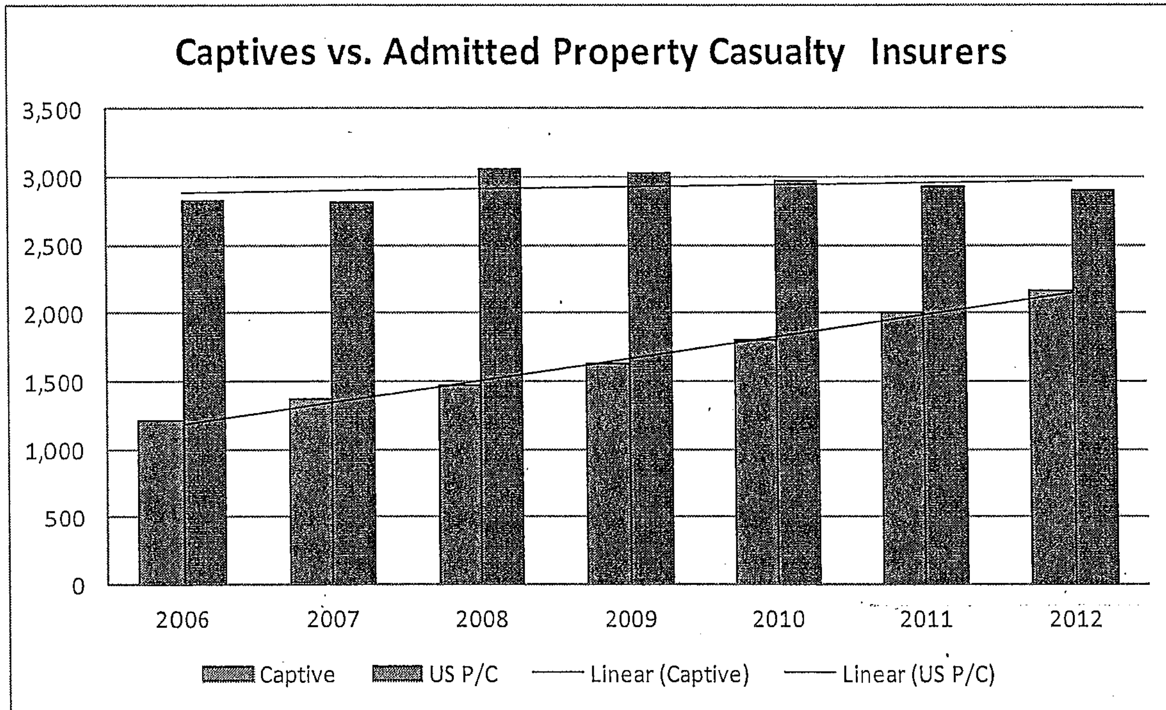
The U.S. Captive Insurance Market

The property casualty insurance industry in the United States has been in a sustained period of fairly negligible premium growth. For example, the following graph by Lockton, Inc.[10] utilizing data from the Insurance Information Institute, shows that the change in written premium net of reinsurance between 2004 and the first quarter of 2013 has been between -3.7% and +4.3% annually. A number of factors contribute to this phenomenon including the economic downturn, high levels of industry capitalization and aggressive levels of price competition.



[10] www.lockton.com/Resource/PageResource/MKT/USPropertyCasualtywithCyberlink.pdf

By comparison, growth in the U.S. captive industry has far exceeded growth in the U.S. admitted market. For example, the following chart shows that the number of U.S. captive insurance companies has grown at an annual rate of 10.2%[11], while the number of admitted insurance companies has grown at a rate of only 0.5%.[12] Clearly, the growth in the U.S. property casualty insurance industry is in captive insurance companies.



In recent years, this growth has been driven by microcaptives[13] and, to a lesser extent, health insurance and benefits captives. The growth has been concentrated in several emerging domiciles with an emphasis in their captive legislation and regulatory framework on microcaptives. In particular Utah, Kentucky, Delaware and, more recently, Tennessee have all experienced significant growth in the number of captives domiciled in their state. Some basic information on the number and size of

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[11] Based on data from Business insurance's "Market Insights: Captive Domiciles 2012" and 2013 and augmented with information from specific domicile regulatory websites.

[12] Based on insurance company annual financial statement data from AM Best Company

[13] Business insurance's "Market Insights: Captive Domiciles 2012" and 2013 shows that most of the growth in the number of captives is in domiciles focusing on microcaptives, such as Delaware, Kentucky, and Utah.

captives in several major domiciles is shown in the table below. The average premium size by domicile shows the smaller average premiums in domiciles focused on microcaptives such as Kentucky, Montana, Nevada, and Utah. Delaware is a bit misleading as sometimes dozens of SBUs in a single series LLC captive, each potentially making an 831(b) tax election, are all counted as a single captive and inflate the average captive size. The large average premiums in established domiciles (Vermont, South Carolina), domiciles with a historical emphasis on RRGs (Arizona), and domiciles with a number of very large life reinsurance captives (Missouri) can also be seen in the table's results.

Domicile	Number of Captives	Total 2012 Captive Premium ($M)	Average 2012 Premium per Captive
AZ	84	3,648	43,431,190
DE	181	2,406	13,292,928
DC	77	357	4,633,506
HI	161	2,441	15,163,292
KY	136	121	886,324
MO	28	6,564	234,415,357
MT	114	120	1,052,632
NV	100	104	1,042,800
SC	133	2,863	21,524,211
UT	285	544	1,908,842
VT	500	25,138	50,276,000

Source: NAIC Insurance Department Resources

Regulatory Trends

Two regulatory trends are currently threatening to deter the growth of captives in the United States: increased scrutiny from the Internal Revenue Service and activities seeking to curtail or halt certain types of captive formations from individual state insurance regulators and the National Association of Insurance Commissioners (NAIC).

The IRS has taken notice of not only the potentially significant tax benefits available to microcaptives, but also to the aggressive marketing of the benefits by some captive managers, wealth management advisors and others. As a result, according to Jay Adkisson of Riser Adkisson LLP in a recent article[14] on the website for Forbes magazine, "the IRS has more cases pending in tax court against captives than

[14] "IRS Filling The Pipeline With Captive Insurance Cases And Focusing On Dubious Practices," Jay Adkisson, www.forbes.com/sites/jayadkisson/2013/09/22/irs-filling-the-pipeline-with-captive-insurance-cases-and-focusing-on-dubious-practices/, September 9, 2013.

ever before – and the growth of the sector means the IRS will be tasking more resources toward abusive practices."

The IRS is contending that captives often violate one or more of the fundamental requirements for an enterprise to be recognized as a bona fide insurance company. These criteria[15] include:

1) The captive insurance company must be formed for a valid business purpose, rather than simply tax avoidance. A key element of this criterion is that the company should function and operate as an insurance company.
2) The captive's coverages must include "insurance risk," which involves the transfer of both timing and the risk of economic loss. It must also be "consistent with commonly accepted notions of insurance." These notions include premiums being determined on an "at arm's length basis," preferably by an independent actuary, the presence of claims activity, and the employment or outsourcing of staff to perform the typical functions of an insurer (e.g. claims, accounting, underwriting, actuarial, etc.).
3) The insurance arrangement must result in "risk shifting" from the insured to the insurer.
4) The insurance arrangement must result in "risk distribution" from the insurer's perspective. This is typically accomplished either through "brother-sister" distribution of risk within a complex corporate organization or through insurance of "unrelated-related" risk. A more detailed discussion of these risk distribution theories is beyond the scope of this report.

Some specific issues drawing specific attention from the IRS appear to be pooling mechanisms used to provide risk distribution, certain coverages that appear to cover risks more correctly identified as business risk than insurable risk, and other coverages that appear to have a very low likelihood of resulting in a claim which the IRS has characterized as "dubious risks". The IRS has singled out both terrorism coverage and "audit defense" coverage and related fees and penalties for closer scrutiny as the IRS views them as potentially subject to abuse. A detailed discussion of these issues is extremely technical in nature and well beyond the scope of this report. Basically, all of these issues are associated with programs that the IRS alleges are taking advantage of the tax treatment of being an insurance company without meeting one or more of the basic requirements of a transaction being insurance.

In recent years, the IRS' primary focus relative to captives has been on microcaptives making the §831(b) election because of the significant impact this election can have on income tax receipts.

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[15] This information is based on a review of Roberta Walski, Transferee, et al. v. Commissioner of Internal Revenue and is similar to arguments presented in other captive insurance cases in the U.S. Tax Court.

In an unrelated series of highly publicized activities, the New York Department of Financial Services[16] has sought to halt approvals of captives being formed to provide life insurance reinsurance for large life insurance companies. These captives, known as "XXX captives", seek to provide a remedy for statutory reserve requirements for term life and no-lapse guaranteed universal life insurance products. These statutory reserves, known as "XXX" reserves for term life insurance products and "AXXX" for no-lapse guarantee universal life (UL) products, and the related risks associated with them can be ceded to a wholly-owned captive, thereby effectively removing the risk from the life insurer's balance sheet. While a detailed discussion of the points for and against XXX captives is beyond the scope of this report, the level of U.S. insurance regulatory scrutiny currently being directed at life reinsurance captives is a noteworthy risk factor for new captive domiciles that might want to target this type of large captive. The NAIC[17] has questioned the need for a moratorium on these captive formations. However, according to NAIC President Jim Donelon, the NAIC already has a group reviewing captives and that state regulators support improved transparency.

[16] "Shining a Light on Shadow Insurance: A Little-known Loophole That Puts Insurance Policyholders and Taxpayers at Greater Risk," New York State Department of Financial Services, June 2013

[17] "N.Y.'s Call for Moratorium on Life Insurance Captives Questioned by NAIC," Insurance Journal, June 13, 2013, www.insurancejournal.com/news/east/2013/06/13/295483.htm .

Data Sources

Our analysis relied upon a number of sources. The sources are categorized and discussed as follows:

1) Pinnacle's Experience in the Captive Industry
2) Captive Managers
3) Insurance Departments
4) Captive Associations
5) Others

In addition, a comprehensive list of relevant websites and resources is attached as Exhibit 4. This exhibit is a particularly useful tool for readers interested in additional detailed information. In particular, links to many domiciles' enabling legislations, captive application details, state captive regulators, and state captive associations are provided.

Pinnacle's Experience in the Captive Industry

Pinnacle's consultants have been serving captives and captive service providers since the mid 1980's. Today, Pinnacle serves hundreds of captives with over 6,000 insureds. In addition, Pinnacle serves almost every major captive manager including Aon Captive & Insurance Management, Marsh Captive Solutions, Willis Global Captive Management, Strategic Risk Solutions, USA Risk Group, Kane Group Ltd., AIG Captive Management, R&Q Quest Management Ltd. and numerous other managers. In 2013 alone, Pinnacle has averaged over 150 new captive member funding studies per month. Pinnacle also serves several U.S. captive insurance regulators, including state insurance departments in Connecticut, Kentucky, Missouri, New York, Tennessee, and Vermont. Third, Pinnacle serves captive consultants such as Captive Resources LLC, Artex Risk Solutions, Inc., Alternative Risk Underwriting and numerous brokers that are involved in the formation and daily administration of captives. Finally, Pinnacle works with numerous auditors responsible for audits of captive insurance companies. All of this experience is an essential part of this study and represents decades of Pinnacle's work with captives.

Captive Managers

Captive managers are in the business of helping organizations determine whether it is worthwhile to form a captive, what type of captive would be most effective for their risks, and where to domicile a captive. Educational materials the captive managers use with captive owners, the captive managers' websites and discussions with the captive managers themselves all provided valuable insights that supported this report. Pinnacle's consultants talk to captive managers on a daily basis. These relationships, and the captive managers' willingness to discuss matters pertinent to this study, were very useful in developing this report. The websites for many of the leading captive managers are provided in Exhibit 4.

State Insurance Departments

The vast majority of state insurance departments in captive domiciles have a specific section of their website dedicated to captive regulation. The captive sections of the insurance department websites tend to contain information such as:

- Contact information for key insurance department personnel
- Steps to forming captives
- Captive regulations in the domicile
- Applications and other captive forms, such as state tax returns
- Annual filing instructions
- Approved captive managers and other captive service providers, such as auditors and actuaries
- Data and statistics regarding captives in the domicile
- Information and links related to the captive association in the domicile
- Benefits of forming a captive.
- Benefits of forming a captive in this domicile.
- Background on types of captives and common coverages.

Individual websites for the larger U.S. captive domiciles are listed in Exhibit 4.

Pinnacle also serves over twenty state insurance departments, many of them regulating captives. As a result, we talk to captive insurance regulators on a regular basis and their input and willingness to discuss captive regulation with us is a valuable part of this report.

In addition, the National Association of Insurance Commissioners (NAIC) has developed a research study called "State Insurance Regulation: Key Facts and Trends." This document contains a wealth of information regarding the insurance industry in each state. This includes the number of insurance companies by type (e.g. property-casualty, life, captive), premium volume in the state and regulatory expenses in the state.

Captive Associations

Most of the state captive associations in significant U.S. domiciles also have a variety of resources available including brochures, annual educational seminars, and websites presenting the benefits of captives and the domicile, association events, membership costs and benefits, marketing opportunities, and current news and events. These educational materials are useful to developing a working understanding of the captive insurance industry.

Individual websites for the larger U.S. captive domicile associations are listed in Exhibit 4.

In addition to the individual domicile associations, another source of information is the Captive Insurance Companies Association (CICA). According to their website, www.cicaworld.com , "The Captive Insurance Companies Association is the only domicile-neutral captive insurance association. That means CICA is free from jurisdictional or commercial ties since it is not linked with a domicile or government entity. Founded by risk managers for their collective benefit, CICA continues to work to provide the foremost education, networking and leadership for captive and risk retention group professionals." CICA's website, semi-annual educational seminars and other educational materials were utilized in this report.

Another valuable source of information regarding captives is RIMS, the risk management society™ (RIMS). While not a captive association per se, a great many members of RIMS own one or more captives or actively provide services in the captive industry. The RIMS website, www.rims.org, has an extensive amount of educational materials, information on international and local events, and a wide variety of publications and tools for risk management professionals. RIMS also has both one of the largest captive related continuing educational events in the U.S. and an extensive lobbying arm advancing and protecting the interests of its membership.

Other Sources

There are numerous other sources, related to the captive insurance industry that were useful in developing this report. These include the International Risk Management Institute, Inc. (IRMI, www.irmi.com). IRMI seeks to provide expert advice and practical strategies for risk management, insurance, and legal professionals. They also publish a monthly newsletter "Captive Insurance Company Reports," a commonly used resource in the captive industry and required reading for all those involved in servicing captives.

In addition, the report "Fiscal Year 2012 Annual Report of the Maryland Insurance Administration to the Maryland General Assembly Pursuant to §2-110 of The Maryland Insurance Article," dated November 2, 2012 was a very useful resource in understanding the Maryland insurance market. The data in the "Facts and Stats" information from the Maryland Department of Business & Economic Development was also useful in understanding the state's economic make up.

Discussion and Analysis

Based on our review of available information regarding captive domiciles in the U.S., our discussions with captive managers and regulators, and our decades of experience in the captive industry, we find that while there is very little downside risk and modest incremental expense associated with Maryland enacting captive legislation and forming a captive domicile, there may also be some factors limiting the growth in both the number of captives and premium that might enter a Maryland captive domicile. In the current insurance environment, a Maryland captive domicile is likely to find itself facing significant opposition to its growth from a growing number of other domiciles. It is also likely that continued challenges from the IRS and potentially elements of the NAIC will temper future captive growth somewhat. In addition, it is possible that the MIA's regulatory emphasis on consumer protection may run counter to the captive industry's desire to innovate and take risks. So while it costs relatively little in terms of regulatory administrative expenses to start a captive domicile, there may be several factors that might reduce the likelihood that the domicile would reach a level of critical mass necessary for long term viability.

Our analysis to arrive at this conclusion focuses on several specific areas requested by the MIA. These include:

1. Background information on other captive domiciles
2. Models of Regulation of the captive insurance industry
3. Estimates of the potential captive market (number and size of captives)
4. Benefits to insured of forming captives
5. Potential impacts on the state of Maryland and the domestic insurance market
6. Administrative and operational costs of establishing and regulating a captive domicile
7. Alternative regulatory approaches
8. The potential need for additional consumer protections
9. Keys to the long term viability of a captive domicile

The following sections of the Discussion & Analysis portion of the report address each of these items in the order they are presented above. We will also provide some additional commentary as appropriate on other issues that may be expected to impact Maryland's performance as a captive domicile.

1) <u>Background Information on Other Captive Domiciles</u>

Pinnacle has compiled a significant amount of detailed information about 16 of the U.S. captive domiciles. This information is intended to provide the reader with an overview of material differences by domicile and also references to allow further research, if desired. This summary is attached as Exhibits 1 through 3. Internet hyperlinks to a great deal of this information are provided in Exhibit 4.

Exhibit 1 provides an overview of each domicile. This includes the year in which the captive law was enacted, high level information about the captive regulator and captive association, the number of captives and premium volume, limitations on coverage, the types of captives permitted in the state, and restrictions on individuals and activities that must be conducted within the domicile.

Exhibit 2 provides a similar summary of captive regulations and the regulatory process. This exhibit shows the captive legislation itself (a hyperlink to each domicile's legislation is contained in Exhibit 4), financial reporting requirements, the frequency of financial examinations, capitalization requirements, options for the type of capitalization that will be accepted, and whether loan-backs are permitted.

Exhibit 3 provides information of filing fees and other fixed costs, as well as premium taxes by premium size and type of captive, along with minimum premium taxes.

Types of Captives

The types of captives a domicile will license and the coverages they are permitted to cover are important characteristics of a captive domicile. Each domicile's willingness to license specific types of captives: particularly segregated cell captives, series LLC captives, and other types of cell captives can be a key differentiator between a domicile and other similar domiciliary states. Exhibit 1 summarizes key differences by domicile. In the current captive environment, where many microcaptives utilize these series LLC or segregated cell structures, the willingness to license cell captives in some manner is a key domicile differentiator and almost essential to the viability of a new domicile. Key coverage limitations, such as prohibitions of captives writing workers compensation on a direct basis or personal lines, especially homeowners insurance, are also shown.

Associations

Information regarding the captive industry associations is provided next in Exhibit 1. These associations are a partnership between regulators, captive managers, service providers (auditors, actuaries, etc.) and most importantly captive owners to promote the domicile and provide continuing educational opportunities. The association has a significant role in crafting the marketing message for the domicile, developing and executing the domicile's promotional plans, and providing communication and coordination between the various stakeholders in the domicile. In particular, the association president plays a key role as one of the faces of the domicile. This is often a rotating assignment among the various captive managers and other stakeholders in the state.

Capitalization

Another key element of the design of a captive law is capitalization requirements. Both the amounts of initial and minimum capital and the types of assets (cash, letters of credit, loans, etc.) that will be accepted vary by domicile and are detailed in Exhibit 2. Lower minimum capital requirements for

specific types of captives may make a domicile more attractive, but also creates additional insolvency risk. Many smaller captives are attracted to domiciles with less stringent capitalization requirements as there may be a significant opportunity cost relative to other uses of that capital.

Fees/Premium Taxes

Another key element of a captive law's design is the required fees and premium taxes charged to captives in the domicile. As with capitalization, lower premium taxes and fees can make a domicile more attractive to new captives and captives seeking to redomesticate; however, it also reduces the revenues available to pay regulatory expenses. With regard to smaller captives, some domiciles seek to attract them using fixed dollar premium taxes, for example Delaware has a minimum premium tax of $5,000. Utah also has a minimum fee, rather than a percentage tax. Other domiciles use a lower premium tax percentage, such as Hawaii's 0.25% tax on the first $20 million of premium. These details by domicile are shown in Exhibit 3.

Financial Reporting

The final characteristic of the design of a captive law relates to financial reporting requirements. This includes the format of annual financial reports, the accounting standards to be applied (statutory accounting versus generally accepted accounting principles or GAAP), and annual requirements for formal statements of actuarial opinion (SAOs) as to the reasonableness of a captive insurance company's accrual for unpaid loss and loss adjustment expenses. These requirements are detailed by domicile in Exhibit 2.

Additional discussion of regulatory nuances is contained in the alternate regulatory approaches section.

2) Models of Regulation of the Captive Insurance Industry

There are several key elements of the regulation of captive insurance companies. These include:

1) The captive formation and application process;
2) Annual financial reporting;
3) Solvency regulation (including dividends, investments and distributions); and
4) Rate and premium regulation.

Exhibits 1 through 3 provide a detailed summary of key differences in captive legislation and regulation in the various U.S. captive domiciles.

Captive Formation

The process of forming a captive is fairly standardized in most U.S. domiciles.[18] These steps include:

- A meeting between the captive owner, the captive manager and the captive regulator,
- Preparation of necessary corporate documents,
- Preparation of captive application,
- Submission of application for regulatory review,
- Petition for a certificate of good standing,
- Payment of required licensing fees, and
- Other steps required for certain types of captives, such as Special Purpose Financial Insurance Companies.

As mentioned, most formations begin with a meeting with the domiciliary regulators to describe the nature of the captive being discussed, introduce the captive owners to the regulators, and discuss the process of completing the captive application. This is a very important step in the formation of the captive from a regulatory perspective. After this meeting, a formal captive application is required. Most captive applications include the following elements:[19]

- A Captive Application form
- A Plan of Operations or Business Plan
- Corporate Documents - Articles of Incorporation and By-Laws
- Biographical Affidavits of Board Members and Officers
- Actuarial Funding Study
- Pro Forma Financial Statements
- Statement of Economic Benefit to the Domicile
- Organization Chart
- Information on the Parent Company
- Reinsurance Contracts and Related Documents

The opportunity for a domicile to differentiate itself from other domiciles is not in the form of the captive application, but rather the service and expertise it provides during the formation process. Communication styles during the initial meeting, prompt responses to questions, timely completion of

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[18] South Carolina (doi.sc.gov\\471\\Licensing-a-Captive) and Vermont (www.dfr.vermont.gov/captives/steps-form-captive) are two excellent examples of the standard captive formation process.

[19] The application blank on the Vermont Department of Insurance website, www.dfr.vermont.gov/sites/default/files/Application-for-Admission-Fillable.pdf, contains a very useful checklist.

captive application reviews, and the quality of the application review (e.g. asking the right questions, not requiring mundane or immaterial documentation) can all improve how a captive domicile is perceived by captive owners, lawyers and captive managers.

Annual Financial Reporting

Some form of annual financial statements is required of every captive. In some domiciles, these are very straightforward and both easy and inexpensive to produce.[20] In other domiciles, unique or more intricate financial reporting forms and requirements[21], such as NAIC annual statements, can provide substantially more information for captive regulators, but at an increased regulatory compliance expense to the captive which may deter new formations. Similarly, different domiciles have different requirements regarding whether a formal statement of actuarial opinion (SAO) is required annually and for what types of captives. For example, captives below a certain size may be exempt from providing an SAO or only RRGs and group captives may have to comply with certain reporting requirements. Again, the approach taken by a domicile here must be wisely chosen to achieve the appropriate balance of information useful for regulatory oversight on the one hand and minimizing regulatory administrative costs and maximizing ease of doing business to the captive on the other.

Solvency Regulation

A third area of regulatory oversight and domicile differentiation is the approach taken to solvency oversight. This includes controls a captive regulator utilizes to ensure the ongoing viability of the captives under their authority and includes issues such as:

- mandatory minimum capitalization standards for captives,
- types of assets that will be accepted as capital,
- the ability and conditions under which a captive can provide loans to its owner ("loan backs"), and
- approaches and requirements for a captive to dividend retained earnings to its owner.

This area is a particularly sensitive one to captive owners who would like to minimize the amount of capital tied up in a captive and perhaps use retained earnings of the captive for other purposes. As

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[20] Delaware is an example of a fairly straightforward financial statement. It is Excel-based and can be found at captive.delawareinsurance.gov\CaptiveForms.shtml.

[21] The District of Columbia requires captives to provide financial statements in a format specified by the NAIC for traditional insurers (which uses statutory accounting principles) on a Generally Accepted Accounting Principles (GAAP) basis. This approach is both cumbersome and confusing to preparers and users of such financial statements.

with the other regulatory issues, a balance must be struck between the regulator's desire for flexibility and having appropriate levels of regulatory oversight to ensure a captive's solvency.

Rate and Premium Regulation

Finally, some captive domiciles, notably South Carolina, have requirements for actuarial certification of a captive's rates or premiums.[22] The intention of these provisions is to require captives to meet the same regulatory standard as admitted insurance companies. This standard requires that rates be "actuarially sound," that is, that rates are not excessive, inadequate or unfairly discriminatory.[23] At this point, the regulation of captive premiums is largely limited to risk retention groups, which are required to file their rates in their domiciliary state and a small number of individual domiciles.

3) Estimates of the Potential Captive Market

Depending on the choices made in captive legislation (e.g. allowing series LLC captives like Delaware or capping premium taxes to encourage XXX captives like Missouri) and captive regulation (e.g. waiving requirements for statements of actuarial opinion for certain types of captives), a captive law in Maryland may attract a variety of different types of captives. Therefore, we will present several potential scenarios of the initial growth of the Maryland captive domicile. As the basis for our assumptions in these scenarios, we will use the experience of other U.S. domiciles that have been formed in recent years.

The first scenario is intended to demonstrate a reasonable approximation of the growth of Maryland as a domicile for microcaptives. It is based on a compilation of the early experiences of Delaware, Kentucky, and Utah. It shows a growth to 100 captives in 4 years and total premium steadily growing to $110 million. This scenario also produces average premium taxes per captive of $3,300 and $4,400 which totals $440,000 in the fourth year of operations. This scenario would appear to be achievable given recent growth in microcaptives as long as the captive legislation and regulatory framework are reasonable.

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[22] Since 2011, the South Carolina Department of Insurance has required an annual statement of actuarial opinion for captives stating that a captive's rates:

a) meet the requirements of the insurance laws governing captive insurance companies domiciled in the state of South Carolina;
b) are computed in accordance with accepted actuarial standards and principles and are developed using an appropriate methodology given the nature of the risks; and
c) are reasonable and based on actuarially sound rates, that is, the rates are not excessive, inadequate nor unduly discriminatory.

[23] Casualty Actuarial Society Statement of Principles Regarding Property and Casualty Insurance Ratemaking.

Assuming that MD writes primarily 831b captives, here is a potential growth scenario:

Years after enactment	1	2	3	4
# of Captives	25	50	75	100
Estimated Average Premium Volume per Captive	825,000	900,000	1,000,000	1,100,000
Estimated Total Premium Volume	20,625,000	45,000,000	75,000,000	110,000,000
Estimated Premium Tax per $ of Premium	0.400%	0.400%	0.400%	0.400%
Estimated Average Premium Tax	3,300	3,600	4,000	4,400
Estimated Total Premium Tax	82,500	180,000	300,000	440,000

The second scenario is similar to the strategy in Michigan and Missouri, focusing on very large captives, particularly XXX and AXXX captives. This scenario requires a life reinsurance company interested in domiciling its captives in Maryland. As you can see, even a few large captives produce substantially more premium than the microcaptive approach. However, there are substantially more microcaptives being formed than XXX captives. Note that while the premium is almost thirty (30) times that of the first scenario, the second scenario produces less than six times the premium tax revenues due to a $200,000 cap on premium taxes per captive.

Assuming that MD writes primarily XXX captives, here is a potential growth scenario:

Years after enactment	1	2	3	4
# of Captives	1	3	6	12
Estimated Average Premium Volume per Captive	40,000,000	125,000,000	200,000,000	250,000,000
Estimated Total Premium Volume	40,000,000	375,000,000	1,200,000,000	3,000,000,000
Estimated Premium Tax per $ of Premium	0.500%	0.160%	0.100%	0.080%
Estimated Average Premium Tax	200,000	200,000	200,000	200,000
Estimated Total Premium Tax	200,000	600,000	1,200,000	2,400,000

The third scenario assumes less emphasis on microcaptives, but also does not seek to attract XXX captives. A domicile pursuing this strategy might target larger single parent captives, group captives, or risk retention groups that typically produce more average premium than microcaptives. This is akin to the experience of the District of Columbia, Hawaii, and Tennessee. The potential growth in the number of captives is somewhat reduced from the microcaptive scenario, but produces more premium and more premium taxes than the microcaptive scenario. While somewhat harder to achieve than the microcaptive scenario, this is also a practical and achievable scenario for a Maryland captive domicile.

Assuming that MD writes fewer captives, but with larger average premiums than the microcaptive domiciles, here is a potential growth scenario:

Years after enactment	1	2	3	4
# of Captives	5	15	30	50
Estimated Average Premium Volume per Captive	2,000,000	6,000,000	8,000,000	10,000,000
Estimated Total Premium Volume	10,000,000	90,000,000	240,000,000	500,000,000
Estimated Premium Tax per $ of Premium	0.400%	0.400%	0.380%	0.360%
Estimated Average Premium Tax	8,000	24,000	30,400	36,000
Estimated Total Premium Tax	40,000	360,000	912,000	1,800,000

These scenarios would suggest that, should the state of Maryland pursue a captive strategy that focuses on microcaptives, it can expect to produce approximately $110 million of total captive premiums in its fourth year of operations. A strategy targeting a somewhat larger average size could produce premiums of up to $500 million by its fourth year of operations. All of these scenarios are contingent on Maryland successfully enacting competitive captive legislation, creating an acceptable regulatory structure and creating an active state captive association.

4) Benefits to Insureds of Forming Captives

There are numerous potential benefits to the insured or insureds of a captive insurance company, as well as potential risks and drawbacks.

Key benefits to insureds of forming a captive include:

- *Control:* The insured can take a more active role in the decision making and management of their insurance program through the captive and has a large amount of influence on the direction the captive will take.
- *Availability of Coverage:* The captive can insure risks that may be unavailable or too expensive for the insured to purchase in the commercial market.
- *Flexibility:* A captive has more flexibility in structuring its insurance program and designing policies that are tailor-made to fit the individual needs of the insured.
- *Affordability of Coverage*: A captive may be able to charge premiums more affordable than the commercial insurance market.
- *Expenses:* Captives benefit from lower operating expenses than a commercial insurance provider, which can help reduce premium for the insured.
- *Return on capital:* A captive may not have the rate of return demand that most commercial insurers face. This reduces the profit provisions in the insurance premiums.

- *Market cycles*: Captives are less sensitive to larger insurance market cycle fluctuations.
- *Reflecting Historical Experience*: Captive's may place greater reliance on an insured's historical experience than most commercial insurance programs.
- *Stability of Coverage Pricing:* Rates for traditional commercial insurance policies are affected by changes in the underwriting cycle. A captive is not subject to the underwriting cycle and can set premium in relation to its own loss experience.
- *Access to Reinsurance:* A captive allows an insured direct access to reinsurance markets, often producing lower costs as the negotiating position of the captive improves.
- *Retained Underwriting Profits:* If the captive is successful in controlling its claims costs, underwriting profits that otherwise would have benefitted the commercial insurer are retained. As a result, the insured has greater incentive to control its costs by active claims management. Attention to claims management and controlling costs is a significant contributor to the long-term success of a captive.
- *Investment Income:* A captive earns investment income on its unearned premium and loss reserves, and paid-in capital. For coverages with long claims paying lags (e.g. workers compensation or products liability) this investment income can be significant. With a commercial insurance policy, the insurer would retain and control the investment income.
- *Enhanced Cash Flow:* Availability of investment income in addition to premium payments to the captive provide substantial cash flow benefits to the captive considering claims payments may be made over a period of years.
- *Additional Revenue Opportunity:* The captive can become a new source of revenue to the owner by insuring unrelated risk.
- *Capacity:* As the captive grows it has greater ability to retain additional risk. This will allow the insured to have less reliance on commercial insurance and reinsurance.
- Tax Deductibility: In most cases, premiums are deductible when they are paid. By comparison, self-insured claims obligations not funded through a captive are only deductible once the claim is paid.

Conversely, captives present challenges and potential risks to their owners, including:

- *Time Commitment:* Establishing and maintaining a captive requires a significant time commitment and usage of internal resources and management.
- *Risk of Unprofitability:* Due to the unknown and potentially volatile nature of insurance claims, the captive owner runs the risk that its premium payments may be inadequate to cover all claims and expense obligations. As a result, the parent may need to contribute additional capital to cover adverse underwriting results. This risk is enhanced when insuring unrelated risk.
- *Lack of Guaranty Fund Coverage:* A commercially insured entity is typically covered by a state guaranty fund in the event that its insurance provider becomes insolvent and can no longer

make claim payments. A captive may not have this protection, unless it uses a fronting arrangement.

- *Capital Commitment:* The parent of the captive must contribute enough capital to establish the captive, meet the ongoing needs of the captive, maintain the necessary collateralization of its claims liabilities and fulfill the regulatory capital requirements of Maryland. Potentially this capital can earn lower investment income than had it been invested in the operations of the parent.
- *Increased Commercial Insurance Cost:* If the insured keeps some of its insurance lines in the commercial market, particularly excess of loss coverage, and places the remainder in a captive, it may see increased rates for the remaining commercially insured coverage.
- *Cost of Reinsurance:* A captive may have increased costs for excess of loss reinsurance due to their smaller size and negotiating leverage.
- *Service Providers:* A captive generally requires securing the services of third-party service providers to ensure the appropriate expertise for managing a captive. The insured must be sure to retain and proactively manage high quality service providers.
- *Mergers and Acquisitions:* The existence of a captive may complicated the merger and acquisition process. The captive can become another item to review during the due diligence process.

5) <u>Potential Impacts on the state of Maryland and the Domestic Insurance Market</u>

When considering the impact of captive legislation on the state of Maryland and its domestic insurance market, it is important to recognize the current landscape.

First, most of the state's domestic insurers, such as GEICO, Brethren Mutual, Harford Mutual, Donegal Mutual, Frederick Mutual and many of the smaller companies would appear to have little interest or opportunity in forming captives as part of their operations. Most of Maryland's domestic insurers write mostly personal lines and small commercial lines insurance policies that are not well suited for captive insurance solutions. These companies are also not likely candidates to form agency captives as an incentive compensation program given their size, typically mutual structure and lines of insurance. One exception to this may be Medical Mutual Liability Insurance Society of Maryland who could have significant opportunities to form medical professional liability captives related to physician groups who purchase large deductible policies from them (a common captive structure) and has expressed an interest in investigating these opportunities. At some point, the Injured Workers' Insurance Fund (IWIF), now Chesapeake Employers' Insurance Company, may also have an interest in forming captives providing workers compensation deductible reimbursement coverage related to their large deductible policyholder. Otherwise, the potential direct impact on the Maryland domestic insurance market appears limited.

It is important to remember that Maryland's property and casualty industry alone is a $10.0 billion dollar premium concern annually and the domestic property and casualty insurers alone produces over $1.3 billion in premium annually.[24] Even if the Maryland captive market were to grow to $100 million, for example 50 captives with an average premium of $2 million, it would still be less than 10% of the domestic property-casualty insurance market and less than 1% of the overall Maryland property-casualty insurance market. Even the medium-sized captive scenario, shown earlier, that produced $500 million of premium in the fourth year of operations is still less than half of the domestic property-casualty insurance market at that size.

Another potential side effect of captive legislation in the state of Maryland would be an increase in the number of insurance professionals in the state. This may include captive managers, auditors, captive attorneys, and others. The insurance industries in states such as Delaware, Hawaii and Vermont have all seen increases in the number of insurance professionals physically located in the state. This available pool of skilled insurance professionals encourages the growth and development of all insurance companies, captive and admitted carriers alike.

Captives have similar impacts on the competitiveness of commercial insurance premiums that new admitted carriers have, namely lower, more competitive premiums for commercial insurance for industries and sizes of companies being served by captives. A prime example of this is the medical professional liability (MPL) market during the last medical malpractice "crisis." The withdrawal of St. Paul Insurance from the medical professional liability market and several insolvencies among MPL insurers, including Legion Insurance, PHICO, MIIX, and Reliance, resulted in a significant increase in MPL insurance rates due to decreased competition and market capacity. Subsequently, captives generally and RRGs particularly were created to address this market need and led to more competitive rates as market forces stabilized.[25]

In addition, as entities move to captive insurance companies for coverage, admitted insurers are forced to react to a reduction in their exposure and premium bases to maintain their premium volume. This does not necessarily equate to reduced rates. However, as insurance companies in the admitted market are forced to compete for a smaller pool of insureds remaining in the admitted market, lower rates may prevail as insurers reassess their competitive position to maintain current premium volume.

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[24] "Fiscal Year 2012 Annual Report of the Maryland Insurance Administration to the Maryland General Assembly Pursuant to §2-110 of The Maryland Insurance Article," November 2, 2012

[25] This phenomenon is documented in numerous Pinnacle industry studies of the MPL insurance market using data from the Medical Liability Monitor Annual Rate Survey along with market concentration statistics, such as the Hirschman-Herfindahl Index, based on insurance company annual financial statement data from AM Best Company.

This phenomenon is a result of basic economic theory of supply and demand as the fixed supply of insurance capital in the admitted market competes for a shrinking demand for insurance in the admitted market due to the exodus of risk to the captive market.

Another element of the competitive dynamic caused by the coverage innovation available in captives is similar innovation from admitted insurers. We have seen numerous examples of this demonstrated by admitted carriers when they have begun to eliminate coverage exclusions in general liability policies, introduced executive risk policies similar to those offered by captives, added coverages and products offering contingent business income due to loss of key supplier and other supply chain risks after captives and captive managers have introduced these coverage expansions and captured market share through coverage expansion and innovation. Admitted carriers, even large international organizations like AIG and Zurich Services Corporation are under significant pressure to offer innovative coverages, tailored to their large insureds' needs or risk losing them to the captive market. The most recent example is the newly introduced supply chain risk insurance coverage offered by Zurich Services Corporation, which appears to be in direct response to comparable coverages available in many captive insurance programs.

There are other risks to the state of Maryland in forming a captive domicile. There is some expenditure needed to develop the regulatory structure required to oversee captives. This issue will be discussed further in the next section. There is also a certain amount of reputational risk to the state insurance department. If captive managers find the state's captive legislation too restrictive or the state's captive regulators hard to work with or the state's regulatory processes too burdensome, they will simply move on to more favorable domiciles. Conversely, if the legislation is too lenient or the regulators too accommodating, this invites captives with too much risk, insufficient capital or a lack of appropriate controls to gravitate to the state. Numerous other domiciles have struggled with a large initial influx of captives, some of whom, in retrospect, presented an inordinate amount of risk. Many of these captive domiciles have subsequently had to go through a reexamination of their risk appetite. This often leads to a reputation of regulatory inconsistency among captive managers and other who influence captive domicile selection. Similarly, domiciles that grow too quickly can also face damage to their reputation for service problems if staffing does not keep up with the growth of the captive market in the state. Outsourcing can be a partial solution to addressing these service concerns. This discussion of regulatory risks and success factors will be continued in the domicile viability considerations section.

6) Administrative and Operational Costs

Ideally, the captive regulatory function can be self-sufficient such that the total captive related fees and premium taxes will be sufficient to cover insurance department expenses related to compliance, financial analysis, regulatory review and market operations. One factor that assists with the self-sufficiency is that many of the services provided by external contractors, e.g. actuaries reviewing

captive applications or financial examiners, are paid either by fees paid the captives, such as captive application fees, or the services are billed directly to the captive. As a result, an insurance department's captive regulation being self-sufficient essentially means that premium taxes from captives must exceed insurance department staffing and overhead costs. Exhibit 3 shows a detailed summary of the various revenue generation mechanisms used by each of the captive domiciles.

Unfortunately, the vast majority of state insurance departments either do not capture revenues and expenses separately for captive regulation or are not willing or able to share this information. A limited amount of either revenues or expenditures information was collected from a few captive regulators. Similarly, no information was available from any regulators regarding start-up costs of regulation. The start-up scenarios shown earlier provide some insight into the revenues that can be expected in the early years of a new captive domicile which can provide some guidance on the funds available while a captive regulatory team is being developed. As mentioned elsewhere, other regulatory staff can be utilized in some cases to support and assist the captive regulatory team as it grows.

To address this limited data, one useful benchmark is the NAIC's State Insurance Regulation Key Facts and Markets Trends report which shows historical costs of regulation per thousand dollars of premium. This is all regulatory costs for all types of insurance companies. This mismatch is somewhat mitigated by the significant amount of captive premium in many of these domiciles. The current regulatory costs in several of the key captive domiciles are shown in the following table. It is noteworthy that overall regulatory costs are typically less than 0.20% of total premiums in the domicile. This compares to premium taxes that typically range from 0.25% to 0.40% for the first $20 million of captive premiums. This would suggest that if regulatory costs for regulating captives are comparable to the costs of regulation of other types of insurance companies as a percentage of premium, captive premium taxes should be more than sufficient to cover captive regulatory expenses. The anecdotal data specific to captive regulation in domiciles including Arizona, the District of Columbia, Nevada, South Carolina, Utah and Vermont all supports the conjecture that captive premium taxes in these domiciles appear to be larger than captive regulatory expenses, in some case much greater.

Domicile	Insurance Department Budget as a % of Premium - 2012	Captive Premium Taxes for First $20M of Premium
DC	0.09%	0.25%
DE	0.02%	$5,000 fee
HI	0.09%	0.25%
KY	0.09%	0.40%
MD	0.09%	
MO	0.04%	0.38%
NV	0.14%	0.40%
SC	0.06%	0.40%
UT	0.09%	$5,000 fee
VT	0.03%	0.38%

Source: NAIC Insurance Department Resources

The results for Missouri and Vermont are lower than average due to the very large average captive size in these states. Similarly, the results in Nevada may be higher than average due to their very small average captive size. It is reasonable to assume that unless the Maryland captive domicile had some unusual characteristics, for example several very large captives or XXX captives, regulatory costs can reasonably be assumed to be approximately $1.00 per $1,000 of premium or equivalently 0.1% of premiums, based on the results in the table above excluding Vermont due to its size and maturity as a domicile. It is also important to recognize that captives do not require the same level of consumer protection or rate regulatory oversight that admitted property-casualty, life and health insurance companies require. Regulatory costs for captives are primarily focused on formations, business plan changes and solvency oversight. As a result, the NAIC data may overstate the regulatory costs for captive insurance regulation as a percentage of premium. Exhibits 1 and 3 provide some additional information on captive regulatory staffing levels, revenue sources, and expenditures. It is noteworthy that the captive premium taxes in most of the major captive domiciles range from 0.25% to 0.400% of premiums. By comparison, typical regulatory costs for all insurance companies, including captives, in states with a large number of captives, ranges from are well in excess of the 0.02% to 0.21% of premiums. This suggests that U.S. captive domiciles may generate significantly more revenues that are required for regulatory costs once the domicile has become established.

The use of current insurance department staff and external vendors, including actuaries and regulatory consultants, on an "as needed" basis can minimize these costs in the event that there is a smaller than expected number of captive formations after the captive legislation is enacted.

There is limited information available on start-up costs for state insurance departments when enacting captive laws. Two available fiscal notes in Connecticut[26] and Tennessee[27] suggest that additional budget allocations of between $200,000 and $400,000 may be reasonable in a new captive domicile until premium taxes and fees can provide the necessary funds for regulatory oversight. We know of one domicile, who requested that they remain anonymous, that had an initial annual budget allocation of $800,000 to develop their regulatory structure and promote the new domicile.

7) Alternative Regulatory Approaches

A number of variations in regulatory approach can be seen in the various U.S. domiciles. Most of these alternatives are fairly modest in their impact, but are worth noting. One regulatory variation is related to captive premium taxes and fees. A domicile seeking to grow aggressively can make their premium taxes more competitive than domiciles it views as peers. Some states, such as Nevada, have even temporarily waived premium taxes for microcaptives altogether to attract new captives. Other states either lower the premium tax percentage (e.g. Hawaii) or impose a maximum premium tax amount (Missouri), if they are targeting large captives including XXX captives. These premium tax advantages will quickly be identified by captive managers and become part of their discussion with potential captive owners. However, this comes at the expense of generating the less revenues needed to fund captive regulation.

Another variation has to do with the amount of activity required to be conducted within the captive's domiciliary state. If a captive manager is not required to have a significant physical presence in the state, this may allow captive managers to "walk before they run" in the state by having a few captive formations before they make the financial commitment to have an office there. However, this reduces the economic benefit to the state by reducing the number of jobs created and the related tax revenues.

Similarly, relaxing requirements regarding the physical attendance of annual board meetings in the state increases the perceived flexibility of the domicile, but at the expense of hospitality and travel related revenues.

Finally, requirements regarding the nature and form of annual financial reporting requirements vary by domicile. For example,

- some states waive audited annual financial reports for small captives,

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[26] www.cga.ct.gov/2008/FN/2008SB-00281-R000159-FN.htm

[27] www.capitol.tn.gov/Bills/107/Fiscal/SB1540.pdf and www.capitol.tn.gov/Bills/108/Fiscal/HB0069.pdf

- some states have simplified and standardized annual financial reports, others have unique forms of their own, still others require NAIC annual statements in many situations,
- some require GAAP accounting while others require statutory accounting,
- some perform financial examinations every three years, others every five,
- some domiciles have simplified requirements or waivers for statements of actuarial opinion and other regulatory requirements commonly made of insurance companies.

All of these elements can contribute to a message that the state is "open for business" and encourage new captive formations and redomestications from other states. Risk averse choices can also create additional bureaucratic red tape depending on the decisions that are made in regulatory style. The benefit of increased ease of doing business must be balanced by appropriate regulatory oversight. These are decisions that each domicile must make and review periodically to remain their relevance as a domicile, to be true to their regulatory mission and values, and to provide adequate solvency protection for claimants of captive insurers.

8) The Potential Need for Different or Additional Consumer Protections

While we understand that consumer protection has been and continues to be a major point of emphasis for insurance regulation in the state of Maryland, there is very little need for different or additional consumer protections related to captives. The captive insurance transaction is commonly providing commercial lines of insurance, as compared to personal lines, and involves sophisticated insurance buyers. The admitted insurance rates for commercial lines coverages are often subject to commercial lines deregulation laws and regulations intended to reduce regulatory oversight and recognize the sophisticated nature of the coverages and the insurance expertise of the insurance buyer. One example is the New Jersey Commercial Insurance Deregulation Act of 1982. Another example of the reduced regulatory oversight of insurance as it relates to captive owners and insureds are state guaranty funds. Guaranty funds are funds that are intended to step in and pay insurance claims in the event of insurance company insolvency. Many guaranty funds specifically exclude coverage for large companies (typically companies with net worth of over $50 million) under "net worth tests."[28] Maryland Insurance Code §9-301.d.3.1 states that "'Covered claim' does not include a first party claim by an insured whose net worth exceeds $50,000,000 on December 31 of the year before the year in which the insurer becomes an insolvent insurer." According to the National Conference of Insurance Guaranty Funds (NCIGF), this distinction of only applying the net worth test to first party claims, and not third party claims, is unique to the state of Maryland. While not every captive owner or insured would be subject to a net worth test, it demonstrates the reduced regulatory oversight and consumer protections related to large commercial insurance programs.

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[28] Porter, K., *Insurance Regulation,* Insurance Institute of America, 2008, Chapter 12

The primary consumer protection mechanism related to insurance companies is a guaranty fund. A guaranty fund is a state fund that provides a system to pay the claims of insolvent insurers. It is generally funded by assessments collected from all insurers licensed in the state. Most property-liability policies, if issued by insurers licensed to transact insurance in the state, are covered. Title, credit, mortgage and ocean marine are almost always excluded and all reinsurance and surplus lines contracts are excluded. Except for workers compensation claims, there is generally a maximum covered claim cap. There is generally a stated deductible per covered claim over any policy deductibles. Many states have adopted a "net worth test" that imposes coverage exclusions or special deductibles for claims made by insureds with large net worth. These tests are based on the presumption that large commercial insureds are sophisticated insurance buyers and should be able to avoid insurers that have a risk of insolvency.

Given Maryland's regulatory emphasis on consumer protection, some additional elements protecting third party claimants might be worthy of consideration in Maryland's captive legislation. We would recommend that the following consumer protections be considered:

- Treatment of workers compensation risks – given that employees have little or no control over how their employer funds workers compensations claims costs, some form of additional protection for injured workers would appear prudent. This might take the form of prohibiting captives from writing workers compensation on a direct basis (that is, without a fronting insurer that would step into the captive's shoes in the event of the captive's insolvency) and/or access for captives writing workers compensation to some form of guaranty fund, possibly a self-insurers guaranty fund.
- Personal lines - Covering personal lines of insurance, typically homeowners or personal auto insurance, in a captive has been successfully implemented in a limited number of captives. However, captives offering personal lines of coverage do not have the sophisticated insurance buyer more common in most captives. One can certainly see how a captive insurer providing coastal homeowners insurance going into insolvency due to a catastrophic windstorm and not having guaranty fund protection would be a significant consumer protection risk. As such, a domicile with the consumer protection reputation of Maryland would need to either prohibit personal lines insurance entirely in captives or provide additional consumer protections to insureds purchasing coverage from a captive that would be on par with those required of admitted insurers.
- Protection of third party claimants – Similar to the workers compensation and personal lines discussions, other third party coverages (e.g. auto liability, general liability, and medical professional liability) often have seriously injured claimants with no control over the insurance source of the defendant and who are relying on the availability of the insurance proceeds for

their ongoing well-being. Consider a severely injured patient involved in a medical professional liability claim who no longer receives compensation because the captive has gone insolvent. This would suggest that a heightened level of regulatory solvency review for captives providing third party coverages may be prudent. Communication to third parties notifying them that their healthcare provider, contractor, auto repair shop, et al. purchase their insurance from a captive may also be prudent.

- Insurance comparison guides – MIA has developed several effective comparison guides showing information regarding insurance companies providing personal automobile, homeowners, medical professional and health insurance. Captives providing medical professional liability and workers compensation coverages to parties other than the captive owner could certainly be added to these tools and could be used to provide additional consumer education.
- Education and communication tools - MIA has a history of emphasis on educational and communication tools to facilitate consumer protection. This is currently carried out by the Consumer Education & Advocacy Unit. Should Maryland enact captive legislation, this would almost certainly be a part of MIA's consumer protection strategy.

9) Factors that Impact Domicile Viability

When discussing the viability of a potential captive domicile there are really two fundamental questions: "What needs to happen for a captive domicile to succeed?" and "What can go wrong?" In the case of captive legislation, previous attempts in other domiciles show that a number of things can go wrong between the idea of forming a captive and the reality. We will investigate several aspects of forming and managing a captive domicile and address these questions for each of them.

Maryland Specific Issues

There are several issues specific to the state of Maryland that may contribute to the success of a captive domicile. Maryland's proximity to two fairly large and successful domiciles (Delaware and the District of Columbia) may allow captive managers, auditors and other service providers to serve Maryland captives with existing offices and staffing. It is clearly an advantage that there are numerous captive managers and captive professionals in close proximity to the state. Messaging along the lines of "Maryland is a newer domicile that is interested in growth, and able to provide more personalized and timely service to new formations" may well be effective. This may allow Maryland to be sold as a counterpoint to these domiciles. This is particularly true if Delaware struggles with timeliness and service issues due to the influx of new captive applications.[29] Complaints with timeliness (e.g. months to review captive applications) and costs of regulatory oversight (e.g. high financial examination costs) are not uncommon in newer captive domiciles that are experiencing significant growth. Mr. Adkisson's

[29] www.forbes.com/sites/jayadkisson/2013/09/28/manager-complaints-bubble-to-surface-regarding-delaware-captive-insurance-companies/

article, other recent criticisms of regulatory service (some 2012 captive applications were not approved until June 2013) and regulatory costs were a major topic of discussion at the recent Delaware Captive Insurance Association Fall Forum. The Delaware Insurance Department made repeated assurances that they were taking steps to improve service and reviewing best practices of other major domiciles.

Maryland's proximity to Delaware and the District of Columbia may also be a hindrance if captive managers and owners do not see a compelling reason to select Maryland over the more established options. The proximity of Delaware and D.C. to Maryland also raises the bar in terms of the need to differentiate the domicile through the captive legislation and regulation. Maryland needs to at least win its share of formations that would otherwise be in Delaware or D.C. to be viable.

As previously discussed, the viability of a captive domicile is not dependent on domestic captive owners or activity with domestic insurers. However, the current lack of a strong advocate among the state's insurers, with the possible exception of Medical Mutual Liability Insurance Society of Maryland, industry associations or others is currently a potential drawback. A strong core of advocates and a visible regulatory presence will need to be found for a Maryland captive domicile to thrive.

The economic demographics of the state, particularly the lack of a strong workers compensation self-insurance market and the low number of Fortune 500 companies, may also provide some headwinds to deter growth of captives in Maryland from Maryland businesses. At first blush, the emphasis on healthcare in Maryland's economy might be viewed as a potential opportunity. However, there are numerous healthcare professional liability captives already in place, especially in Vermont, D.C., Bermuda and the Cayman Islands. The D.C. and Cayman domiciles in particular place great emphasis on healthcare-related captives. Most of these captives are firmly entrenched and satisfied with their domicile and would require significant incentives to redomicile to Maryland. For example, Johns Hopkins is involved in two captives: MCIC Vermont, Inc., a Vermont domiciled risk retention group that provides general and medical professional liability coverage to several leading teaching hospitals[30] and a wholly-owned, single parent captive insurance company that provides other coverages including property, fleet vehicle liability and physical damage, directors & officers, workers' compensation, fiduciary liability, cyber liability and terrorism.[31] We were not able to determine where this captive is domiciled.

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[30] www.mcic.com/AboutUs/Pages/AboutUs.aspx

[31] www.rcmd.com/knowledge-center/case-studies/johns-hopkins

Captive Legislation

The captive legislation itself needs to provide sufficient flexibility for captive managers to find the domicile attractive, without allowing captives that are at too great a risk of insolvency or that present too great a reputational risk to the state to be formed. One noteworthy element of each of the new captive domiciles that have had early success in attracting formations is some form of innovation in their legislation. In Delaware, this was the basis for the development and focus on the series LLC structure. The series LLC captive structure allows substantially lower regulatory costs, financial reporting requirements[32], and possibly initial capitalization than in other states all of which are extremely attractive to captives making 831(b) tax elections and are typically very conscious of captive expenses and capitalization levels. In Tennessee, the differentiator was the ability to write workers compensation on a direct basis. In Kentucky and Utah, the legislation and regulatory framework contained elements that provided incentives for microcaptives to be formed in the states.

The captive legislation enacted also presents several risks. A straightforward imitation of another state's legislation, for example a "me-too" of the Vermont captive law, while quite common, may not form a compelling argument to draw the desired number of new captives or redomestications of existing captives to the state. However, innovation in the captive legislation also presents a significant risk of allowing, encouraging and attracting excessively risky or highly scrutinized captive structures to come to the domicile. This risk may come in the form of captives proposing too little capital for the risks being covered, a lack of adequate reinsurance, structures likely to be contested by the IRS, or coverage with a material risk of claims greater than anticipated and thus threatening the solvency of the captive.

Captive Regulation

As mentioned earlier, there is a balance that must be struck by captive regulators in a new domicile. There needs to be on the one hand a willingness to attract business and allow innovation, while at the same time demonstrating the expertise to recognize the inherent risks in a captive and a willingness to say no when a proposed captive simply does not meet the state's risk appetite or have adequate solvency protection. Historically, several very promising domiciles that had a large number of captive formations shortly after their legislation was enacted, some of which turned out to be riskier than they appeared or ultimately did not meet the domiciles true risk appetite. The domiciles then had to revise their stated risk appetite, and sometimes their captive legislation, as a result of these experiences. This manifested itself with a significant reduction in new captive approvals and several existing captives being required to redomesticate to other domiciles. This retrenching of regulatory approach and captive risk appetites can have a lingering effect on a domicile's reputation. This on again, off again

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[32] As an example, Delaware series LLC captives are required to produce complete financial statements only on a consolidated basis. Each individual series/SBU is only required to file a balance sheet and income statement. In addition, both the statement of audit opinion and statement of actuarial opinion are only required on a consolidated basis.

regulatory approach can be particularly damaging to a domicile's reputation and their ability to attract new captives who are wary of regulators with alternately hot then cold treatments of captives.

The presence of a regulator with significant captive experience and reputation can help avoid some of these missteps early in the life of a captive domicile. This recognized expert will have existing relationships with captive managers and brokers that might be considering having a presence in the domicile and will instill confidence regarding the regulatory approach. This individual will also help the new domicile differentiate itself from others domiciles fighting for the same new captive formations.

Over time, the most successful domiciles are able to achieve an elusive and prized reputation – regulatory consistency. Vermont, for example, does not have the most lenient or flexible captive law; however, decades of consistent enforcement of their regulations, adequate regulatory staffing and consistently excellent service, and a "can do" attitude for captives that meet their risk profile has made it the gold standard of U.S. domiciles.

The final aspect of how the regulatory framework can contribute to the success or failure of a captive domicile is regulatory commitment. Captive domiciles that invest in both the regulatory infrastructure and in promoting growth in the domicile deliver a strong message to captive managers, brokers and prospective captive owners about the commitment of the state to the captive market. On the other hand, some insurance departments staff their captive regulatory team with staff accustomed to working with admitted insurance companies. The lack of knowledge and experience can make working with these staff members on captive issues time consuming, expensive (e.g. on financial examinations) and frustrating to captive owners, captive managers and other service providers including actuaries and auditors. Without this commitment to the regulatory framework, it will be difficult for Maryland, or any other potential domicile, to be viable in the long run.

Leadership and Promotion of a Captive Domicile

Another key factor that can contribute to the long term viability of a captive domicile is the leadership, or lack thereof, promoting the domicile and encouraging captive formations there. In some cases, this leadership has featured an exceptionally strong individual. For example, Len Crouse and subsequently Dave Provost in Vermont, Dave Dimmit in Missouri, and Michael Corbett in Tennessee, each as the heads of their respective insurance department's captive regulatory division, have all excelled in this role. In some cases, this strong personality is a regulator, in others it is not. One or more captive managers may also provide strong promotion of a domicile, such as Wilmington Trust in Delaware. In still other cases, a number of parties, typically through a strong domicile association, provide this leadership. This is the case with the captive managers in both Bermuda and the Cayman Islands. Conversely, a lack of leadership can reduce a domicile to simply another state on the long, and growing, list of "also-ran" domiciles.

This leadership also extends to the commitment the domicile and the association has to promoting themselves at industry trade shows, on their website, and via other promotional opportunities (e.g. promotional "road shows" around the state and around the country). A well constructed marketing and promotion plan and the commitment to working the plan is essential to success of a new domicile.

Reputational Risk

The final category of issues that can impact the viability of a domicile can be broadly described as reputational risk. A captive domicile can have one of several reputations, fairly earned or not, that can impact its long term viability.

First, a captive domicile that has a reputation with captive managers of being difficult to work with, arbitrary or inconsistent in their decisions, or not interested in innovative captive solutions runs a substantial risk of this reputation impacting their long term viability. Captive managers, who commonly make recommendations to their customers, the captive owners, regarding the domicile in which to form their captive, have significant influence over this decision. Captive domiciles are actively engaged in competition with other domiciles, both on and off-shore to be a preferred domicile for captive managers. Captive domiciles that are inconsistent in their risk appetite or unable to provide timely regulatory service also run the risk of a tarnished reputation with captive managers and other service providers that are called upon to make recommendations to captive owners regarding the choice of captive domicile. These issues can also cause existing captives to redomesticate to another domicile that is perceived to be preferable.

Similarly, a captive domicile can develop a reputation of allowing excessively risky captives or captives that come too close to failing to meet the IRS requirements for a captive being an insurance company. Domiciles that have an inordinate number of insolvencies or IRS investigations run a significant reputational risk that will impact their long term viability as many captive owners and managers alike will avoid a domicile with this reputation because of the increased scrutiny this reputation brings with it. For example, the Cayman Islands reputation, whether deserved or not, was substantially impacted by its inclusion in the John Grisham novel *The Firm*.

Glossary of Terms & Abbreviations

The definitions included in this glossary are intended to be practical definitions to assist non-technical readers in understanding the key technical contents of this report. We recognize that some technical clarifications and elaborations have been omitted for the sake of clarity and brevity. We do not believe any of these omissions materially impact the reader's understanding of the report or materially misrepresent the terms. The International Risk Management Institute, Inc. glossary of insurance terms, www.irmi.com/online/insurance-glossary/default.aspx was particularly useful in developing this glossary and we would commend it to readers seeking definitions to additional captive insurance terminology.

Actuarial Funding Study – An actuarial analysis which estimates expected losses for a given set of exposures over a given period of time.

Actuary - An individual, often holding a professional designation—for example, Fellow of the Casualty Actuarial Society (FCAS)—who computes statistics relating to insurance, typically estimating loss reserves and developing premium rates.

Admitted Insurance Company, or Admitted Carrier - An insurer licensed to do business in the state or country in which the insured exposure is located.

Captive Manager - A firm specializing in accounting, underwriting and other services for captive insurance companies, usually serving as the captive's principal representative in the domicile. The management company usually handles all necessary filings and recordkeeping and deals with other captive service providers such as auditors, actuaries, investment advisers, and visiting insureds.

Cede - When a company reinsures its liability with another. The original or primary insurer, the insurance company that purchases reinsurance, is the "ceding company" that "cedes" business to the reinsurer.

Commercial Insurance – 1) Insurance lines used to cover commercial risks as opposed to personal lines, which cover personal risks. Examples include commercial general liability (CGL), workers compensation, and commercial property insurance, 2) Insurance purchased in the commercial market, that through an admitted insurance carrier as compared to a captive insurer.

Contingent Business Income - Time element property insurance that pays for the loss of income or increase in expenses resulting from damage from a covered cause of loss to the premises of another organization on which the insured depends, such as a key supplier or customer.

Deductible - An amount the insurer will deduct from the loss before paying up to its policy limits.

Excess Coverage - A policy issued to provide limits in excess of an underlying policy.

Frequency - The likelihood that a loss will occur, often expressed as low frequency (meaning the loss event is possible, but the event has rarely happened in the past and is not likely to occur in the future), or high frequency (meaning the loss event happens regularly and can be expected to occur regularly in the future).

Insolvency – The state of an insurance company not possessing the funds to meet all of the financial obligations it is contracted to meet.

Large Deductible - A workers compensation insurance or other property casualty insurance program that allows the insured to retain a portion of each loss through a substantial deductible and to transfer onto an insurer losses in excess of that deductible. The insurer also handles losses falling below the deductible and bills back these costs to the insured.

Loan Back - A loan of assets from a captive to a shareholder or affiliated entity.

Offshore Domicile – a non-United States captive domicile, such as the Bahamas, Bermuda, the Cayman Islands, or Nevis.

Onshore Domicile – a captive domicile within the United States, including Hawaii.

Pool – An arrangement whereby premiums, losses, and expenses from different sources are combined and shared in agreed ratios.

Premium – The amount of money an insurer charges to provide the coverage described in the insurance policy.

Reinsurance - A transaction in which one party, the "reinsurer," in consideration of a premium paid to it, agrees to indemnify another party, the "reinsured," for part or all of the liability assumed by the reinsured under a policy of insurance that it has issued. The reinsured may also be referred to as the "original" or "primary" insurer or the "ceding company."

Reserves - An amount of money earmarked for a specific purpose. Insurers establish unearned premium reserves and loss reserves indicated on their balance sheets. Unearned premium reserves

show the aggregate amount of premiums that would be returned to policyholders if all policies were canceled on the date the balance sheet was prepared. Loss reserves are estimates of outstanding losses and loss adjustment expenses (LAE).

Self-Insured - An organization that has satisfied state filing requirements, met the minimum financial and size criteria, and received approval to self-insure workers compensation or automobile liability. Each state has its own approval process, and its own restrictions on retention limits and security requirements.

Severity - The amount of damage that is (or that may be) inflicted by a loss. Sometimes quantified as a severity rate, which is a ratio relating the amount of loss to values exposed to loss during a specified period.

Underwriting - The process of determining whether to accept a risk and, if so, what amount of insurance the company will write on the acceptable risk, and at what rate.

Underwriting Profit - The profit that an insurer derives from providing insurance or reinsurance coverage, exclusive of the income it derives from investments.

Legal Disclosures

Distribution and Use

This report is provided for the use of the Maryland Insurance Administration who commissioned the study. It is understood that this report may also be distributed to representatives of various makers of public policy and other stakeholders in the insurance industry in the State of Maryland. Distribution to these parties is granted on the conditions that the entire report be distributed rather than any excerpts and that all recipients are made aware that Pinnacle is available to answer any questions regarding the report.

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Judgments as to conclusions, recommendations, and analysis contained in this report should be made only after studying the report in its entirety. Furthermore, Pinnacle is available to explain any matter presented herein; it is assumed that the user of this report will seek such explanation as to any matter in question. It should be understood that the exhibits, graphs and figures are integral elements of the report.

We have relied upon a great deal of publicly available data and information, without audit or verification. Pinnacle reviewed as many elements of this data and information as practical for reasonableness and consistency with our knowledge of the insurance industry. As regards the legislative costing elements of this report, it is possible that the historical data used to make our estimates may not be predictive of future experience in the captive industry in Maryland or any other domicile. We have not anticipated any extraordinary changes to the legal, judicial, social or economic environment which might affect the captive insurance market, such as material IRS rulings, NAIC model laws, or substantial changes in accounting standards and requirements.

Any estimates of future insurance market behavior, particular when trying to estimate the impact of possible legislative changes, are subject to potential errors of estimation due to the fact that the

ultimate results are subject to the outcome of events yet to occur, e.g., final legislation terminology and interpretation, regulatory changes and changes in tax law or accounting standards. Pinnacle has employed techniques and assumptions that we believe are appropriate, and we believe the conclusions presented herein are reasonable, given the information currently available. It should be recognized that future insurance results will likely deviate, perhaps substantially, from our estimates.

Pinnacle is not qualified to provide formal legal interpretations of state legislation. The elements of this report that require legal interpretation should be recognized as reasonable interpretations of the available statutes, regulations, and administrative rules. State governments and courts are also constantly in the process of changing and reinterpreting these statutes.

Exhibits

Exhibit 1. Overview of Captive Domiciles

Exhibit 2. Captive Regulations and Regulatory Approaches

Exhibit 3. Sources of Revenue

Exhibit 4. Captive Data Sources Reference

	AL	AZ	DE	DC	HI
Year Enacted	2006	2002	1984	2000	1986
Supervisory Jurisdiction					
Number of Employees	Not Available	2 dedicated, others from DOI as needed	4	9	10
Outsourced Functions	Not Available	Limited	Confidential	Financial Examinations	Not Available
Contact	Walter A.Bell Commissioner	Germaine L. Marks Director of Insurance	Steve Kinion Director of Bureau of Captive and Financial Insurance Products	Dana Sheppard Associate Commissioner Risk Finance Bureau	Sanford Saito Deputy Commissioner
	Insdept@insurance.alabama.gov	captive@azinsurance.gov	steve.kinion@state.de.us	Dana.Sheppard@dc.gov	captiveins@dcca.hawaii.gov
Captive Association	None	Arizona Captive Insurance Association	Delaware Captive Insurance Association	Captive insurance Council of D.C.	Hawaii Captive Insurance Council
Association Website	N/A	www.azcia.org	www.delawarecaptive.org	www.dccaptives.org	hawaiicaptives.com
Association President	N/A	Marcia Philpott	Richard F. Klumpp	Melissa Hancock	Fay Okamoto
Email	N/A	Marcia.Philpott@srpnet.com	info@delawarecaptive.org	webmaster@dccaptives.org	Fay_Okamoto@artexrisk.com
Association Funding	N/A	By Membership Only	Membership Dues and Conference Fees	Membership Dues and Conference Fees	Membership Dues and Conference Fees
Annual Meeting	N/A	Western Captive Conference (September 27-28)	Fall Forum (November 6-7, 2013)	Fall Seminar (10/8/2013)	November 5-8, 2013

	AL	AZ	DE	DC	HI
Captives					
Number of Captives	23	84	181	77	161
Number Closed in 2012	Not Available	4	3	5	5
2012 Premium Volume ($M)	16.5	3,648.2	2,406.0	356.8	2,441.3
Coverage Limitations	Cannot write WC and Personal Motor Vehicle. Homeowners can only be written in coastal areas	Cannot write WC (unless reinsurance) and Personal Lines	Cannot write Personal Motor Vehicle and Homeowners	Cannot write Direct Workers Compensation and Personal Auto	Personal Lines have not been written
Permission of Segregated Captives	Yes	Yes	Yes (SPFC)	Yes (PCC and SPFC)	Yes (Sponsored and SPFC)
Permission of LLC Captives	Not Available	Yes	Yes	Yes	Yes
Permission of Cells as LLC's & Corp	Not Available	Yes	Possible	Yes	Possible
In State Captive Managers	Required	Required	Not Required	Not required, but some exist	Not required, but encouraged
Local Director Required	No	No	No	No	No
Principal Place of Business in State	Not Required	Required	Required	No local captive manager office until captive reaches critical mass	Required
Resident Agent	Required	Required	Not Required	Required	Required
In State Annual Meeting Required	Not currently enforcing	Required	Exempt from board meeting in DE if there are 5 full time employees in DE	Required	At least 1

	KY	MO	MT	NV	NJ
Year Enacted	2000	2007	2001	1999	2011
Supervisory Jurisdiction					
Number of Employees	Not Available	Not Available	Not Available	2	3
Outsourced Functions	Not Available	Not Available	Not Available	Not Available	Financial Examinations, some company applications
Contact	Russell Coy II Captive Coordinator	John Rehagen Captive Manager	Steve Matthews Captive Coordinator	Michael Lynch Deputy Commissioner	John Talley Acting Chief of Captive Insurance
	russell.coy@ky.gov	John.Rehagen@insurance.mo.gov	smatthews@mt.gov	mlynch@doi.nv.gov	john.talley@dobi.state.nj.us
Captive Association	Kentucky Captive Association	Missouri Captive Insurance Association	Montana Captive Insurance Association, Inc.	Nevada Captive Insurance Association	New Jersey Captive Insurance Association
Association Website	www.kycaptive.com	mocaptive.com	www.mtcaptives.org	www.nvcaptive.com/home.aspx	www.njcia.org
Association President	Stuart Ferguson	Mike Mead	Richard C. Goff	James Wadhams	Greg Sgambati
Email	stuartferguson@uscky.com	info@mocaptive.com	info@mtcaptives.org	jwadhams@fclaw.com	gregg.s@njcia.org
Association Funding	Membership Dues and Conference Fees	By Membership	Membership Dues and Conference Fees	By Membership	By Membership
Annual Meeting	June 2014	Western Captive Conference (September 27-28)	July 23-25, 2013	Yes	Semi-annual; October 16, 2013

	KY	MO	MT	NV	NJ
Captives					
Number of Captives	136	28	114	100	5
Number Closed in 2012	12	Not Available	5	4	0
2012 Premium Volume ($M)	120.5	6,563.6	120.0	104.3	220.0
Coverage Limitations	Reviewed on an individual basis	No direct writing of workers compensation, employer's liability, private passenger automobile or homeowners. Missouri captives may reinsure qualified self-funded workers compensation plans or provide excess workers compensation coverage.	Not Available	Not Available	Cannot write Primary Workers Compensation; Personal Lines has not been written
Permission of Segregated Captives	Yes (Sponsored)	No	Yes	Yes	Yes (Sponsored)
Permission of LLC Captives	Yes	Yes	Yes	Yes	Yes
Permission of Cells as LLC's & Corp	Yes	No	Possible	No	No
In State Captive Managers	Required	Not required, but some exist	Not Available	Not required	Required
Local Director Required	No	No	Not Available	No	Yes
Principal Place of Business in State	Retain Captive Manager doing business in KY	Required	Requires headquarters in state	Requires NV Bank	Not required but preferred for service providers
Resident Agent	Not Required	Required	Not Available	Required	Required
In State Annual Meeting Required	Required, choose own meeting date	Required	Required	Required	At least 1

	NY	OK	SC	TN	UT
Year Enacted	1997	2004	2000	2007	2003
Supervisory Jurisdiction					
Number of Employees	Not Available	Not Available	3	Not Available	8
Outsourced Functions	Not Available	Not Available	Not Available	Not Available	Triennial Examinations
Contact	Jody T. Wald Captive Insurance Coordinator jody.wald@dfs.ny.gov	Frank Stone Chief Actuary frank.stone@oid.ok.gov	Jeff Kehler Program Manager Alternative Risk Transfer Services jkehler@doi.sc.gov	Michael A. Corbett Director Captive Insurance michael.corbett@tn.gov	Ross Elliott Captive Insurance Director rcelliott@utah.gov
Captive Association	None	Oklahoma Captive Insurance Association	South Carolina Captive Insurance Association	Tennessee Captive Insurance Association, Inc.	Utah Captive Insurance Association
Association Website	N/A	oklahomacaptive.com	www.sccia.org	http://www.tncaptives.org	www.utahcaptive.com
Association President	N/A	Jerry D. Messick	Andrea Bartlett	Kevin Doherty	Jon Soules
Email	N/A	Email via webpage	andreab@bartlettactuarialgroup.com	jmiller@tncaptives.org	uca@utahcaptive.com
Association Funding	N/A	By Membership	By Membership	Membership Dues	Membership Dues
Annual Meeting	N/A	August 29, 2013	September 16-18, 2013	November 20-21, 2013	Western Captive Conference (September 27-28)

	NY	OK	SC	TN	UT
Captives					
Number of Captives	50	5	133	9	285
Number Closed in 2012	Not Available	Not Available	19	Not Available	19
2012 Premium Volume ($M)	721.6	0.0	2,862.7	45.0	544.0
Coverage Limitations	Cannot write Life Insurance, Annuities, A&H and Mortgage Guarantee	Not Available	Cannot write Direct Workers Compensation or Personal Lines	Cannot write Direct Workers Compensation or Personal Lines	Cannot write Direct Workers Compensation, Punitive Damages, Personal Home and Personal Auto
Permission of Segregated Captives	Not Available	Not Available	Yes (Sponsored)	Yes	Yes
Permission of LLC Captives	Not Available	Not Available	Yes	Yes	Possible
Permission of Cells as LLC's & Corp	Not Available	Not Available	No	No	Possible
In State Captive Managers	Required	Not required, but some exist	Required	Not required, but some exist	Not required, but some exist
Local Director Required	At least 2 Board Members must by NY Residents	Not Available	Yes	Yes	Yes
Principal Place of Business in State	Principal office in state	Must maintain place of business in state	Required	Required	Required
Resident Agent	Required	Required	Required	Required	Required
In State Annual Meeting Required	Required	Not Required	Required	Required	Required

	VT
Year Enacted	1981
Supervisory Jurisdiction	
Number of Employees	32
Outsourced Functions	Not Available
Contact	David Provost Deputy Commissioner of Captive Insurance dprovost@bishca.state.vt.us
Captive Association	Vermont Captive Insurance Association
Association Website	www.vcia.com
Association President Email	Richard Smith smith@vcia.com
Association Funding	Membership Dues
Annual Meeting	August 12-14, 2014

	VT
Captives	
Number of Captives	500
Number Closed in 2012	36
2012 Premium Volume ($M)	25,138.0
Coverage Limitations	Cannot write Personal Lines and Anything Direct to Consumer
Permission of Segregated Captives	Yes (Sponsored and SPFC)
Permission of LLC Captives	Yes
Permission of Cells as LLC's & Corp	No
In State Captive Managers	Required
Local Director Required	Yes
Principal Place of Business in State	Required
Resident Agent	Required
In State Annual Meeting Required	Required

	AL	AZ	DE	DC
Legislative Act(s)	2008 Alabama Coastal Captive Insurance Co. Act	Arizona Revised Statutes 20-1098 et seq. plus applicable parts of Title 20	Title 18, Delaware Insurance Code, Chapter 69 (Captive Insurance Companies), 1984, revised in Captive structures in 2010	The Captive Insurance Company Act of 2004; Special Purpose Financial Captive Authorization Amendment Act of 2006; Captive Insurance Company Amendment Act of 2006.
Financial Reporting Requirements				
Filling date	Fiscal: March 1, Calendar Year: 60 Days following year end	Calendar Year: 90 days following year end	March 1 of following year	RRG: March 2; Non RRG: March 2
SAO required for all captives	Varies	Small Company Exemption (GWP < $1M& Reserves < $1M) or Undue Hardship Waiver	Required	Required
Accounting Standards	GAAP/SAP	GAAP/SAP	GAAP/SAP/IAS	GAAP/SAP

	AL	AZ	DE	DC
Financial Examinations	Every 3 Years	Non-RRG captives are not subject to statutory financial examinations	Every 3 Years	Every 5 Years
Capitalization Requirements				
Pure	$250,000	$250,000	$250,000	$100,000
Association	$750,000	$500,000	$750,000	$100,000
Industrial	$500,000		$500,000	
Sponsored	$1,000,000		$500,000	
Reciprocal	$1,000,000			
Single-parent		$250,000		$100,000
Agency		$500,000	$250,000	$100,000
Protected Cell		$500,000		$100,000
Special Purpose Financial			$250,000	
Premium to surplus			3 to 1	
Branch				$100,000
Reinsurance				
RRG		$500,000	$1,000,000	$100,000
Rental				$100,000

	AL	AZ	DE	DC
Surplus Options				
Cash	Yes	Yes	Yes	Yes
Letter of Credit	Yes	Yes	Yes	Yes
Receivables			No	Possible
Intangibles			No	Possible
Other Assets			Other forms approved by the commissioner	Possible
Provision for loan backs to parent/affiliates	Upon Approval	Upon Approval	Upon Approval	Upon Approval

	HI	KY	MO	MT
Legislative Act(s)	Chapter 431, Article 19 of Hawaii's Revised Statutes	Kentucky Revised Statutes 304.49 and Kentucky Administrative Regulations 806 KAR 9:020-49:040; amended 2006	Captive insurance company laws: RSMo 379.1300-1350; Special purpose life reinsurance captive laws: RSMo 379.1353-1421; Rules of Department of Insurance, Financial Institutions and Professional Registration Division 200—Insurance Solvency and Company Regulation, Chapter 20—Captive Insurance Companies	33-28-101 through 306 MCA
Financial Reporting Requirements				
Filling date	6 months after fiscal year end date	Fiscal: March 1, Calendar Year: 60 Days following year end	Annual Filing - March 1; Audited Financials - June 30	180 days after fiscal year end
SAO required for all captives	Required	Required	Required	Required
Accounting Standards	GAAP/SAP	GAAP	GAAP	GAAP

	HI	KY	MO	MT
Financial Examinations	First Exam within 3 years after that every 5 years with Commissioner Discretion	Every 3-5 years	Every 3 Years; may extend to every 5 years	Not Available
Capitalization Requirements				
Pure	$100,000 to $250,000	$250,000	$250,000	$250,000
Association	$500,000	$500,000	$750,000	$500,000
Industrial		$500,000	$500,000	$500,000
Sponsored	$500,000	$500,000		
Reciprocal				
Single-parent				
Agency		$500,000		
Protected Cell	$500,000			$250,000
Special Purpose Financial	$500,000	$250,000	$250,000	
Premium to surplus	Varies by nature of Captive	None		None
Branch			$250,000	$250,000
Reinsurance				$125,000
RRG	$500,000			$500,000
Rental				

	HI	KY	MO	MT
Surplus Options				
Cash	Yes	Yes	Yes	Yes
Letter of Credit	Yes	Yes	Yes	Yes
Receivables	Possible	No	No	No
Intangibles	Possible	No	No	No
Other Assets	Other forms approved by the commissioner	Sponsored captive not assuming risk, other forms upon approval	No	Other forms approved by the commissioner
Provision for loan backs to parent/affiliates	Upon Approval	Upon Approval	Not Available	Pure Captive Only - Upon Approval

	NV	NJ	NY	OK
Legislative Act(s)	Chapter 694C of Nevada Revised Statutes and Nevada Administrative Code	Captive Insurers Act	Article 70 of the New York Insurance Law	HB 1108
Financial Reporting Requirements Filling date	March 1	March 1	March 1 of following year	Calendar Year and Fiscal Year
SAO required for all captives	Required	Required, feasibility study	Not Available	Required; will be removed
Accounting Standards	GAAP	GAAP, will work with others	Not Available	GAAP, SAP

	NV	NJ	NY	OK
Financial Examinations	Every 3 Years	Every 3 Years	Every 5 Years	Every 5 Years
Capitalization Requirements				
Pure	$200,000	$250,000	$250,000	$125,000
Association	$500,000	$750,000	$500,000	$750,000
Industrial		$500,000		$500,000
Sponsored	$500,000	$500,000		$500,000
Reciprocal				
Single-parent				
Agency	$600,000			
Protected Cell				
Special Purpose Financial				$250,000
Premium to surplus		1.8 to 1		
Branch				$250,000
Reinsurance				
RRG				$1,000,000
Rental	$800,000			

	NV	NJ	NY	OK
Surplus Options				
Cash	Yes	Yes	Yes	Yes
Letter of Credit	Yes	Yes	Yes	Yes
Receivables	No	Possible		Yes
Intangibles	No	Possible		Yes
Other Assets	Other forms approved by the commissioner	Possible		
Provision for loan backs to parent/affiliates	Pure Captive Only - Upon Approval by Commissioner	Yes, prior approval, demand note basis	Upon Approval	None

	SC	TN	UT	VT
Legislative Act(s)	S.C. Code of Laws 38-90-10 38-87-10 38-10-10 with regulation 69-60	The Tennessee Captive Insurance Company Act, Chapter 13, Title 56, 1978	Captive Insurance Companies Act	Special Insurer Act of 1981
Financial Reporting Requirements				
Filling date	Fiscal Year	Fiscal: March 1, Calendar Year: 60 Days following year end	Fiscal: March 1, Calendar Year: 60 Days following year end	Fiscal: March 1, Calendar Year: 60 Days following year end
SAO required for all captives	Required	Required	Required	Required
Accounting Standards	US GAAP, IFRS, UK GAAP, Canadian GAAP	GAAP/SAP	US GAAP, IFRS, UK GAAP, Canadian GAAP	US GAAP, IFRS, UK GAAP, Canadian GAAP

	SC	TN	UT	VT
Financial Examinations	Every 3 Years	Every 3 Years	Every 3 Years	Every 3 Years
Capitalization Requirements				
Pure	$100,000	$250,000	$250,000	$250,000
Association	$400,000	$500,000	$750,000	$500,000
Industrial	$200,000	$500,000	$500,000	$500,000
Sponsored	$750,000		$1,000,000	$500,000
Reciprocal			$1,000,000	
Single-parent				
Agency				
Protected Cell		$500,000		
Special Purpose Financial	$250,000	$250,000		
Premium to surplus				
Branch		$250,000		
Reinsurance				
RRG		$1,000,000		$1,000,000
Rental				

	SC	TN	UT	VT
Surplus Options				
Cash	Yes	Yes	Yes	Yes
Letter of Credit	Yes	Yes	Yes	Yes
Receivables	No	Possible	Possible	Possible
Intangibles	No	Possible	Possible	Possible
Other Assets	Sponsored captive not assuming risk, other forms upon approval	Other forms approved by the commissioner	Other forms approved by the commissioner	Possible
Provision for loan backs to parent/affiliates	Limited to Pure Captives at the discretion of the regulatory body	Yes, with prior written approval of the commissioner	Pure Captive Only - Upon Approval	Yes, prior approval, demand note basis

	AL	AZ	DE	DC
Costs/Filing Fees				
Application Fee	$200		$200	$500
License Fee	$300			
First Year		$1,000		
Renewal		$5,500		
Processing Fee			$3,200	
Filing Fee (Franchise Report)			$50	
Series Business Processing Fee			$1,800	
Fraud Fee				
Annual Fee			$300	$300
Certification Fee				$300
Review Fee				
Administration and Enforcement				
e-commerce Fee				
Articles of Incorporation		$60		
Charter Document Bylaws		$75		
Examiner's Revolving Fund		$100		
Initial Examination		Varies		
Ongoing Examinations		Varies		
Registration & Incorporation				
First Year	$1,000			
Renewal	$5,500			
Incorporation Fee				
Minimum App Review				
Pure reviewer firm fee				
Non Pure reviewer firm fee				

	AL	AZ	DE	DC
Taxation				
Premium Tax				
First $20 M	0.225%	None		0.250%
$20 M to $40 M	0.150%	None		0.150%
$40 M to $60 M	0.050%	None		
$60 M and greater	0.025%	None		0.500%
Reinsurance Tax				
First $20 M				0.225%
$20 M to $40 M				0.150%
$40 M to $60 M				
$60 M and greater				
Assumed Tax				
First $20 M				
$20 M to $40 M				
$40 M to $60 M				
$60 M and greater				
Direct Business			$0	
Reinsurance			$0	
Minimum Premium Tax	$5,000		$5,000	$7,500
Maximum Premium Tax			$200,000	$100,000

	HI	KY	MO	MT
Costs/Filing Fees				
Application Fee	$1,000	$600		$200
License Fee	$300 to $1,000		$7,500	$300
First Year				
Renewal				
Processing Fee				
Filing Fee (Franchise Report)		$55		
Series Business Processing Fee				
Fraud Fee				
Annual Fee				
Certification Fee		$50		
Review Fee			4,000 Max	
Administration and Enforcement				
e-commerce Fee				
Articles of Incorporation		$50		
Charter Document Bylaws				
Examiner's Revolving Fund				
Initial Examination				
Ongoing Examinations				
Registration & Incorporation				
First Year	$15			
Renewal	$15	$300	$7,500	
Incorporation Fee	$50			
Minimum App Review				
Pure reviewer firm fee				
Non Pure reviewer firm fee				

	HI	KY	MO	MT
Taxation Premium Tax				
First $20 M	0.250%	0.400%	0.380%	0.400%
$20 M to $40 M	0.150%	0.300%	0.285%	0.300%
$40 M to $60 M	0.050%	0.200%	0.190%	0.200%
$60 M and greater		0.075%	0.072%	0.075%
Reinsurance Tax				
First $20 M				0.225%
$20 M to $40 M				0.150%
$40 M to $60 M				0.050%
$60 M and greater				0.005%
Assumed Tax				
First $20 M		0.225%	0.214%	
$20 M to $40 M		0.150%	0.143%	
$40 M to $60 M		0.050%	0.048%	
$60 M and greater		0.025%	0.024%	
Direct Business				
Reinsurance				
Minimum Premium Tax	No Minimum	$5,000	$7,500	$5,000
Maximum Premium Tax	$200,000		$200,000	$100,000

	NV	NJ	NY	OK
Costs/Filing Fees				
Application Fee	$500	$4,000		$2,000
License Fee	$300			
First Year				$300
Renewal				$300
Processing Fee				
Filing Fee (Franchise Report)				
Series Business Processing Fee				
Fraud Fee				
Annual Fee		$300		
Certification Fee				
Review Fee				
Administration and Enforcement	$250			
e-commerce Fee				
Articles of Incorporation				
Charter Document Bylaws				
Examiner's Revolving Fund				
Initial Examination				
Ongoing Examinations				
Registration & Incorporation				
First Year				
Renewal	$300			
Incorporation Fee			% of par value of stock	
Minimum App Review	$75			
Pure reviewer firm fee	$4,000			
Non Pure reviewer firm fee	$5,000			

	NV	NJ	NY	OK
Taxation				
Premium Tax				
First $20 M	0.400%	0.380%	0.400%	0.200%
$20 M to $40 M	0.200%	0.285%	0.300%	0.200%
$40 M to $60 M			0.200%	0.200%
$60 M and greater	0.075%	0.072%	0.075%	0.200%
Reinsurance Tax				
First $20 M	0.225%	0.214%	0.225%	0.100%
$20 M to $40 M	0.150%	0.143%	0.150%	0.100%
$40 M to $60 M			0.050%	0.100%
$60 M and greater	0.025%	0.024%	0.005%	0.100%
Assumed Tax				
First $20 M				
$20 M to $40 M				
$40 M to $60 M				
$60 M and greater				
Direct Business				
Reinsurance				
Minimum Premium Tax				$5,000
Maximum Premium Tax	$175,000			$100,000

	SC	TN	UT	VT
Costs/Filing Fees				
Application Fee	$200	$675	$200	
License Fee				
First Year	$300		$5,000	$500
Renewal			$5,000	$500
Processing Fee	$200			
Filing Fee (Franchise Report)				
Series Business Processing Fee				
Fraud Fee				$425
Annual Fee	$500	$515		
Certification Fee		$440		
Review Fee	$3,200			$5,000
Administration and Enforcement				
e-commerce Fee			$250	
Articles of Incorporation				
Charter Document Bylaws				
Examiner's Revolving Fund				
Initial Examination				
Ongoing Examinations				
Registration & Incorporation				
First Year				
Renewal				
Incorporation Fee				
Minimum App Review				
Pure reviewer firm fee				
Non Pure reviewer firm fee				

	SC	TN	UT	VT
Taxation				
Premium Tax				
First $20 M	0.400%	0.400%		0.380%
$20 M to $40 M				0.285%
$40 M to $60 M				0.190%
$60 M and greater	0.300%	0.300%		0.072%
Reinsurance Tax				
First $20 M	0.225%	0.225%		
$20 M to $40 M	0.150%	0.150%		
$40 M to $60 M	0.050%	0.050%		
$60 M and greater	0.025%	0.025%		
Assumed Tax				
First $20 M				0.214%
$20 M to $40 M				0.143%
$40 M to $60 M				0.048%
$60 M and greater				0.024%
Direct Business				
Reinsurance				
Minimum Premium Tax	$5,000	$5,000		$7,500
Maximum Premium Tax	$100,000	$100,000		$200,000

Maryland Insurance Administration
Captive Data Sources Reference

This comprehensive list of websites and links relevant to captive insurance is intended to be a resource for readers interested in additional detailed information. Included are hyperlinks to many domiciles' captive regulators, enabling legislations, captive application details, and state captive associations.

Insurance Departments

This section contains links to state insurance departments in current captive domiciles, captive enabling legislation and other specific areas of the state insurance department websites pertinent to captives. In addition, links to all of the U.S. state and territorial insurance departments can be found in a convenient map format at the National Association of Insurance Commissioners (NAIC) website, www.naic.org/state_web_map.htm.

Alabama
- Captive Annual Financial Statement Requirements
- Steps to Forming a Captive
- Captive Insurer Regulations
- Alabama Captive Insurers Act

Arizona
- Captive Year End Filing
- Reference Guide: Captives Other than Risk Retention Groups Updated as of September 2012
- Arizona Captive Insurance Companies Audited Financial Report Exemption Standards and Filing Requirements
- Arizona Department of Insurance 2011/2012 Annual Report
- Captive Insurance Division Facts and Statistics as of December 31, 2012

Delaware
- Annual Filing Requirements
- Taxes and Fees
- Title 18 Insurance Code, Chapter 69. Captive Insurance Companies
- Title 18, 300 Financial Reporting
- Delaware is Your First Choice for Captive Insurance
- Delaware Captive Insurance Association Spring Forum
- Captive filing Requirements for Domestic Captive Insurance Companies

District of Columbia
- Washington, DC: A World-Class City for Captive Insurance
- Department of Insurance, Securities, and Banking Operating Budget
- Annual Reporting Instructions
- Captive Act of 2004
- Captive Amendment of 2006

District of Columbia (cont.)
- Special Purpose Financial Captive Amendment of 2006
- Captive Insurance Company Regulations
- Captive Insurance Company Amendment of 2012
- 2012 Reporting Instructions

Hawaii
- Captive Insurance Fact Sheet
- 2012 Captive Recap
- Hawaii Captive Insurance Briefing and Update
- Captive Basics
- Ongoing Procedures

Kentucky
- Captive Application and Fees
- 806 Kentucky Administrative Regulations 49:030. Captive Insurer Reporting Requirements

Missouri
- Type of Captive Structures Available in Missouri
- Captive Insurance Ongoing Requirements
- Captive Statutes
- Captive Regulations

Montana
- 2012 Reporting Instructions
- Formation and Regulation of Captive Insurance Companies (Rule 6.6.68)

Nevada
- Captive Insurance Annual Requirements
- Executive Budget – Captive Insurers
- 2013 Nevada Insurance Market Report

New Jersey
- Captive Laws and Regulations
- Reference Guide

New York
- Captive Annual Statements
- Forming a Captive in New York State
- Article 70 - Captive Insurance Companies

Oklahoma
- Annual Report Instructions
- Title 36, Chapter 2, Section 6470.3 Captive Insurance Company Limitations and Requirements

South Carolina
- Chapter 90. Captive Insurance Companies
- Annual Reports for Captives

Tennessee
- Public Chapter No. 468, House Bill No. 2007, Revised Tennessee Captive Insurance Act
- Tennessee Captive Brochure

Maryland Insurance Administration
Captive Data Sources Reference

Utah	• 31A-37-501. Reports to Commissioner
	• 31A-37-502. Examination
	• Rule R590-238. Captive Insurance Companies
	• Captive Division Budget Fiscal Year 2012 (7/1/2011-6/30/2012)
	• Licensing & Forms
Vermont	• Advantages of Captive Insurance
	• Annual Filing Instructions
	• Captives Licensed Per Year
	• Active Vermont Captives by Type

Captive Associations

Arizona	
Delaware	• Courting Controversy
	• Captive FAQs
District of Columbia	• The DC Difference
	• Captive FAQs
Hawaii	• Hawai'i Statistics
	• Hawai'i Fact Sheet
	• Captive FAQs
Kentucky	• Kentucky Captive Domicile Off to the Races!
	• Kentucky's Captive Insurance Market Grows
	• Kentucky Courts Middle America's Captives
Missouri	• Missouri Captive Benefits
	• Mid Year Update
Montana	• Montana Licensed Captives Breakdown
	• State Captive Requirements
	• Tax Information
Nevada	• Licensed Captive Insurers
New Jersey	
Oklahoma	
South Carolina	• Captive Insurance Basics
	• Captive Industry Economic Impact Report as of Dec. 31, 2011
Tennessee	• Captive Statistics

Maryland Insurance Administration
Captive Data Sources Reference

Utah
- UT Regulatory Advantage
- Captive Cash Flow
- Factors Considered in Selecting the Domicile for a Captive Insurer

Vermont
- Captive Terminology
- Vermont Domicile Information
- Captive-related Resources

Captive Managers

AIG Captive Management
Alta Holdings, LLC
Aon Captive & Insurance Mgmt.
Beecher Carlson Insurance Services
Captive Resources, LLC
Kane Group Ltd.
Marsh Captive Solutions
R&Q Quest Management Ltd.
Strategic Risk Solutions
USA Risk Group
Willis Global Captive Management

Other Sources

A.M. Best Company
- Number of Property Casualty Insurance Companies by Domicile and Year

Business Insurance
- Market Insights: Captive Domiciles 2012
- Market Insights: Captive Managers and Domiciles 2013
- Gallery: World's 10 Largest Captive Domiciles

Captive.Com
- Reasons to Form A Captive
- Domicile Update
- Contemplating the Competition of Onshore Captive Domiciles, Phillip C. Giles, CEBS

Captive Insurance Companies Association
- Domicile Information

Captive Insurance Alternatives, LLC
- Advantages of a Captive
- Disadvantages of a Captive

International Risk Management Institute, Inc.
Insurance Information Institute

Maryland Insurance Administration
Captive Data Sources Reference

Other Sources (cont.)

Lockton, Inc.

National Association of Insurance Commissioners
- State Report Cards
- Recent Developments in the Captive Insurance Industry
- Captive & SPV Use Survey Results

Marsh USA
- Captive Concept: The Advantages and Disadvantages of a Captive

Property Casualty 360°
- Top 10 Benefits and Risks of Forming a Captive

RIMS, the risk management society™

Attachment 2

New York State Department of Financial Services

Shining a Light on Shadow Insurance

June 2013

Shining a Light on Shadow Insurance

A Little-known Loophole
That Puts Insurance Policyholders and
Taxpayers at Greater Risk

New York State Department of Financial Services
Benjamin M. Lawsky, Superintendent of Financial Services
June 2013

EXECUTIVE SUMMARY

In July 2012, the New York State Department of Financial Services ("DFS") initiated an investigation into "shadow insurance" — a little-known loophole that puts insurance policyholders and taxpayers at greater risk. This report details the initial findings of DFS's inquiry.

Insurance companies use shadow insurance to shift blocks of insurance policy claims to special entities — often in states outside where the companies are based, or else offshore (e.g., the Cayman Islands) — in order to take advantage of looser reserve and regulatory requirements. Reserves are funds that insurers set aside to pay policyholder claims.

In a typical shadow insurance transaction, an insurance company creates a "captive" insurance subsidiary, which is essentially a shell company owned by the insurer's parent. The company then "reinsures" a block of existing policy claims through the shell company — and diverts the reserves that it had previously set aside to pay policyholders to other purposes, since the reserve and collateral requirements for the captive shell company are typically lower. Sometimes the parent company even effectively pays a commission to itself from the shell company when the transaction is complete.

This financial alchemy, however, does not actually transfer the risk for those insurance policies because, in many instances, the parent company is ultimately still on the hook for paying claims if the shell company's weaker reserves are exhausted ("a parental guarantee"). That means that when the time finally comes for a policyholder to collect promised benefits after years of paying premiums (such as when there is a death in their family), there is a smaller reserve buffer available at the insurance company to ensure that the policyholder receives the benefits to which they are legally entitled.

Shadow insurance also could potentially put the stability of the broader financial system at greater risk. Indeed, in a number of ways, shadow insurance is reminiscent of certain practices used in the run up to the financial crisis, such as issuing securities backed by subprime mortgages through structured investment vehicles ("SIVs") and writing credit default swaps on higher-risk mortgage-backed securities ("MBS"). Those practices were used to water down capital buffers, as well as temporarily boost quarterly profits and stock prices at numerous financial institutions. Ultimately, these risky practices left those very same companies on the hook for hundreds of billions of dollars in losses from risks hidden in the shadows, and led to a multi-trillion dollar taxpayer bailout.

Similarly, shadow insurance could leave insurance companies on the hook for losses at their more weakly capitalized shell companies. The events at AIG's Financial Products unit in

the lead up to the financial crisis demonstrate that regulators must remain vigilant about potential threats lurking in unexpected business lines and at more weakly capitalized subsidiaries within a holding company system.

DFS's Investigation into Shadow Insurance

Over the last eleven months, the New York Department of Financial Services has conducted an extensive investigation into shadow insurance at New York-based insurance companies and their affiliates. DFS's investigation revealed:

- ***$48 Billion in Shadow Insurance at New York-based Insurers and Their Affiliates Alone.*** New York-based insurance companies and their affiliates engaged in at least $48 billion of shadow insurance transactions to lower their reserve and regulatory requirements.

- ***Inconsistent, Spotty, and Incomplete Disclosures.*** New York-based insurance companies failed to disclose the parental guarantees associated with nearly 80 percent ($38 billion) of that $48 billion in shadow insurance in their statutory, annual financial statements. And where those companies did make disclosures, those disclosures were often spotty and incomplete.

- ***Reserves Diverted, Artificially Rosy Capital Buffers.*** Shadow insurance allows companies to divert reserves for other purposes besides paying policyholder claims. Those other purposes may include anything from an acquisition of another company to executive compensation to paying dividends to investors. In most cases, though, DFS's investigation revealed that insurance companies manipulated those reserves in order to artificially boost the risk-based capital ("RBC") buffers that they reported to regulators, investors, and the broader public — all without actually raising any new capital or reducing risk. In other words, shadow insurance makes a company's capital buffers — which serve as shock absorbers against unexpected losses or financial shocks — appear larger and rosier than they actually are.

- ***Weak Transparency, Regulatory Blind Spots.*** Most states have laws that provide for strict confidentiality on financial information related to shadow insurance. These confidentiality requirements thwart regulators from outside that state from having a full window into the risks that those transactions create. Indeed, the current lack of transparency surrounding shadow insurance is what, in great part, drove DFS to undertake this investigation.

- ***Regulatory Race to the Bottom.*** A number of the other states outside New York where shadow insurance is written permit the use of riskier types of "collateral" to back shadow

insurance claims, including "hollow assets," "naked parental guarantees," and "conditional letters of credit" (each of which is described in further detail below). Those weaker collateral requirements mean that policyholders are at greater risk.

As part of its investigation, under Section 308 of the New York Insurance Law, DFS required all life insurers based in New York to provide information on shadow insurance transactions. The findings of this investigation and DFS's authority under Section 308 are limited to New York-based life insurers. As such, the $48 billion in shadow insurance transactions DFS's investigation uncovered are likely to be just the tip of the iceberg nationwide. There are almost certainly tens, if not hundreds, of billions of dollars of additional shadow insurance on the books of insurance companies across the country.

DFS's Recommendations on Shadow Insurance

Given the troubling findings uncovered during its investigation, DFS is taking immediate action and making several recommendations to address the potential risks and lack of transparency surrounding shadow insurance:

- Through its authority under the New York Insurance Law, DFS will require detailed disclosure of shadow insurance transactions by New York-based insurers and their affiliates.

- In the interest of national uniformity, the National Association of Insurance Commissioners ("NAIC") should develop enhanced disclosure requirements for shadow insurance across the country.

- The Federal Insurance Office ("FIO"), Office of Financial Research ("OFR"), the NAIC, and other state insurance commissioners should conduct similar investigations to document a more complete picture of the full extent of shadow insurance written nationwide.

- State insurance commissioners should consider an *immediate national moratorium* on approving additional shadow insurance transactions until those investigations are complete and a fuller picture emerges.

I. DFS'S INVESTIGATION INTO SHADOW INSURANCE

A. Background/Objectives of the Investigation

The use of shadow insurance emerged in great part due to a desire from insurers to do an end-run around higher reserve requirements that states established for certain term and universal life insurance policies. The fact that certain insurers are inappropriately using shell games to hide risk and loosen reserve requirements is greatly troubling to DFS and caused the Department to launch an investigation.

On July 18, 2012, pursuant to Section 308 of the New York Insurance Law, DFS required all 80 life insurers based in New York to provide information concerning reinsurance with affiliated captive or affiliated offshore insurers, including those with parental guarantees ("shadow insurance").

The investigation also focused on the following additional areas of concern surrounding shadow insurance — each of which present serious potential risks to policyholders and taxpayers:

1. ***Conditional Letters of Credit.*** DFS examined whether any of those 80 New York-based insurers and their affiliates engaged in reinsurance transactions using "conditional letters of credit" (i.e., letters of credit that have stipulated conditions that must be met before they can be drawn upon). A conditional letter of credit is at greater risk of not being available to fund policyholder claims during periods of financial stress. New York requires that letters of credit used as collateral have unconditional terms. However, other states allow conditional letters of credit as collateral.

2. ***Two-step Transactions.*** DFS examined whether any of those 80 New York-based insurers and their affiliates transferred insurance to another insurer outside of New York, which then subsequently transferred that risk to a captive subsidiary affiliated with the original insurer (a "two-step transaction"). Two-step transactions are particularly problematic because, in some instances, although a New York-based insurer may not report any direct shadow insurance activity, the New York-based insurer is still ultimately on the hook for losses through a parental guarantee. This complex shell game obscures the risks that insurers are taking on through shadow insurance.

3. ***Hollow Assets.*** DFS examined whether any of those 80 New York-based insurers and their affiliates engaged in reinsurance transactions with affiliated captives or affiliated offshore reinsurers where a letter of credit with a parental guarantee is recorded as an asset on the books of the captive or offshore affiliate ("hollow asset"). In other words, the insurer counts the undrawn letter of credit as an asset — rather than a real asset that

it actually holds, such as cash or a bond. While New York does not allow insurers to count undrawn letters of credit as assets, other states allow such arrangements.

4. ***Naked Parental Guarantees.*** Through a "naked parental guarantee," a captive insurance subsidiary engaging in shadow insurance does not even bother to obtain a letter of credit — conditional or otherwise — as collateral. It simply promises that its parent company would cover potential losses, without identifying any specific, dedicated resources to pay for them. While New York does not allow insurers to back insurance claims with naked parental guarantees, other states allow such arrangements.

B. Summary of the Findings of the Investigation

As part of its investigation, DFS uncovered that 17 New York-based insurers used some form of parental guarantee to support collateral arrangements in reinsurance transactions. Those shadow insurance transactions together totaled more than $48 billion.

Eight of those 17 respondents reported direct reinsurance arrangements through a subsidiary operating in New York. Nine of those 17 respondents reported reinsurance arrangements solely through non-New York affiliates.

- Of the eight insurers that reported direct transactions, their parental guarantees totaled $14.9 billion in the aggregate. In addition, five of those eight New York-based insurers also reported that their non-New York affiliate insurers engaged in transactions that used some form of parental guarantee that, in the aggregate, totaled an additional $18.2 billion.
- Of the nine insurers that reported transactions only through non-New York affiliates in their holding company systems, the total amount of parental guarantees reported amounted to approximately $15.3 billion.

Specific details on the shadow insurance transactions at each of these 17 firms are available in Section I. D of this report.

Conditional Letters of Credit

Five New York-based insurers reported that non-New York-based affiliates within their holding company systems used conditional letters of credit, although only three insurers reported the amounts associated with those conditional letters of credit ("Conditional LOCs"). (*See* Table 1.)

Table 1: Insurers Reporting Conditional LOCs

Case	Total LOCs with Credit Reimbursement Agreements	Amount of Conditional LOCs, If Reported*
Case 3	$658,650,000	$391,000,000
Case 5	$4,322,570,267	0
Case 8	$1,911,071,300	$1,840,571,300
Case 10	0	0
Case 17	$450,000,000	$450,000,000
Totals	$7,342,291,567	$2,681,571,300

*For entries noted as zero in this column, the firms indicated that they have previously or intend to engage in these practices, but they are not currently active as of the date of the DFS's inquiry.

Hollow Assets

The Department's investigation further revealed that the captive reinsurers of 11 New York-based insurers reported LOCs as admitted assets in the cases where the reinsurers are located in the states of Missouri, Delaware, Iowa, South Carolina, Nebraska, and Vermont. These states — unlike New York — permit LOCs to be reported as admitted assets on the books of the captive reinsurers. All but one insurer that reported a captive with an LOC in the aforementioned six states specifically identified the amount of LOCs reported as admitted assets. The total amount of LOCs reported as assets is approximately $9.6 billion. (*See* Table 2 for a summary.)

Table 2: LOCs Reported as Admitted Assets

Case	Total LOCs with Credit Reimbursement Agreements	LOCs where Reinsurers Are Located in MO, DE, IA, SC, NE or VT	Amount of LOCs Specifically Reported as Assets**
Case 1	$7,109,685,769	$4,446,000,000	$4,446,000,000
Case 2	$216,000,000	$85,000,000	$85,000,000
Case 3	$658,650,000	$658,650,000	$658,650,000
Case 5	$4,322,570,267	$1,879,122,053	0
Case 8	$1,911,071,300	$1,840,571,300	$1,840,571,300
Case 9	$4,745,590,260	$727,000,000	$727,000,000

Case 10	0	0	0
Case 11	$130,040,984	$130,040,984	$130,040,984
Case 14	$1,173,300,000	$1,148,000,000	$1,148,000,000
Case 16*	$100,807,387	$100,807,387	$100,807,387
Case 17	$450,000,000	$450,000,000	$450,000,000
Totals	$20,817,715,967	$11,465,191,724	$9,586,069,671

*This represents a parental guarantee that was reported as an admitted asset.

**For entries noted as zero in this column, the firms indicated that they have previously or intend to engage in these practices, but they are not currently active as of the date of the DFS's inquiry.

Two-step Transactions

The Department's investigation also uncovered several "two-step" transactions where New York-based insurers transferred business to another U.S.-based life insurer outside New York, which then transferred the business to a captive or offshore insurer affiliated with the original New York insurer. Indeed, six New York-based insurers reported engaging in some sort of two-step transactions and, of those, five utilized parental guarantees.

Table 3: Insurers Reporting Two-Step Transactions

Case	LOCs with Parental Guarantees*	Surplus Note Guarantees*	Report LOCs as Assets?	Report Conditional LOCs?
Case 1	$7,109,685,769	$4,647,000,000	Yes	No
Case 7	0	0	No	No
Case 8	$1,911,071,300	0	Yes	Yes
Case 9	$4,745,590,260	$2,212,000,000	Yes	No
Case 10	0	$1,480,000,000	Yes	Yes
Case 14	$1,173,300,000	$127,769,311	Yes	No
Totals	**$14,939,647,329**	**$8,466,769,311**		

*For entries noted as zero in this column, the firms indicated that they have previously or intend to engage in these practices, but they are not currently active as of the date of the DFS's inquiry.

Two-step transactions are particularly problematic because, in some instances, although a New York-based insurer may not report any direct activity involving parental guarantees, the

risks of the New York-based insurer are ultimately being guaranteed by the parent through retrocessions (i.e., reinsurance of reinsurance arrangements) within the holding company system.

Naked Parental Guarantees

The Department's inquiry also uncovered other kinds of arrangements, including "naked parental guarantees." In a naked parental guarantee, a captive insurance subsidiary does not even bother to obtain a letter of credit — conditional or otherwise — as collateral. It simply promises that its parent would cover any losses, without identifying specific, dedicated resources to pay for them.

In one situation, an insurer reported that a non-New York-based company entered into an agreement that used a "naked parental guarantee" for the amount of $1.6 billion. In another instance, a non-New York-based company used a similar affiliate guarantee (a "naked guarantee" from an affiliate, as opposed to the ultimate parent) for the amount of $100.8 million in a reinsurance transaction. (*See* Table 4.)

Table 4: "Naked" Parental Guarantees

Case	"Naked" Parental Guarantee Amounts
Case 5	$1,616,883,275
Case 16	$100,807,387
Totals	**$1,717,690,662**

New York regulations do not permit either a naked parental or affiliate guarantee as collateral in support of a reduction in a reserve liability because, in the event of financial difficulty of the reinsurer, there is no readily available assets to seize to pay claims. That type of arrangement puts policyholders at greater risk.

C. Diverting Reserves, Artificially Boosting Capital Buffers

As previously noted, shadow insurance allows companies to divert reserves for other purposes besides paying policyholder claims. Those other purposes could include anything from an acquisition of another company to executive compensation to paying dividends to investors. In most cases, though, DFS's investigation found that companies use those diverted reserves to artificially boost the risk-based capital (RBC) buffers that they report to regulators, investors, and the broader public — without actually raising any new capital or reducing risk. In other words, shadow insurance makes a company's capital buffers — which serve as shock absorbers against unexpected losses or financial shocks — appear larger and rosier than they actually are.

Regulators created RBC standards in the late 1980s were created to provide a capital adequacy standard tied to risk, raise insurers' safety nets, create uniformity among states, and provide regulatory authority for timely action. RBC represents the amount of capital, based on an assessment of risks, that a company should hold to protect customers against adverse developments. The RBC system was developed after the financial crisis of the late 1980s when state insurance commissioners took a fresh look at the low, fixed minimum capital requirements embedded in the various state insurance laws. Regulators throughout the country determined that a new approach was necessary to better protect policyholders and to raise the minimum capital requirements for insurance companies.

Because the RBC ratio is often interpreted as a measure of the financial strength of an insurer by rating agencies, regulators, company management, customers, creditors, and investors, insurance companies are motivated to engage in shadow insurance transactions — such as reinsurance with affiliated captives and offshore insurers with parental guarantees — to artificially boost their RBC ratio.

Publicly traded companies disclose risk-based capital information in their filed statutory annual statements and 10-K reports filed with the U.S. Securities and Exchange Commission, and discuss risk-based capital at their annual investor days and on their public earnings calls. Additionally, regulators and rating agencies consider RBC as they determine a company's financial strength rating. Parent insurance companies that provide minimum capital guarantees for their subsidiaries or affiliate companies also usually tie the guarantees to a percentage of RBC (e.g., a guarantee to maintain 350 percent RBC-company action level).

Companies can use shadow insurance in a number of ways to artificially boost their RBC levels. In a common scenario, the insurer reinsures a block of policies with an affiliated captive. The original insurer then receives a commission, as well as other capital boosts, equal to the amount that the transaction has effectively lowered its reserve requirements. That commission is then counted as "retained earnings" for accounting purposes — which is a form of capital — even though the firm is essentially paying a commission to itself.

Specific details about the impact of shadow insurance on RBC levels at the 17 firms engaging in that practice are available in Section I. D of this report.

D. Details of Findings

1. Insurers Reporting Direct Reinsurance with Affiliated Captives/Offshore Insurers

As noted in Section I. B of this report, the Department's inquiry revealed eight New York-based insurers that reported direct reinsurance activity with affiliated captives and offshore insurers that involved some form of parental guarantee. The New York-based insurers reported direct transactions that used some form of parental guarantee which, in the aggregate, totaled

nearly $15 billion. In addition, five of those eight New York-based insurers also reported that their non-New York affiliate insurers engaged in transactions that used some form of parental guarantee, which, in the aggregate, totaled an additional $18 billion. The activity of each of the eight insurers and their affiliates is described in greater detail below.

Case 1

A New York-based life insurer reported $1,184,000,000 in LOCs that were used by captives and offshore affiliates that were backed by "contractual parental guarantees" from its ultimate parent. In addition, this insurer entered into a treaty with a captive whereby the captive issued surplus notes in the amount of $1,850,000,000 to fund part of the transaction. The performance of the surplus notes was indemnified by the ultimate parent using a Total Rate of Return Swap. As a result of these transactions, the insurer improved its RBC by 109 percent as of December 31, 2011. The total amount of LOCs and surplus notes guaranteed represents about 22 percent of the New York-based insurer's capital and surplus as of December 31, 2011.

With respect to other non-New York-based U.S. affiliates in the same holding company system, the insurer reported $5.9 billion in LOCs that were issued by affiliated captives and offshore reinsurers that were backed by "contractual parental guarantees" from the ultimate parent. As a result of these transactions, the non-New York-based affiliates have increased their RBC ratios individually in amounts ranging from 211.3 percent to 634.0 percent as of December 31, 2011.

This insurer reported that on a consolidated basis its RBC increased 150.8 percent as a result of reinsurance with affiliated captive and offshore reinsurers.

In addition, the insurer also reported that its captive affiliates reported LOCs as an admitted asset in the amounts of $315 million for New York-based activity and $4.1 billion for non-New York-based affiliate activity.

Case 2

A New York-based life insurer reported $216,000,000 in LOCs that were issued by affiliated captives and offshore reinsurers and were backed by "contractual parental guarantees" from the ultimate parent. As a result of these transactions, the insurer improved its RBC by 294.5 percent as of December 31, 2011. The total amount of LOCs guaranteed exceeds the cedent's capital and surplus as of December 31, 2011. The New York-based insurer reported that $85 million of LOCs were reported as assets by the captive reinsurer.

Case 3

A New York-based life insurer reported $129,350,000 in LOCs that were issued by affiliated captives and were backed by "contractual parental guarantees." As a result, the

insurer's RBC increased 538 percent. The total amount of LOCs guaranteed *exceeds the insurer's entire capital and surplus* as of December 31, 2011.

With respect to other non-New York-based U.S. affiliates, this insurer reported $529.3 million in LOCs that were backed by "contractual parental guarantees" and $391 million in conditional LOCs that they reported had no parental guarantees. The insurer reported a total increase of 137 percent in its RBC from these transactions.

Further, the insurer indicated that its captive affiliates report LOCs as an admitted asset in the states that allow such reporting.

Case 4

A New York-based life insurer reported $1.9 billion in LOCs that were issued by affiliated captives as collateral for two treaties and were backed by "contractual parental guarantees" from an affiliate. The insurer reported an increase of 127 percent in its RBC as a result of these treaties. The LOC amount represents about 41 percent of capital and surplus as of December 31, 2011. In addition, the New York-based insurer reported an $8.1 billion trust used for collateral for reserve credit, which has indemnification from an affiliate of the insurer used to hedge GMIB exposure.

Case 5

A New York-based life insurer reported $958,273,155 in LOCs issued by an offshore affiliate, where the parent is a co-applicant on the LOC. The New York-based insurer reported an increase of 97 percent in its RBC as a result of this treaty. The LOC amount *exceeds the insurer's entire capital and surplus* as of December 31, 2011.

With respect to other non-New York-based U.S. affiliates in its holding company system, an insurer entered into three treaties with an affiliated captive that used a parental "indemnification" with respect to surplus notes issued by the captive in the amount of $1.9 billion to fund a trust, which, taken together, increased its RBC by 26 percent. The insurer also entered into a treaty with an affiliated captive that used a naked parental guarantee in the amount of $1.6 billion for support of reserve credit, which increased its RBC by 17 percent. There are also many other reinsurance transactions within this holding company system where the parent is a co-applicant for $3.3 billion in LOCs used as collateral for reserve credits that increased RBC by a total amount of 261 percent.

In addition, the insurer reported that its non-New York-based affiliates have used conditional LOCs. Further, the insurer indicated that its captive affiliates report LOCs and naked parental guarantees as admitted assets in the states that allow such reporting.

Case 6

A New York-based life insurer reported $408.7 million in LOCs issued by an offshore affiliate backed by a contractual parental guarantee. The LOC amount represents about 22 percent of this insurer's capital and surplus as of December 31, 2011.

With respect to other non-New York-based U.S. affiliates, $243 million in LOCs backed by a contractual parental guarantee were issued.

Case 7

A New York-based life insurer reported LOCs in the total amount of $154 million as of December 31, 2011 for two treaties. There is a contractual parental guarantee in the form of a capital maintenance agreement that requires the parent to adequately maintain the capital and surplus of the affiliate reinsurer (it is noted that capital maintenance agreements can exist separate from any reinsurance arrangement). Total RBC impact of the reinsurance was an increase of about 64 percent and the LOC amount represents about 17 percent of capital and surplus as of December 31, 2011.

With respect to the other non-New York-based insurers in the group, capital maintenance agreements were also used to support other collateral arrangements.

Case 8

A New York-based life insurer reported a LOC in the amount of $70 million as of December 31, 2011 for a treaty with an offshore captive that has a contractual parental guarantee.

With respect to the non-New York-based affiliates in its holding company system, an affiliate had several treaties with captives and offshore affiliates. The transactions included contractual parental guarantees in the amount of $1.8 billion, and $500,000 in LOCs and a $474 million trust with no parental guarantees.

In addition, this insurer reported that its non-New York-based affiliates use conditional LOCs. Further, the insurer indicated that its captive affiliates report LOCs as an admitted asset in the states that allow such reporting.

* * *

In total, eight New York-based insurers reported direct reinsurance with affiliated captives and affiliated offshore reinsurers involving some form of parental guarantee totaling nearly $15 billion.

Table 5 summarizes the artificial boosts in risk-based capital buffers from the transactions by the eight New York-based insurers that reported direct activity utilizing some form of parental guarantee (or credit reimbursement agreement).

Table 5: Direct Activity by Individual New York-Based Insurers

Case*	LOCs with Credit Reimbursement Agreements	Surplus Note Guarantees/ Trust Indemnification	Naked Parental Guarantees	Total Amount of Collateral/ Approximate Reserve Credit	Reported RBC Percent Increase
Case 1	$1,184,000,000	$1,850,000,000	0	$3,034,000,000	132%
Case 2	$216,000,000	0	0	$216,000,000	1,111%
Case 3	$129,350,000	0	0	$129,350,000	538%
Case 4	$1,908,005,543	$8,173,500,000	0	$10,081,505,543	127%
Case 5	$958,273,155	0	0	$958,273,155	97%
Case 6	$408,726,594	0	0	$408,726,594	0.62%
Case 8	$70,000,000	0	0	$70,000,000	1 %
Total	$4,874,355,292	$10,023,500,000	0	$14,897,855,292	

*Not included in this table is a case involving a capital maintenance agreement (*see* Case 7 above) that is explicitly tied to the affiliated offshore reinsurer's ability to secure a letter of credit.

The New York-authorized insurers that reported direct reinsurance with affiliated captives and affiliated offshore reinsurers reported direct reinsurance arrangements with guarantees ranging from $70 million to over $10 billion with increases in the RBC ratios up to more than 1,100 percent. The average increase of the RBC ratio was about 287 percent.

Five of the eight New York-based insurers noted above also reported non-New York affiliate reinsurance with affiliated captives and offshore reinsurers involving some form of parental guarantees totaling an additional $18 billion. (*See* Table 6.)

Table 6: Activity by Non-New York Affiliates of New York-Based Insurers

Case	LOCs with Credit Reimbursement Agreements	Surplus Note Guarantees/ Trust Indemnificatio n	Naked Parental Guarantees	Total Amount of Collateral/ Approximate Reserve Credit	Reported RBC Percent Increase*
Case 1 Affiliates	$5,925,685,769	$2,797,000,000	0	$8,722,685,769	758%
Case 3 Affiliates	$529,300,000	0	0	$529,300,000	85%
Case 5 Affiliates	$3,364,297,112	$1,891,474,947	$1,616,883,275	$6,872,655,334	304%
Case 6 Affiliates	$243,706,386	0	0	$243,706,386	0.94%

Case 8 Affiliates	$1,841,071,300	0	0	$1,841,071,300	33%
Total	$11,904,060,567	$4,688,474,947	$1,616,883,275	$18,209,418,789	

*Amounts are cumulative for all non-New York-based affiliates

The New York-authorized life insurers that reported direct activity (as shown in Table 5) that also reported activity by non-New York affiliates reported increases in RBC for their affiliates up to 758 percent in the aggregate. The average increase in RBC was about 236 percent.

2. Insurers Reporting Only Non-New York Affiliate Reinsurance with Affiliated Captives/Offshore Insurers

As noted in Section I. B of this report, the Department's investigation revealed nine New York-based insurers that reported transactions only by non-New York-based affiliates in their holding company system that involved some form of parental guarantee. The total amount of parental guarantees reported by these nine insurers for their non-New York-based affiliates amounts to approximately $14.8 billion. Each of those instances is described below.

Case 9

The insurer reported about $4.7 billion in LOCs with parental guarantees and about $2.2 billion in surplus notes issued that were "indemnity guaranteed" by the parent.

With respect to whether the New York-based insurer engaged in any two-step transactions, the insurer stated:

> There is a treaty . . . whereby a non-domestic insurer assumed business from a domestic insurer which it then retroceded to an affiliated captive involving $95 million in contractual parental guarantees. There is second treaty . . . whereby the non-domestic insurer assumed business from the NY domestic which it then retroceded to an affiliated captive involving $400 million in contractual parental guarantees. There is a third treaty . . . whereby the non-domestic insurer assumed business from the NY domestic insurer which it then retroceded to an affiliated captive involving $232 million in contractual parental guarantees.

The above response makes clear that although the New York-based insurer did not report any direct activity involving parental guarantees by the New York domestic, risks of the New York-based insurer are ultimately being guaranteed by the parent through retrocessions within the holding company.

In addition, the insurer reported that its captive affiliates report LOCs as admitted assets in the states that allow such arrangements.

Case 10

A non-New York-based insurer that has a New York affiliate insurer entered into a treaty with an offshore reinsurer using a trust with collateral of approximately $362 million, $82 million of which would not meet either New York regulations or NAIC guidance for acceptable forms of collateral. However, the non-conforming collateral was accepted by the non-domiciliary state regulator because an affiliate guaranteed the $82 million in non-conforming collateral.

In three other treaties with an affiliated captive, the non-New York-based insurer used LOCs totaling $1.48 billion as collateral. The LOCs that were issued do not meet the requirements for an unconditional LOC, and would therefore be contrary to New York regulation, as well as NAIC guidance. Yet the domiciliary state regulator approved the LOCs as another form of acceptable collateral. Also, the state in which the captive is domiciled granted the captive a permitted practice to record the LOCs as an asset.

Further, the non-New York-based insurer entered into a reinsurance treaty with a captive using a trust for collateral that was funded by the issuance of $1.1 billion in surplus notes. The non-New York-based insurer entered into an agreement with the financial guarantor of the surplus notes to indemnify the captive, the financial guarantor, and other parties to the transaction.

The non-New York-based insurer also entered into another reinsurance treaty with a captive that used a trust as collateral, which was funded from the issuance of $315 million in surplus notes by the captive. The ultimate parent corporation then entered into a Liquidity Commitment Agreement with the captive and the capital market investors that guaranteed the market value of the assets held in the trust. In addition, the ultimate parent entered into a limited guaranty with the captive under which the ultimate parent guaranteed that the captive will receive a prescribed rate of return on certain Modco reinsurance assets. The intent of the limited guaranty is to mitigate credit/interest rate risk within the captive. The Department views these agreements as parental guarantees of the collateral used in the reinsurance transaction.

With respect to the question whether the insurer engaged in any two-step transactions, the insurer stated:

> The NY domestic cedes term business to an affiliate, who retrocedes the business to various captive reinsurers. All of the collateral used in the two-step transactions received either parental guarantee or indemnification . . . .

The above response makes it clear that although the New York-based insurer did not report any direct activity involving parental guarantees by the New York domestic, risks of the New York-based insurer that are reinsured to the affiliated non-New York-based insurer are ultimately being guaranteed by the parent through retrocessions within the holding company.

In addition, the insurer reported that its non-New York-based affiliates use conditional LOCs and that its captive affiliates report LOCs as admitted assets in the states that allow such reporting.

Case 11

A non-New York-based affiliate of a New York insurer entered into a reinsurance transaction with an affiliated captive reinsurer whereby an LOC in the amount of $130,040,984 was issued that had a contractual parental guarantee. The insurer reported an approximately 30 percent increase in RBC for this reinsurance.

Case 12

Two non-New York-based affiliates of a New York insurer entered into two separate reinsurance transactions with an affiliated offshore reinsurer whereby two LOCs totaling $198,000,000 were issued that had contractual parental guarantees. The insurer reported an increase in RBC of approximately 3.01 percent for these two transactions.

Case 13

A non-New York-based affiliate of a New York insurer entered into a treaty with an offshore affiliate using as collateral an LOC in the amount of $370 million and a trust in the amount of $2.08 billion, which was secured by a contractual parental guarantee and parental indemnification of the bonds issued to fund the trust. In another transaction, the same affiliate entered into a treaty with an affiliated captive reinsurer whereby the collateral in the form of a $1.2 billion trust was funded by the issuance of debt that was ultimately guaranteed by the parent corporation. In addition, a transaction between a different non-New York-based affiliate and an offshore affiliate reinsurer used an LOC in the amount of $213 million, which was secured by a contractual parental guarantee. The insurer reported no RBC impact on the first transaction, and a 208 percent and 63 percent increase for the last two treaties, respectively.

Case 14

A non-New York-based affiliate of a New York insurer entered into a treaty with an offshore captive reinsurer whereby an LOC in the amount of $25.3 million was used as collateral for reserve credit purposes that had a "contractual parental guarantee." The insurer reported an increase in its RBC ratio of 434 percent. In another transaction, the same non-New York-based affiliate entered into a treaty with a different offshore captive reinsurer, whereby a trust used as collateral in the amount of $127,769,311 was funded by surplus notes that had parental

indemnification. The insurer reported an increase in its RBC ratio of 360 percent. Also, in another treaty between a non-New York-based affiliate and an affiliated U.S. captive reinsurer, an LOC in the amount of $1.14 billion was used as collateral for reserve credit purposes that had a "contractual parental guarantee."

Case 15

A non-New York-based affiliate of a New York insurer entered into a treaty with an offshore captive reinsurer whereby a trust in the amount of $813 million was used as collateral. The trust was funded from the issuance and guarantee of bonds by the parent of the cedent.

Case 16

Two non-New York-based affiliates of a New York insurer entered into two separate treaties with a U.S. affiliated captive. The reserve credit taken with respect to the two treaties was secured by an Affiliate Guarantee by an entity within the holding company system in the amount of $100.8 million. The amount of the Affiliate Guarantee was recorded as an asset in the financial statements of the reinsurer.

Case 17

A non-New York-based affiliate of a New York insurer entered into a treaty with a U.S.-affiliated captive whereby the reserve credit was secured by an LOC in the amount of $450 million. The LOC is conditional and has a partial contractual parental guarantee for payment of only the LOC fees. The LOC is recorded in the financial statements as an asset of the reinsurer. The insurer reported an RBC increase of 500 percent for this transaction.

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In total, nine New York-based insurers reported that only non-New York-based affiliates in their holding company systems had reinsurance transactions with affiliated captives and offshore reinsurers involving some form of parental guarantee, totaling approximately $15 billion.

Table 7 summarizes the artificial boosts in capital realized from the transactions involving non-New York-based affiliates utilizing parental guarantees, as reported by nine New York-based insurers.

Table 7: Activity limited to Non-New York-Based Affiliates

Case	LOCs with Credit Reimbursement Agreements	Surplus Note Guarantees/ Trust Indemnification	Naked Parental Guarantees	Total Amount of Collateral/ Approximate Reserve Credit	Reported RBC Percent Increase*
Case 9 Affiliates	$4,745,590,260	$2,212,000,000	0	$6,957,590,260	30%
Case 10 Affiliates	0	$1,480,000,000	0	$1,480,000,000	-256%
Case 11 Affiliates	$130,040,984	0	0	$130,040,984	30%
Case 12 Affiliates	$198,000,000	0	0	$198,000,000	3.01%
Case 13 Affiliates	$583,000,000	$3,280,000,000	0	$3,863,000,000	271%
Case 14 Affiliates	$1,173,300,000	$127,769,311	0	$1,301,069,311	794%
Case 15 Affiliates	0	$813,000,000	0	$813,000,000	355%
Case 16 Affiliates	0	0	$100,807,387	$100,807,387	0%
Case 17 Affiliates	$450,000,000	0	0	$450,000,000	500%
Total	$7,279,931,244	$9,167,797,695	$100,807,387	$15,293,507,942	

*Amounts are cumulative for all non-New York-based affiliates

New York-based life insurers that only reported activity by non-New York-based affiliates reported increases in RBC for those affiliates ranging from 0 percent to 794 percent in the aggregate (excluding one outlier reporting negative changes). The average increase in RBC was about 248 percent.

II. INVESTIGATION INTO LACK OF TRANSPARENCY SURROUNDING SHADOW INSURANCE

A. Scope of Transparency Investigation

DFS required the 17 New York-based life insurers that reported reinsurance activity utilizing parental guarantees in connection with affiliated captive or affiliated offshore reinsurers to provide additional information. The Department sought to determine the extent that parental guarantees through shadow insurance are disclosed in publicly available documents. To that end, the Department requested the following information:

1. Whether the parental guarantees they reported were specifically disclosed in the ceding insurer's statutory financial statements; in those of any entity within the holding company system; or in any filing that is available to investors, policyholders, or any other segment of the public. If so, what these disclosures were and whether and to what extent reserves have been set aside to support those parental guarantees within the holding company system. If no disclosure was made, the Department requested a detailed explanation as to why not.

2. Whether information regarding the parental guarantees referenced was provided to the ceding insurer's certified public accountants ("CPAs") during their annual review and any such documentation or other information shared with the CPAs. If no information was provided to the CPAs, the Department requested a detailed explanation as to why not. The Department also requested the contact information for the insurer's CPA firm.

B. Findings of Disclosure Inquiry

Of the 17 insurers that responded, the Department carefully reviewed the adequacy and extent of the disclosure. The Department assessed the sufficiency of the disclosures by rating them as either good, fair, or poor. The evaluation criteria are set forth in the following chart.

Disclosure Evaluation Criteria

Type of Disclosure	Information typically included:
"Good"	• Tables (or another clear format) identifying reinsurers in the holding company system that were using LOCs as collateral for reinsurance transactions with affiliates; • Expiration date of the LOCs; • Each reinsurance affiliate's borrowing capacity for LOCs; • Amount of LOCs issued for each reinsurance affiliate; • Amount of draw downs to date on each LOC; • Amount of unused commitments; • Committed borrowing facilities that are used for collateral for affiliated reinsurance liabilities, and lists the fees paid for such facilities; • Identification of the entity that is the ultimate guarantor of the issued LOCs; and • For collateral financing arrangements, description of the reinsurance transaction in detail, the risk-takers and financial institutions involved, financing interest rates, surplus note arrangements, pledges or guarantees, and repayment methods.
"Fair"	• Description, in paragraph form, stating that the ultimate parent maintains LOC facilities with third-party banks to support the reinsurance obligations of onshore captive subsidiaries and/or offshore affiliates. Includes total amounts for all reinsurance captives and how much has been utilized and how much is guaranteed; • Description, in paragraph form, of total amounts of all collateral financing arrangements for all transactions whereby the ultimate parent is the guarantor; and • Moderate detail of certain transactions, but not in an easily understood tabular format.
"Poor"	• Description in paragraph format of the existence by the ultimate parent of credit facilities for general corporate purposes with total amounts committed and utilized; and • Very brief description of reinsurance transactions that are indemnified, or guaranteed by the ultimate parent.

The following table summarizes where the disclosures were made — the statutory annual statement, SEC reporting, and/or consolidated annual report — as well as the amounts of the associated parental guarantees. Only three of the 17 reporting insurers made disclosures in all three places (i.e., statutory statement, SEC filing, and annual report). And only three other insurers made disclosures in even two of the three statements (SEC filing and annual report).

Table 8: Disclosure Request Responses

Guarantee Amounts (Approx.)	Statutory Statement Disclosure	SEC Disclosure	Consolidated Annual Report Disclosure
$12 billion	None	Yes/Good	Yes/Good
$216 million	None	Yes/Good	Yes/Good
$659 million	None	None	None
$10 billion	None	Yes/Fair	None
$2 billion	None	None	None
$8 billion	Yes/Poor	Yes/Poor	Yes/Fair
$652 million	Yes (cedent)/Good	Yes/Good	Yes/Good
$130 million	Yes (parent)/Good	None	None
$1.5 billion	Yes (cedent/reinsurer)/Good	Yes/Poor	Yes/Poor
$450 million	None	Yes/Good	None
$198 million	None	Yes/Good	None
$6.5 billion	None	Yes/Fair	None
$4 billion	None	Yes/Poor	Yes/Poor
$1.3 billion	None	None	Yes/Poor
$813 million	None	None	None
$100 million	Yes (reinsurer)/Fair	None	None
Used Capital Maintenance Agreement	None	None	None

Twelve of the 17 responding insurers stated that they made no disclosure in the statutory financial statements filed with state insurance regulators, *each generally claiming that disclosure of the guarantee obligations of an insurer's ultimate parent company is not required by applicable statutory accounting guidance.*

DFS's investigation revealed that New York-based insurers and their non-New York-based affiliates failed to disclose nearly 80 percent ($38 billion) of the $48 billion in reserve collateral secured by parental guarantees in their statutory annual statements. And even where disclosure may have been made in some form to state insurance regulators, most states have laws that provide for strict confidentiality of the financial information of a captive.

Only five of the 17 responses showed any disclosure in either the cedent's, reinsurer's or ultimate parent's statutory financial statement filed with state insurance regulators. And of those, only three made what DFS considers "good" disclosure.

Ten of the 17 responding insurers asserted that their holding company made relevant disclosures in SEC filings. DFS reviewed those SEC disclosures, however, and found that only five of them were what DFS would consider a "good" disclosure. The other five disclosures were either "fair" or "poor." Seven insurers made no disclosure whatsoever of parental guarantees in any disclosures in their filings with the SEC.

Ten of the 17 responding insurers made no disclosure in their annual reports. While seven stated that they made some disclosure in the annual reports, only three of those were what the Department considers a "good" disclosure.

All 17 of the responding insurers reported that the information concerning their reinsurance collateral arrangements and parental guarantees was provided to their CPAs.

Perhaps most troubling, none of the 17 responses demonstrated that significant reserves or contingent liabilities have been established for the parental guarantees. Sixteen reported no reserves or contingent liabilities whatsoever. One responding insurer, which has about $1.5 billion in total parental guarantees, reported setting up a reserve of only $6 million for one of its guarantees. This lack of reserves for the parental guarantees is exceedingly troublesome because of the potential unfunded liability that would be incurred by the parent company should a drawdown of a letter of credit occur, which could lead to a liquidity issue within the holding company — and thus adversely impact policyholders with ties throughout the holding company system — should a bank demand immediate repayment from the parent company after the drawdown.

III. RECOMMENDATIONS

Given the troubling findings uncovered during its investigation, DFS is taking immediate action and making several recommendations to address the potential risks and lack of transparency surrounding shadow insurance:

- Through its authority under New York Insurance Law, DFS will require detailed disclosure of shadow insurance transactions by New York-based insurers and their affiliates.

- In the interest of national uniformity, the National Association of Insurance Commissioners ("NAIC") should develop enhanced disclosure requirements for shadow insurance across the country.

- The Federal Insurance Office ("FIO"), Office of Financial Research ("OFR"), the NAIC, and other state insurance commissioners should conduct similar investigations to document a more complete picture of the full extent of shadow insurance written nationwide.

- State insurance commissioners should consider an *immediate national moratorium* on approving additional shadow insurance transactions until those investigations are complete and a fuller picture emerges.

Attachment 3

Minimum Capital and Surplus Requirements by Type of Captive[1] Top Ten U.S. Domiciles										
	VT 8 V.S.A. §6004.	**UT** Utah Code Ann. §§31A-37-204 and 205.	**HI** HRS §431:19-104.	**SC** S.C. Code Ann. §§38-90-40 and 50.	**KY** KRS §304.49-040.	**NV** Nev. Rev. Stat. Ann. §694C. 250.	**DE** 18 Del. C. §6905.	**AZ** A.R.S. §20-1098.03.	**D.C.** D.C. Code §31-3931.06.	**MT** 33-28-104, MCA.
Pure	$250K	$250K	$100K-$250K	$250K	$250K	$200K	$250K	$250K	$250K	$250K
Association	$500K	$750K	$500K	$750K-$1.150M	$500K	$500K	$750K	$500K	$400K - $600K	$500K
Industrial	$500K	$500K		$500K-$700K	$500K		$500K			$500K
Sponsored	$500K	$1M	$500K	$1M	$500K	$500K	$500K			
Reciprocal		$1M								
Single-Parent								$250K	$100K	
Agency					$500K	$600K	$250K	$500K	$400K	
Protected Cell			$500K					$500K	$100K*	$250K
Special Purpose Financial		**	$500K	**	$250K		$250K	$250K		
Branch							$250K			$250K
Reinsurance		Not less than the greater of $300M or 10% of the reserves. (§31A-37-603)		**				½ above amounts		$125K
RRG	$1M		$500K				$1M	$500K		$500K
Rental						$800K			$400K	

* This is the capital amount only, surplus amount to be determined by Commissioner.
** Capital and surplus amount to be determined by Commissioner.

[1] Blanks in the table mean that either this type of captive is not available in that state or the state does not require a minimum capitalization requirement. Additionally, the amounts listed in this table reflect minimum requirements and could be subject to additional requirements depending on the type, volume, and nature of the insurance business transacted.

Attachment 4 **Comparison of Permitted Coverages for Captives – Top Ten U.S. Captive Domiciles**	
VT	Permits: life, health, casualty (except workers' compensation), marine and transportation, marine protection and indemnity, wet marine and transportation, property, surety, title, and annuity contracts. Captives may not write personal motor vehicle or homeowner's insurance. A captive may provide excess workers' compensation insurance to parent or affiliated company unless it is prohibited by federal law or laws of the state having jurisdiction. A captive may reinsure workers' compensation of qualified self-insured plan of its parent and affiliated companies unless prohibited by federal law. 8 V.S.A. §6002
UT	Permits all lines of insurance authorized by the insurance code except workers' compensation insurance, personal motor vehicle, and homeowners' insurance. Utah Code Ann. §31A-37-202.
HI	Permits: casualty, marine and transportation, marine protection and indemnity, wet marine and transportation, property, surety, title, credit life, credit disability, and other lines of insurance that the commissioner may allow. With limited exceptions, may not provide personal motor vehicle or homeowner's insurance. HRS §431:19-102. A captive may be licensed to provide personal lines if the commissioner deems that extraordinary circumstances exist which make it appropriate and in the best interest of the public. HRS §431:19-102.2
SC	Permits all lines of insurance authorized by the insurance title, except workers' compensation written on a direct basis, personal motor vehicle and homeowner's insurance. SPVs may provide insurance or reinsurance, or both, for risks as approved by the director. S.C. Code Ann. §38-90-20.
KY	Permits all lines of insurance defined in the insurance code except for except workers' compensation written on a direct basis, personal motor vehicle and homeowner's insurance coverage. May provide excess workers' compensation to a parent or affiliated companies if not prohibited by federal or state law. May reinsurer workers' compensation of a qualified self-insured plan for parent or affiliated company unless prohibited by federal law. KRS §304.49-020.
NV	Permits casualty, continuous care coverage, health, life, marine and transportation, property, surety and title. Prohibits writing direct personal motor vehicle or homeowner's insurance coverage. May provide excess workers' compensation to its parent or affiliated companies if not prohibited by federal or state law. May reinsure workers' compensation of a qualified self-insured plan for parent or affiliated company unless prohibited by federal law. Nev. Rev. Stat. Ann. §694C.300.
DE	Permits all life, health, property, surety, casualty (except workers' compensation), marine and transportation, title and annuities. No captive may provide personal motor vehicle or homeowner's insurance. May provide excess workers' compensation to its parent or affiliated companies if not prohibited by federal or state law. May reinsurer workers' compensation of a qualified self-insured plan for parent or affiliated company unless prohibited by federal law. 18 Del. C. §6903.
AZ	Permits commercial property and casualty, surety, life and disability except that a captive shall not directly insure: hospital service corporations, medical service corporations, dental service corporations, optometric service corporations or hospital, medical, dental and optometric service corporations, health care services organizations, prepaid dental plan organizations, prepaid legal insurance contracts, title, personal motor vehicle or homeowner's insurance, mortgage guaranty, workers' compensation or employers' liability, except in connection with a self-insurance program. Captives may directly insure deductible reimbursement risk and employer practices liability risk. A.R.S. §20-1098.01.
DC	Permits any insurance or annuity business except direct personal motor vehicle or homeowners' coverage. May offer excess workers' compensation to parents and affiliates. May reinsure workers' compensation pursuant to a program of self-funded insurance. D.C. Code §31-3931.02.
MT	Permits property, casualty, life, disability income, surety, marine, and health insurance or a group health plan except that: an SPV may not provide insurance or reinsurance for risks unless approved by the commissioner. Captive may not provide personal lines of insurance, including motor vehicle and homeowner's insurance, accept or cede reinsurance except according to state law, provide health insurance coverage or group health plan unless providing for its parent or affiliated companies, or write workers' compensation on a direct basis. 33-28-102, MCA.

Attachment 5

	Comparison of Premium Tax Rates – Top Ten U.S. Captive Domiciles									
	VT 8 V.S.A. §6014.	**UT** Utah Code Ann. §31A-37-202.	**HI** HRS §431:19-116.	**SC** S.C. Code Ann. §38-90-140.	**KY** KRS §304.49-220.	**NV** Nev. Rev. Stat. Ann. §694C.450.	**DE** 18 Del. C. §6914.	**AZ** A.R.S. §20-1098.17.	**D.C.** D.C. Code §31-3931.12.	**MT** 33-28-201, MCA.
Prem. Tax	To $20M 0.380% $20M-$40M 0.285% $40M-$60M 0.190% $60M+ 0.072%	No premium tax (annual fee)	to $25M .250% $25M-$50M 0.150% $50M-$250M 0.050% $250M+ 0.0%	To $20M 0.400% $20M+ 0.300%	To $20M 0.40% $20M-$40M 0.30% $40M-$60M 0.20% $60M+ 0.075%	To $20M 0.400% $20M-$40M 0.200% $40M+ 0.075%	0.2% (max of $125,000)	No premium tax (annual fee)	To $25M .250% $25M-$50M 0.150% $50M+ 0.050%	To $20M 0.40% $20M+ 0.30%
Reins. Tax	None	None	None	To $20M 0.225% $20M-$40M 0.150% $40M-$60M 0.050% $60M+ 0.025%	None	To $20M 0.225% $20M-$40M 0.150% $40M+ 0.025%	0.1% (max $75,000)	None	To $25M 0.225% $25M-$50M 0.150% $50M+ 0.250%	To $20M 0.225% $20M-$40M 0.150% $40M+-.050%
Assumed Tax	To $20M 0.214% $20M-$40M 0.143% $40M-$60M 0.048% $60M+ 0.024%	None	None		To $20M 0.225% $20M-$40M 0.150% $40M-$60M 0.050% $60M+ 0.025%	None	None	None	None	None
Min./ Max. Tax	$7,500 / $200,000	None	No min. / $200,000	$5,000 / $100,000	$5,000 / No maximum	$5,000 / $175,000	$5,000 / $200,000	None	$7,500 / $100,000	$5,000 / $100,000
Other		Annual fee $5,000						Annual renewal fee $5,500	RRG premium tax rates	

Attachment 6

Comparison of Financial Reporting Requirements Top Ten U.S. Captive Domiciles										
	VT 8 V.S.A. §6007	**UT** Utah Code Ann. §31A-37-501	**HI** HRS §431:19-107	**SC** S.C. Code Ann. §38-90-70	**KY** KRS §304.49-070.	**NV** Nev. Rev. Stat. Ann. §694C.400.	**DE** 18 Del. C. §6907	**AZ** A.R.S. §20-1098.07.	**D.C.** D.C. Code §31-3931.13.	**MT** 33-28-107, MCA.
Statement of Actuarial Opinion	Required	Required	Required	Required	Required	Required	Required	Required except small company exemption and undue hardship waiver	Required	Required
Accounting Standards	GAAP unless Comm. requires, approves or accepts the use of other	GAAP unless Comm. requires, approves or accepts the use of other	GAAP or as deemed appro-priate by the Comm.	GAAP unless Comm. approves SAP	GAAP unless Comm. approves SAP or IAS.	GAAP	GAAP unless Comm. approves SAP or IAS	GAAP unless Director requires SAP	GAAP	GAAP unless Comm. requires SAP
Financial Exams frequency	3 years	3 years	1st exam at 3 years, after that 5 years	3 years	3-5 years	3 years	3-5 years	Whenever Director deter-mines it prudent.	5 years	5 years

Attachment 7

A BILL ENTITLED

AN ACT concerning

Insurance - Regulation of Captive Insurance Companies

For the purpose of specifying certain fees to be paid by certain insurers; establishing the Captive Insurance Companies subtitle under the Insurance Article; specifying a statement of policy; specifying certain definitions; permitting captive insurers to engage in certain types of business; prohibiting captive insurance companies from engaging in certain types of business; creating certain requirements for captive insurers; requiring an applicant for a certificate of authority as a captive insurer to pay certain fees; permitting the Commissioner to grant a certain certificate of authority under certain circumstances; specifying certain minimum surplus and capital requirements for captive insurers; requiring that dividends be paid in a certain manner; specifying that captive insurers may be formed as certain types of business entities; requiring certain information be filed with the Commissioner; requiring certain information be filed with the Department of Assessments and Taxation; specifying certain reports to be filed by a captive insurer; permitting the Commissioner to conduct certain examinations; permitting the Commissioner to refuse to renew, suspend or revoke the certificate of authority of a captive insurer under certain circumstances; permitting certain investments under certain circumstances; permitting the assumption of reinsurance under certain circumstances; prohibiting a captive insurer from participating in certain risk sharing pools; requiring a captive insurer to pay certain taxes; permitting the Commissioner to adopt certain regulations; permitting a captive insurer to redomesticate to the State under certain circumstances; creating the Captive Insurance Division within the Insurance Administration; creating the Captive Insurance Regulatory Fund; requiring certain funding be provided to the Captive Insurance Division; and generally relating to captive insurance companies.

By repealing and reenacting with amendments
Article- Insurance
Section 2-112
Annotated Code of Maryland
(2011 Replacement Volume and 2013 Supplement)

BY adding to
Article - Insurance
Section 25-501 through 25-526, inclusive, to be under the new subtitle
"Subtitle 5. Captive Insurance Companies"
Annotated Code of Maryland
(2013 Replacement Volume and 2013 Supplement)

SECTION 1. BE IT ENACTED BY THE GENERAL ASSEMBLY OF MARYLAND, That the Laws of Maryland read as follows:

Article - Insurance

2-112.

(a) Fees for the following certificates, licenses, and services shall be collected in advance by the Commissioner, and shall be paid by the appropriate persons to the Commissioner:

(1) fees for certificates of authority:

(i) application fee for initial certificate of authority, including filing the application, articles of incorporation and other charter documents, except as provided in item [(2)] (3) of this subsection, bylaws, financial statement, examination report, power of attorney to the Commissioner, and all other documents and filings in connection with the application..$1,000

(ii) fee for initial certificate of authority................................$200

(iii) fee for annual renewal of certificate of authority for all foreign insurers and for domestic insurers with their home or executive office in the State............$500

(iv) fee for annual renewal of certificate of authority for domestic insurers with their home or executive office outside the State, except those domestic insurers that had their home or executive office outside the State before January 1, 1929:

1. with premiums written in the most recent calendar year not exceeding $500,000... $2,500

2. with premiums written in the most recent calendar year not exceeding $1,000,000... ....$5,000

3. with premiums written in the most recent calendar year not exceeding $2,000,000... ....$7,000

4. with premiums written in the most recent calendar year not exceeding $5,000,000... ....$9,000

5. with premiums written in the most recent calendar year of more than $5,000,000.. $11,000

(v) reinstatement of certificate of authority...........................$500

(2) FEES FOR CERTIFICATE OF AUTHORITY AS A CAPTIVE INSURER:

(I) APPLICATION FEE FOR INITIAL CERTIFICATE OF AUTHORITY, INCLUDING FILING THE APPLICATION, ARTICLES OF INCORPORATION AND OTHER CHARTER DOCUMENTS, EXCEPT AS PROVIDED IN ITEM [(2)] (3) OF THIS SUBSECTION, BYLAWS, FINANCIAL STATEMENT, EXAMINATION REPORT, POWER OF ATTORNEY TO THE COMMISSIONER, AND ALL OTHER DOCUMENTS AND FILINGS IN CONNECTION WITH THE APPLICATION....................$1,000

(II) FEE FOR INITIAL CERTIFICATE OF AUTHORITY.........$200

(III) FEE FOR ANNUAL RENEWAL OF CERTIFICATE OF AUTHORITY FOR ALL CAPTIVE INSURERS WITH THEIR HOME OR EXECUTIVE OFFICE IN THE STATE....................$500

[(2)](3) fees for articles of incorporation of a domestic [insurer or] INSURER, foreign insurer, OR CAPTIVE INSURER, exclusive of fees required to be paid to the Department of Assessments and Taxation:

(i) fee for filing the articles of incorporation with the Commissioner for approval....................$25

(ii) fee for amendment of the articles of incorporation.................$10

[(3)](4) fees for filing bylaws or amendments to bylaws with the Commissioner....................$10

[(4)](5) fees for certificates of qualification:

(i) application fee....................$25

(ii) managing general agent certificate of qualification:

1. fee for initial certificate....................$30

2. annual renewal fee....................$30

(iii) surplus lines broker certificate of qualification:

1. fee for initial certificate within 1 year of renewal........$100

2. fee for initial certificate over 1 year from renewal......$100

3 biennial renewal fee....................$200

[(5)](6) fee for temporary insurance producer licenses and appointments....................$27

[(6)](7) fees for licenses:

(i) public adjuster license:

1. fee for initial license within 1 year of renewal............$25

2. fee for initial license over 1 year from renewal...........$50

3. biennial renewal fee..$50

(ii) adviser license:

1. fee for initial license within 1 year of renewal...........$100

2. fee for initial license over 1 year from renewal..........$200

3. biennial renewal fee...$200

(iii) insurance producer license:

1. fee for initial license..$54

2. biennial renewal fee..$54

(iv) application fee...$25

[(7)](8) fee for each insurance vending machine license, for each machine, every second year..$50

[(8)](9) fees for filing the annual statement by an unauthorized insurer applying for approval to become an accepted insurer or applying for approval to become an accepted reinsurer or surplus lines carrier or both..$1,000

[(9)](10) fees for required filings, including form and rate filings, under Title 11, Subtitles 2 through 4, Title 26, and §§ 12-203, 13-110, 14-126, and 27-605 of this article..$125

[(10)](11) service of legal process fee under §§ 3-318(b), 3-319(d), and 4-107 of this article..$15

(b) A court may award reimbursement of a service of process fee imposed under subsection **[(a)(10)] (A)(11)** of this section to a prevailing plaintiff in any proceeding against an insurer or surplus lines broker.

SUBTITLE 5. CAPTIVE INSURANCE COMPANIES

25-501.

THE PURPOSE OF THIS SUBTITLE IS:

(A) TO FACILITATE THE FORMATION AND OPERATION OF CAPTIVE INSURANCE COMPANIES WITHIN THE STATE;

(B) TO ENSURE RESPONSIBLE UTILIZATION OF THE CAPTIVE FORM AS A RISK MANAGEMENT TOOL;

(C) TO PROHIBIT TRANSACTIONS THAT DO NOT CONSTITUTE A LEGITIMATE TRANSFER OF RISK; AND

(D) TO ENCOURAGE RESPONSIBLE GROWTH IN THE CAPTIVE INSURANCE INDUSTRY IN THE STATE.

25-502.

(A) IN THIS SUBTITLE, THE FOLLOWING WORDS HAVE THE MEANING INDICATED.

(B) "AFFILIATE" HAS THE MEANING STATED IN § 7-101 OF THIS ARTICLE.

(C) "ASSOCIATION" MEANS ANY LEGAL ASSOCIATION OF INDIVIDUALS, OR OTHER BUSINESS ENTITIES, OF WHICH OR WHICH DOES ITSELF, WHETHER OR NOT IN CONJUNCTION WITH SOME OR ALL OF THE MEMBER ORGANIZATIONS:

(1) OWN, CONTROL, OR HOLD WITH POWER TO VOTE ALL OF THE OUTSTANDING VOTING SECURITIES OF AN ASSOCIATION CAPTIVE INSURER INCORPORATED AS A STOCK INSURER; OR

(2) HAVE COMPLETE VOTING CONTROL OVER AN ASSOCIATION CAPTIVE INSURER INCORPORATED AS A MUTUAL INSURER; OR

(3) CONSTITUTE ALL OF THE SUBSCRIBERS OF AN ASSOCIATION CAPTIVE INSURER FORMED AS A RECIPROCAL INSURER.

(D) "ASSOCIATION CAPTIVE INSURER" MEANS ANY COMPANY THAT INSURES ONLY THE RISKS OF THE MEMBER ORGANIZATIONS OF THE ASSOCIATION, AND THEIR AFFILIATES.

(E) "ASSUMED REINSURANCE" MEANS THE PORTION OF RISK ACCEPTED BY A CAPTIVE INSURER FROM THE ORIGINAL INSURER OR CEDING ENTITY.

(F) "BUSINESS ENTITY" MEANS A CORPORATION, PROFESSIONAL ASSOCIATION, PARTNERSHIP, LIMITED LIABILITY PARTNERSHIP, OR OTHER LEGAL ENTITY.

(G) "CAPTIVE INSURER" MEANS ANY PURE CAPTIVE INSURER, ASSOCIATION CAPTIVE INSURER, OR INDUSTRIAL INSURED CAPTIVE INSURER.

(H) "CONTROLLED UNAFFILIATED BUSINESS ENTITY" MEANS ANY BUSINESS ENTITY:

(1) THAT IS NOT IN THE CORPORATE SYSTEM OF A PARENT AND AFFILIATES;

(2) THAT HAS AN EXISTING CONTRACTUAL RELATIONSHIP WITH A PARENT OR AFFILIATE; AND

(3) WHOSE RISKS ARE MANAGED BY A PURE CAPTIVE INSURER IN ACCORDANCE WITH § 25-522 OF THIS SUBTITLE.

(I) "DEPARTMENT" MEANS THE DEPARTMENT OF ASSESSMENTS AND TAXATION.

(J) "EXCESS WORKERS' COMPENSATION INSURANCE" MEANS, IN THE CASE OF AN EMPLOYER THAT HAS INSURED OR SELF-INSURED ITS WORKERS' COMPENSATION RISKS IN ACCORDANCE WITH APPLICABLE STATE OR FEDERAL LAW, INSURANCE IN EXCESS OF A SPECIFIED PER-INCIDENT OR AGGREGATE LIMIT ESTABLISHED BY THE WORKERS' COMPENSATION COMMISSION OR UNDER THE LAW OF THE STATE IN WHICH THE INSURANCE IS CONTRACTED.

(K) "FUND" MEANS THE CAPTIVE INSURANCE REGULATORY FUND.

(L) "INDUSTRIAL INSURED" HAS THE MEANING INDICATED IN § 4-201(A) OF THIS ARTICLE.

(M) "INDUSTRIAL INSURED CAPTIVE INSURER" MEANS ANY COMPANY THAT INSURES RISKS OF THE INDUSTRIAL INSUREDS THAT COMPRISE THE INDUSTRIAL INSURED GROUP, AND THEIR AFFILIATED COMPANIES.

(N) "INDUSTRIAL INSURED GROUP" MEANS ANY GROUP OF INDUSTRIAL INSUREDS THAT COLLECTIVELY:

(1) OWN, CONTROL, OR HOLD WITH POWER TO VOTE ALL OF THE OUTSTANDING VOTING SECURITIES OF AN INDUSTRIAL INSURED CAPTIVE INSURER INCORPORATED AS A STOCK INSURER;

(2) HAVE COMPLETE VOTING CONTROL OVER AN INDUSTRIAL INSURED CAPTIVE INSURER INCORPORATED AS A MUTUAL INSURER; OR

(3) CONSTITUTE ALL OF THE SUBSCRIBERS OF AN INDUSTRIAL INSURED CAPTIVE INSURER FORMED AS A RECIPROCAL INSURER.

(O) "MEMBER ORGANIZATION" MEANS ANY INDIVIDUAL OR BUSINESS ENTITY THAT BELONGS TO AN ASSOCIATION.

(P) "MUTUAL INSURER" HAS THE MEANING STATED IN §1-101(BB).

(Q) "NET DIRECT PREMIUM" MEANS NEW AND RENEWAL GROSS DIRECT PREMIUMS LESS RETURNED PREMIUMS, INCLUDING DIVIDENDS ON UNABSORBED PREMIUMS OR PREMIUM DEPOSITS RETURNED OR CREDITED TO POLICYHOLDERS, WRITTEN BY THE CAPTIVE INSURER DURING THE PRECEDING CALENDAR YEAR.

(R) "PARENT" MEANS A BUSINESS ENTITY OR INDIVIDUAL, THAT DIRECTLY OR INDIRECTLY OWNS, CONTROLS, OR HOLDS WITH POWER TO VOTE MORE THAN 50% OF THE OUTSTANDING VOTING:

(1) SECURITIES OF A PURE CAPTIVE INSURER ORGANIZED AS A STOCK CORPORATION; OR

(2) MEMBER INTERESTS OF A PURE CAPTIVE INSURER ORGANIZED AS A NONSTOCK CORPORATION.

(S) "PURE CAPTIVE INSURER" MEANS ANY COMPANY THAT INSURES RISKS OF ITS PARENT AND AFFILIATES OR CONTROLLED UNAFFILIATED BUSINESS ENTITIES.

(T) "REDOMESTICATE" MEANS TO TRANSFER TO THE STATE THE INSURANCE DOMICILE OF A FOREIGN OR ALIEN CAPTIVE INSURER WHICH HOLDS A CERTIFICATE OF AUTHORITY OR LICENSE UNDER THE LAWS OF ANY OTHER STATE OR JURISDICTION.

25-503.

(A) EXCEPT AS PROVIDED IN THIS SUBTITLE, A CAPTIVE INSURER MAY ORGANIZE AND OPERATE IN ANY FORM OF BUSINESS ORGANIZATION AUTHORIZED UNDER THIS ARTICLE TO TRANSACT ANY INSURANCE BUSINESS AS AN INSURER.

(B) A CAPTIVE INSURER AUTHORIZED PURSUANT TO THIS SUBTITLE:

(1) MAY NOT PROVIDE ANY KIND OR COMPONENT OF PRIVATE PASSENGER MOTOR VEHICLE INSURANCE OR HOMEOWNER'S INSURANCE;

(2) MAY NOT ASSUME OR CEDE REINSURANCE, EXCEPT AS OTHERWISE PROVIDED IN § 25-516 OF THIS SUBTITLE;

(3) MAY NOT WRITE DIRECT WORKERS' COMPENSATION INSURANCE.

(4) MAY PROVIDE EXCESS WORKERS' COMPENSATION INSURANCE TO ITS PARENT AND AFFILIATES, UNLESS OTHERWISE PROHIBITED BY THE LAWS OF THE STATE IN WHICH THE INSURANCE IS CONTRACTED FOR;

(5) MAY REINSURE WORKERS' COMPENSATION INSURANCE PROVIDED UNDER A PROGRAM OF SELF-FUNDED INSURANCE OF ITS PARENT AND AFFILIATES IF:

(I) THE PARENT OR AFFILIATE PROVIDES THE SELF-FUNDED INSURANCE UNDER A SELF-FUNDED INSURANCE PLAN THAT IS APPROVED BY THE WORKERS' COMPENSATION COMMISSION IF THE INSURANCE IS BEING CONTRACTED FOR IN THE STATE; OR

(II) THE PROGRAM OF SELF-FUNDED INSURANCE IS OTHERWISE QUALIFIED UNDER, OR IN COMPLIANCE WITH, THE LAWS OF THE STATE IN WHICH THE INSURANCE IS CONTRACTED FOR;

(6) MAY NOT INSURE ANY RISKS OTHER THAN THOSE OF ITS PARENT AND AFFILIATES IF IT IS A PURE CAPTIVE INSURER;

(7) MAY NOT INSURE ANY RISKS OTHER THAN THOSE OF THE MEMBER ORGANIZATIONS OF ITS ASSOCIATION AND THE AFFILIATES OF THE MEMBER ORGANIZATIONS IF IT IS AN ASSOCIATION CAPTIVE INSURER;

(8) MAY NOT INSURE ANY RISKS OTHER THAN THOSE OF THE INDUSTRIAL INSUREDS THAT COMPRISE THE INDUSTRIAL INSURED GROUP, AND THEIR AFFILIATES IF IT IS AN INDUSTRIAL INSURED CAPTIVE INSURER; AND

(9) MAY NOT WRITE LIFE INSURANCE, HEALTH INSURANCE OR ANNUITIES AS DEFINED IN § 1-101 OF THIS ARTICLE.

25-504.

(A) A CAPTIVE INSURER MAY NOT ENGAGE IN THE INSURANCE BUSINESS IN THE STATE UNLESS:

(1) THE CAPTIVE INSURER HAS A CERTIFICATE OF AUTHORITY ISSUED BY THE COMMISSIONER;

(2) THE CAPTIVE INSURER'S BOARD OF DIRECTORS, OR, IN THE CASE OF A RECIPROCAL INSURER, THE SUBSCRIBERS' ADVISORY COMMITTEE, HOLDS AT LEAST ONE MEETING EACH YEAR IN THE STATE;

(3) THE CAPTIVE INSURER MAINTAINS ITS PRINCIPAL PLACE OF BUSINESS IN THE STATE;

(4) (I) SUBJECT TO SUBPARAGRAPH (II), THE CAPTIVE INSURER APPOINTS A RESIDENT AGENT TO ACCEPT SERVICE OF PROCESS AND TO OTHERWISE ACT ON ITS BEHALF IN THE STATE; AND

(II) WHENEVER THE RESIDENT AGENT CANNOT WITH REASONABLE DILIGENCE BE FOUND, THE COMMISSIONER SHALL ACCEPT ANY PROCESS ISSUED AGAINST THE CAPTIVE INSURER IN THE STATE;

(5) IN THE CASE OF A CAPTIVE INSURER:

(I) FORMED AS A CORPORATION, AT LEAST ONE OF THE MEMBERS OF THE BOARD OF DIRECTORS SHALL BE A RESIDENT OF THE STATE, OR;

(II) FORMED AS A RECIPROCAL INSURER, AT LEAST ONE OF THE MEMBERS OF THE SUBSCRIBERS' ADVISORY COMMITTEE SHALL BE A RESIDENT OF THE STATE.

(6) THE CAPTIVE INSURER HAS MADE ARRANGEMENTS SATISFACTORY TO THE COMMISSIONER WITH A BANK WHICH IS LOCATED IN THE STATE AND IS AUTHORIZED UNDER STATE OR FEDERAL LAW TO TRANSFER MONEY;

(7) THE CAPTIVE INSURER EMPLOYS OR HAS CONTRACTED WITH AN INDIVIDUAL OR BUSINESS ENTITY TO MANAGE THE AFFAIRS OF THE CAPTIVE INSURER THAT MEETS THE STANDARDS OF COMPETENCE AND EXPERIENCE SATISFACTORY TO THE COMMISSIONER;

(8) THE CAPTIVE INSURER EMPLOYS OR HAS CONTRACTED FOR THE SERVICES OF A QUALIFIED AND EXPERIENCED CERTIFIED PUBLIC

ACCOUNTANT OR A FIRM OF CERTIFIED PUBLIC ACCOUNTANTS THAT IS SATISFACTORY TO THE COMMISSIONER;

(9) THE CAPTIVE INSURER EMPLOYS OR HAS CONTRACTED FOR THE SERVICES OF A QUALIFIED AND EXPERIENCED ACTUARY OR ACTUARIAL FIRM THAT IS SATISFACTORY TO THE COMMISSIONER TO PERFORM REVIEWS AND EVALUATIONS OF THE OPERATIONS OF THE CAPTIVE INSURER; AND

(10) THE CAPTIVE INSURER EMPLOYS OR HAS CONTRACTED FOR THE SERVICES OF AN ATTORNEY WHO IS LICENSED TO PRACTICE LAW IN THE STATE AND IS SATISFACTORY TO THE COMMISSIONER.

(B) (1) BEFORE RECEIVING A CERTIFICATE OF AUTHORITY, A CAPTIVE INSURER SHALL:

(I) FILE WITH THE COMMISSIONER A CERTIFIED COPY OF ITS ORGANIZATIONAL DOCUMENTS, A STATEMENT UNDER OATH OF ITS PRESIDENT AND SECRETARY SHOWING ITS FINANCIAL CONDITION, A PRO FORMA FINANCIAL STATEMENT FOR THE FIRST 24 MONTHS OF ITS ANTICIPATED OPERATION THAT DEMONSTRATES ITS FINANCIAL VIABILITY BASED ON REASONABLE ASSUMPTIONS, ITS BUSINESS PLAN AND ANY OTHER STATEMENTS OR DOCUMENTS REQUIRED BY THE COMMISSIONER; AND

(II) SUBMIT TO THE COMMISSIONER FOR APPROVAL A DESCRIPTION OF THE COVERAGES, DEDUCTIBLES, COVERAGE LIMITS, AND RATES, INCLUDING AN ACTUARIAL REPORT PREPARED BY A QUALIFIED INDEPENDENT ACTUARY OR ACTUARIAL FIRM, TOGETHER WITH ANY ADDITIONAL INFORMATION THE COMMISSIONER MAY REQUIRE.

(2) IN THE EVENT OF ANY SUBSEQUENT MATERIAL CHANGE IN ANY ITEM SUBMITTED UNDER SUBSECTION (B)(1), THE CAPTIVE INSURER SHALL SUBMIT AN APPROPRIATE REVISION TO THE COMMISSIONER.

(3) EACH APPLICANT CAPTIVE INSURER SHALL ALSO FILE WITH THE COMMISSIONER EVIDENCE OF THE FOLLOWING:

(I) THE AMOUNT AND LIQUIDITY OF ITS ASSETS RELATIVE TO THE RISKS TO BE ASSUMED;

(II) THE ADEQUACY OF THE EXPERTISE, EXPERIENCE, AND CHARACTER OF THE INDIVIDUAL OR INDIVIDUALS WHO WILL MANAGE THE CAPTIVE INSURER;

(III) THE OVERALL SOUNDNESS OF ITS PLAN OF OPERATION;

(IV) THE ADEQUACY OF THE LOSS PREVENTION PROGRAMS OF ITS PARENT, MEMBER ORGANIZATIONS, OR INSUREDS AS APPLICABLE;

(V) MINIMUM CAPITAL AND SURPLUS REQUIREMENTS AS SET FORTH IN § 25-508 OF THIS SUBTITLE; AND

(VI) OTHER FACTORS DEEMED RELEVANT BY THE COMMISSIONER IN ASCERTAINING WHETHER THE PROPOSED CAPTIVE INSURER WILL BE ABLE TO MEET ITS POLICY OBLIGATIONS.

(4) SUBJECT TO PARAGRAPH (5) OF THIS SUBSECTION, INFORMATION SUBMITTED PURSUANT TO THIS SUBSECTION SHALL BE AND REMAIN CONFIDENTIAL, AND MAY NOT BE MADE PUBLIC BY THE COMMISSIONER OR AN EMPLOYEE OR AGENT OF THE COMMISSIONER WITHOUT THE WRITTEN CONSENT OF THE CAPTIVE INSURER.

(5) (I) SUBJECT TO SUBPARAGRAPH (II) OF THIS PARAGRAPH, THE COMMISSIONER MAY SHARE INFORMATION SUBMITTED PURSUANT TO THIS SUBSECTION ONLY WITH OTHER STATE, FEDERAL, OR INTERNATIONAL REGULATORY AGENCIES OR STATE, FEDERAL, OR INTERNATIONAL LAW ENFORCEMENT AUTHORITIES.

(II) A DISCLOSURE MAY BE MADE UNDER SUBPARAGRAPH (I) OF THIS PARAGRAPH ONLY IF:

1. THE DISCLOSURE IS MADE FOR REGULATORY, LAW ENFORCEMENT, OR PROSECUTORIAL PURPOSES;

2. THE AUTHORITY OR AGENCY RECEIVING THE INFORMATION AGREES IN WRITING TO KEEP THE INFORMATION CONFIDENTIAL AND IN A MANNER CONSISTENT WITH THIS SUBSECTION; AND

3. THE COMMISSIONER IS SATISFIED THAT THE AUTHORITY OR AGENCY HAS THE AUTHORITY TO KEEP THE INFORMATION CONFIDENTIAL AND WILL TAKE REASONABLE STEPS TO PRESERVE THE CONFIDENTIAL INFORMATION.

25-505.

(A) AN APPLICATION BY A CAPTIVE INSURER FOR A CERTIFICATE OF AUTHORITY SHALL INCLUDE THE FEE REQUIRED IN § 2-112 OF THIS ARTICLE.

(B) THE COMMISSIONER MAY, AS PART OF AN INITIAL APPLICATION OR UPON RENEWAL, AS NEEDED:

(1) RETAIN AN INDEPENDENT LEGAL, FINANCIAL, ACTUARIAL, OR OTHER EXPERT FROM OUTSIDE THE ADMINISTRATION TO REVIEW AND

MAKE RECOMMENDATIONS REGARDING THE APPLICANT'S QUALIFICATIONS; AND

(2) REQUIRE THE APPLICANT TO PAY THE COST OF THE SERVICES.

(C) A CAPTIVE INSURER SHALL PAY THE FEE REQUIRED IN § 2-112 OF THIS ARTICLE FOR THE ISSUANCE OF A CERTIFICATE OF AUTHORITY AND SHALL PAY THE FEE REQUIRED UNDER § 2-112 OF THIS ARTICLE FOR THE RENEWAL OF ITS CERTIFICATE OF AUTHORITY.

25-506.

IF THE COMMISSIONER IS SATISFIED THAT THE DOCUMENTS AND STATEMENTS THAT THE CAPTIVE INSURER HAS FILED COMPLY WITH THE PROVISIONS OF THIS SUBTITLE, THE COMMISSIONER MAY GRANT A CERTIFICATE OF AUTHORITY AUTHORIZING THE CAPTIVE INSURER TO ENGAGE IN INSURANCE BUSINESS IN THE STATE UNTIL THE FOLLOWING JUNE 30, AT WHICH TIME THE CAPTIVE INSURER MAY RENEW THE CERTIFICATE OF AUTHORITY.

25-507.

A CAPTIVE INSURER MAY NOT ADOPT A NAME THAT IS THE SAME, DECEPTIVELY SIMILAR TO, OR LIKELY TO BE CONFUSED WITH OR MISTAKEN FOR ANY OTHER EXISTING BUSINESS NAME REGISTERED IN THE STATE.

25-508.

(A) A CAPTIVE INSURER MAY NOT BE ISSUED A CERTIFICATE OF AUTHORITY UNLESS IT POSSESSES AND MAINTAINS UNIMPAIRED PAID-IN CAPITAL AND SURPLUS OF:

(1) IN THE CASE OF A PURE CAPTIVE INSURER, NOT LESS THAN $250,000;

(2) IN THE CASE OF AN ASSOCIATION CAPTIVE INSURER, NOT LESS THAN $750,000; AND

(3) IN THE CASE OF AN INDUSTRIAL INSURED CAPTIVE INSURER, NOT LESS THAN $500,000.

(B) THE COMMISSIONER MAY PRESCRIBE ADDITIONAL CAPITAL AND SURPLUS BASED UPON THE TYPE, VOLUME, AND NATURE OF INSURANCE BUSINESS TRANSACTED.

(C) CAPITAL AND SURPLUS MAY BE IN THE FORM OF:

(1) CASH;

(2) SECURITIES OF THE CLASSES DESCRIBED, AUTHORIZED AND LIMITED BY AMOUNT IN § 5-601 THROUGH § 5-609 OF THIS ARTICLE; OR

(3) AN IRREVOCABLE EVERGREEN LETTER OF CREDIT ISSUED:

(I) IN A FORM APPROVED BY THE COMMISSIONER; AND

(II) ISSUED BY A QUALIFIED UNITED STATES FINANCIAL INSTITUTION, AS DEFINED BY §5-901 OF THIS TITLE.

25-509.

(A) A CAPTIVE INSURER MAY NOT ISSUE A DIVIDEND OR OTHER DISTRIBUTION OUT OF CAPITAL OR SURPLUS WITHOUT THE PRIOR APPROVAL OF THE COMMISSIONER.

(B) APPROVAL OF AN ONGOING PLAN FOR THE PAYMENT OF DIVIDENDS OR OTHER DISTRIBUTIONS SHALL BE CONDITIONED UPON THE RETENTION, AT THE TIME OF EACH PAYMENT, OF CAPITAL OR SURPLUS IN EXCESS OF AMOUNTS SPECIFIED BY, OR DETERMINED IN ACCORDANCE WITH FORMULAS APPROVED BY THE COMMISSIONER.

25-510.

(A) A PURE CAPTIVE INSURER MAY BE INCORPORATED AS A STOCK INSURER WITH ITS CAPITAL DIVIDED INTO SHARES AND HELD BY THE STOCKHOLDERS, AS A NONSTOCK CORPORATION WITH ONE OR MORE MEMBERS.

(B) AN ASSOCIATION CAPTIVE INSURER OR AN INDUSTRIAL INSURED CAPTIVE INSURER MAY BE:

(1) INCORPORATED AS A STOCK INSURER WITH ITS CAPITAL DIVIDED INTO SHARES AND HELD BY THE STOCKHOLDERS;

(2) INCORPORATED AS A MUTUAL INSURER; OR

(3) ORGANIZED AS A RECIPROCAL INSURER IN ACCORDANCE WITH TITLE 3, SUBTITLE 2 OF THIS ARTICLE.

(C) THE CAPITAL STOCK OF A CAPTIVE INSURER INCORPORATED AS A STOCK INSURER MAY BE AUTHORIZED WITH NO PAR VALUE.

(D) A CAPTIVE INSURER INCORPORATED OR ORGANIZED IN THE STATE SHALL HAVE NOT LESS THAN THREE INCORPORATORS OR THREE ORGANIZERS OF WHOM NOT LESS THAN ONE SHALL BE A RESIDENT OF THE STATE.

(E) (1) BEFORE THE ARTICLES OF INCORPORATION ARE FILED WITH THE DEPARTMENT, THE INCORPORATORS OF A CAPTIVE INSURER FORMED AS A CORPORATION SHALL PETITION THE COMMISSIONER TO ISSUE A CERTIFICATE SETTING FORTH THE COMMISSIONER'S FINDING THAT THE ESTABLISHMENT AND MAINTENANCE OF THE PROPOSED CORPORATION WILL PROMOTE THE GENERAL GOOD OF THE STATE.

(2) IN ARRIVING AT SUCH A FINDING THE COMMISSIONER SHALL CONSIDER:

(I) THE CHARACTER, REPUTATION, FINANCIAL STANDING AND PURPOSES OF THE INCORPORATORS;

(II) THE CHARACTER, REPUTATION, FINANCIAL RESPONSIBILITY, INSURANCE EXPERIENCE, AND BUSINESS QUALIFICATIONS OF THE OFFICERS AND DIRECTORS; AND

(III) ANY OTHER ASPECTS THE COMMISSIONER DEEMS ADVISABLE.

(3) THE ARTICLES OF INCORPORATION AND THE CERTIFICATE SHALL BE FILED WITH THE DEPARTMENT, WHICH SHALL ACCEPT AND RECORD BOTH THE ARTICLES OF INCORPORATION AND THE CERTIFICATE.

(F) (1) THE ORGANIZERS OF A CAPTIVE INSURER FORMED AS A RECIPROCAL INSURER SHALL PETITION THE COMMISSIONER TO ISSUE A CERTIFICATE SETTING FORTH THE COMMISSIONER'S FINDING THAT THE ESTABLISHMENT AND MAINTENANCE OF THE PROPOSED RECIPROCAL INSURER WILL PROMOTE THE GENERAL GOOD OF THE STATE.

(2) IN ARRIVING AT SUCH A FINDING THE COMMISSIONER SHALL CONSIDER:

(I) THE CHARACTER, REPUTATION, FINANCIAL STANDING AND PURPOSES OF THE ORGANIZERS;

(II) THE CHARACTER, REPUTATION, FINANCIAL RESPONSIBILITY, INSURANCE EXPERIENCE, AND BUSINESS QUALIFICATIONS OF:

1. THE ATTORNEY-IN-FACT'S OFFICERS AND DIRECTORS, IF THE ATTORNEY-IN-FACT IS A CORPORATION; OR

2. THE ATTORNEY-IN-FACT'S MEMBERS, IF THE ATTORNEY-IN-FACT IS A FIRM ; AND

(III) ANY OTHER ASPECTS THE COMMISSIONER DEEMS ADVISABLE.

(G) EXCEPT AS OTHERWISE SPECIFICALLY PROVIDED IN THIS SUBTITLE, EACH DOMESTIC CAPTIVE INSURER SHALL COMPLY WITH THE APPLICABLE PROVISIONS OF THE CORPORATIONS AND ASSOCIATIONS ARTICLE THAT RELATE TO FORMATION, POWERS VESTED IN, AND DUTIES OF CORPORATIONS FORMED UNDER THE GENERAL PROVISIONS OF THE CORPORATIONS AND ASSOCIATIONS ARTICLE.

(H) IF THE PROVISIONS OF THIS SUBTITLE CONFLICT WITH THE GENERAL PROVISIONS OF THE CORPORATIONS AND ASSOCIATIONS ARTICLE, THE PROVISIONS OF THIS SUBTITLE SHALL CONTROL.

(I) THE ARTICLES OF INCORPORATION OR BYLAWS OF A CAPTIVE INSURER FORMED AS A CORPORATION MAY AUTHORIZE A QUORUM OF ITS BOARD OF DIRECTORS TO CONSIST OF NO FEWER THAN ONE-THIRD OF THE FIXED OR PRESCRIBED NUMBER OF DIRECTORS.

(J) THE SUBSCRIBERS' AGREEMENT OR OTHER ORGANIZING DOCUMENT OF A CAPTIVE INSURER FORMED AS A RECIPROCAL INSURER MAY AUTHORIZE A QUORUM OF ITS SUBSCRIBERS' ADVISORY COMMITTEE TO CONSIST OF NO FEWER THAN ONE-THIRD OF THE NUMBER OF ITS MEMBERS.

25-511.

AFTER RECEIVING A CERTIFICATE OF AUTHORITY, IF A CAPTIVE INSURER MAKES A MATERIAL CHANGE TO ANY OF THE ITEMS UNDER §25-504(B)(1), THE CAPTIVE INSURER SHALL SUBMIT THE MATERIAL CHANGE TO THE COMMISSIONER FOR APPROVAL AND MAY NOT OFFER ANY ADDITIONAL KINDS OF INSURANCE OR IMPLEMENT A RATE CHANGE UNTIL THE MATERIAL CHANGE IS APPROVED BY THE COMMISSIONER.

25-512.

(A) CAPTIVE INSURERS SHALL NOT BE REQUIRED TO MAKE ANY ANNUAL REPORT EXCEPT AS PROVIDED IN THIS SUBTITLE.

(B) ON OR BEFORE TO MARCH 1 OF EACH YEAR, UNLESS THE COMMISSIONER EXTENDS THE TIME FOR GOOD REASON, A CAPTIVE INSURER SHALL SUBMIT TO THE COMMISSIONER:

(1) A REPORT OF ITS FINANCIAL CONDITION, VERIFIED UNDER OATH BY TWO OF ITS EXECUTIVE OFFICERS; AND

(2) ANY MODIFICATION TO THE PLAN OF OPERATION AT LAST YEAR END.

(C) ON OR BEFORE JULY 1 OF EACH YEAR, A CAPTIVE INSURER SHALL FILE WITH THE COMMISSIONER AN AUDITED FINANCIAL REPORT WITH AN OPINION FROM AN INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT FOR THE IMMEDIATELY PRECEDING YEAR.

(D) A CAPTIVE INSURER SHALL REPORT USING GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, UNLESS THE COMMISSIONER APPROVES THE USE OF STATUTORY ACCOUNTING PRINCIPLES, WITH ANY APPROPRIATE OR NECESSARY MODIFICATIONS OR ADAPTATIONS REQUIRED OR APPROVED OR ACCEPTED BY THE COMMISSIONER FOR THE TYPE OF INSURANCE AND KINDS OF INSURERS TO BE REPORTED UPON, AND AS SUPPLEMENTED BY ADDITIONAL INFORMATION REQUIRED BY THE COMMISSIONER.

25-513.

(A) AT LEAST ONCE EVERY FIVE YEARS, AND WHENEVER THE COMMISSIONER DETERMINES IT TO BE ADVISABLE, A CAPTIVE INSURER SHALL BE SUBJECT TO EXAMINATION IN ACCORDANCE WITH §§ 2-205 AND 2-207 OF THIS ARTICLE.

(B) ALL ADOPTED EXAMINATION REPORTS, PROPOSED EXAMINATION REPORTS OR RESULTS, WORKING PAPERS, RECORDED INFORMATION, DOCUMENTS AND COPIES THEREOF PRODUCED BY, OBTAINED BY OR DISCLOSED TO THE COMMISSIONER OR ANY OTHER PERSON IN THE COURSE OF AN EXAMINATION MADE UNDER THIS SECTION ARE CONFIDENTIAL AND SHALL NOT BE DISCLOSED PURSUANT TO THE CONFIDENTIALITY PROVISIONS IN §§2-209(G) AND (H) OF THIS ARTICLE.

(C) THE EXPENSES AND CHARGES OF THE EXAMINATION SHALL BE PAID TO THE STATE BY THE COMPANY OR COMPANIES EXAMINED.

25-514.

(A) THE COMMISSIONER MAY REFUSE TO RENEW, SUSPEND OR REVOKE THE CERTIFICATE OF AUTHORITY OF A CAPTIVE INSURER FOR ANY OF THE FOLLOWING REASONS:

(1) INSOLVENCY OR IMPAIRMENT OF CAPITAL OR SURPLUS;

(2) FAILURE TO MEET THE REQUIREMENTS OF § 25-508 OF THIS TITLE;

(3) FAILURE TO SUBMIT A REPORT REQUIRED BY LAW OR BY LAWFUL ORDER OF THE COMMISSIONER;

(4) FAILURE TO COMPLY WITH THE PROVISIONS OF ITS OWN CHARTER, BYLAWS OR OTHER ORGANIZATIONAL DOCUMENT;

(5) FAILURE TO SUBMIT TO OR PAY THE COST OF EXAMINATION OR ANY LEGAL OBLIGATION RELATED TO AN EXAMINATION, AS REQUIRED BY THIS SUBTITLE;

(6) USE OF METHODS THAT, ALTHOUGH NOT OTHERWISE SPECIFICALLY PROHIBITED BY LAW, RENDER ITS OPERATION DETRIMENTAL OR ITS CONDITION UNSOUND WITH RESPECT TO THE PUBLIC OR TO ITS POLICYHOLDERS;

(7) REMOVAL OF THE HOME OFFICE OF THE CAPTIVE INSURER OR REMOVAL OF THE RECORDS OF THE CAPTIVE INSURER FROM THE STATE;

(8) FAILURE TO PAY ANY APPLICABLE TAXES;

(9) VIOLATION OF ANY PROVISION OF THIS SUBTITLE;

(10) KNOWINGLY FAILING TO COMPLY WITH A REGULATION OR ORDER OF THE COMMISSIONER;

(11) THE COMMISSIONER FINDS THAT THE PRINCIPAL MANAGEMENT PERSONNEL OF THE INSURER IS:

(I) UNTRUSTWORTHY OR NOT OF GOOD CHARACTER; OR

(II) SO LACKING IN INSURER MANAGERIAL EXPERIENCE AS TO MAKE THE PROPOSED OPERATION HAZARDOUS TO THE INSURANCE-BUYING PUBLIC OR TO THE INSURER'S STOCKHOLDERS; OR

(III) THE COMMISSIONER HAS GOOD REASON TO BELIEVE THAT THE INSURER IS AFFILIATED, DIRECTLY OR INDIRECTLY, THROUGH OWNERSHIP, CONTROL, MANAGEMENT, REINSURANCE TRANSACTIONS, OR OTHER INSURANCE OR BUSINESS RELATIONS WITH A PERSON WHOSE BUSINESS OPERATIONS ARE OR HAVE BEEN MARKED BY THE MANIPULATION OF ASSETS, ACCOUNTS, OR REINSURANCE OR BY BAD FAITH, TO THE DETRIMENT OF INSUREDS, STOCKHOLDERS, OR CREDITORS.

(12) FAILURE TO OTHERWISE COMPLY WITH THE LAWS OF THE STATE.

(B) THE COMMISSIONER MAY REFUSE TO RENEW, SUSPEND OR REVOKE THE INSURER'S CERTIFICATE OF AUTHORITY IF THE COMMISSIONER DEEMS IT IN THE BEST INTEREST OF THE PUBLIC AND THE POLICYHOLDERS OF SUCH CAPTIVE INSURER.

25-515.

(A) EXCEPT AS AUTHORIZED BY THE COMMISSIONER, ASSOCIATION CAPTIVE INSURERS SHALL COMPLY WITH THE APPLICABLE INVESTMENT REQUIREMENTS CONTAINED IN TITLE 5, SUBTITLES 5.

(B) (1) TITLE 5, SUBTITLE 4 OF THIS ARTICLE SHALL APPLY TO ASSOCIATION CAPTIVE INSURERS EXCEPT TO THE EXTENT IT IS INCONSISTENT WITH ACCOUNTING STANDARDS IN USE BY THE INSURER THAT HAVE BEEN APPROVED BY THE COMMISSIONER.

(2) THE COMMISSIONER MAY APPROVE THE USE OF ALTERNATIVE RELIABLE METHODS OF VALUATION AND RATING.

(C) (1) EXCEPT AS PROVIDED IN SUBSECTION (C)(2), A PURE CAPTIVE INSURER OR INDUSTRIAL INSURED CAPTIVE INSURER SHALL NOT BE SUBJECT TO ANY RESTRICTIONS ON ALLOWABLE INVESTMENTS.

(2) THE COMMISSIONER MAY PROHIBIT OR LIMIT ANY INVESTMENT THAT THE COMMISSIONER DETERMINES, IN THE COMMISSIONER'S SOLE DISCRETION, THREATENS THE SOLVENCY OR LIQUIDITY OF A PURE CAPTIVE INSURER OR AN INDUSTRIAL INSURED CAPTIVE INSURER.

(D) (1) A PURE CAPTIVE INSURER MAY NOT MAKE A LOAN TO OR AN INVESTMENT IN ITS PARENT COMPANY OR AFFILIATES WITHOUT PRIOR WRITTEN APPROVAL OF THE COMMISSIONER AND ANY SUCH LOAN OR INVESTMENT MUST BE EVIDENCED BY DOCUMENTATION APPROVED BY THE COMMISSIONER.

(2) LOANS OF THE MINIMUM CAPITAL AND SURPLUS FUNDS REQUIRED BY § 25-508 OF THIS SUBTITLE ARE PROHIBITED.

25-516.

(A) A CAPTIVE INSURER MAY ASSUME REINSURANCE ON RISKS CEDED BY ANY OTHER INSURER OR CAPTIVE INSURER.

(B) (1) A CAPTIVE INSURER MAY TAKE CREDIT FOR THE REINSURANCE OF RISKS OR PORTIONS OF RISKS CEDED TO REINSURERS IN COMPLIANCE WITH TITLE 5, SUBTITLE 9, OF THIS ARTICLE AND ANY APPLICABLE REGULATIONS.

(2) PRIOR APPROVAL OF THE COMMISSIONER SHALL BE REQUIRED FOR CEDING OR TAKING CREDIT FOR THE REINSURANCE OF RISKS OR PORTIONS OF RISKS CEDED TO REINSURERS NOT COMPLYING WITH TITLE 5, SUBTITLE 9OF THIS ARTICLE AND ANY APPLICABLE REGULATIONS.

(C) (1) IN ADDITION TO REINSURERS AUTHORIZED UNDER THE PROVISIONS OF TITLE 5, SUBTITLE 9 OF THIS ARTICLE, A CAPTIVE INSURER MAY TAKE CREDIT FOR THE REINSURANCE OF RISKS OR PORTIONS OF RISKS CEDED TO A POOL, EXCHANGE OR ASSOCIATION ACTING AS A REINSURER WHICH HAS BEEN AUTHORIZED BY THE COMMISSIONER.

(2) THE COMMISSIONER MAY REQUIRE ANY DOCUMENTS, FINANCIAL INFORMATION OR OTHER EVIDENCE THAT SUCH A POOL, EXCHANGE, OR ASSOCIATION WILL BE ABLE TO PROVIDE ADEQUATE SECURITY FOR ITS FINANCIAL OBLIGATIONS TO THE CAPTIVE INSURER.

(3) THE COMMISSIONER MAY DENY AUTHORIZATION OR IMPOSE ANY LIMITATIONS ON THE ACTIVITIES OF A REINSURANCE POOL, EXCHANGE OR ASSOCIATION THAT, IN THE COMMISSIONER'S SOLE DISCRETION, ARE NECESSARY AND PROPER TO PROVIDE ADEQUATE SECURITY FOR THE CEDING CAPTIVE INSURER AND FOR THE PROTECTION AND CONSEQUENT BENEFIT OF THE PUBLIC AT LARGE.

(D) FOR ALL PURPOSES OF THIS SUBTITLE, INSURANCE WRITTEN BY A CAPTIVE INSURER OF ANY WORKERS' COMPENSATION QUALIFIED SELF FUNDED INSURANCE PLAN OF ITS PARENT OR AFFILIATES SHALL BE DEEMED TO BE REINSURANCE.

25-517.

A CAPTIVE INSURER SHALL NOT BE REQUIRED TO JOIN A RATING ORGANIZATION.

25-518.

(A) A CAPTIVE INSURER MAY NOT JOIN OR CONTRIBUTE FINANCIALLY TO A RISK-SHARING PLAN, RISK POOL, OR THE PROPERTY AND CASUALTY INSURANCE GUARANTY CORPORATION IN THE STATE.

(B) A CAPTIVE INSURER OR ITS INSURED, ITS PARENT OR AN AFFILIATE, OR ANY MEMBER ORGANIZATION OF ITS ASSOCIATION MAY NOT RECEIVE ANY

BENEFIT FROM A RISK-SHARING PLAN, RISK POOL, OR GUARANTY CORPORATION FOR CLAIMS ARISING OUT OF THE OPERATIONS OF THE CAPTIVE INSURER.

(C) A CAPTIVE INSURER THAT ISSUES MEDICAL PROFESSIONAL LIABILITY INSURANCE MAY NOT PARTICIPATE IN THE HEALTH CARE PROVIDER RATE STABILIZATION FUND UNDER TITLE 19, SUBTITLE 8 OF THIS ARTICLE.

25-519.

(A) EXCEPT AS OTHERWISE PROVIDED IN THIS SECTION, EACH CAPTIVE INSURER SHALL PAY TO THE STATE, ON OR BEFORE MARCH 15 OF EACH YEAR, A TAX ON NET DIRECT PREMIUMS WRITTEN BY THE CAPTIVE INSURER DURING THE PRECEDING YEAR ENDING DECEMBER 31, AT THE RATE OF:

(1) FOUR-TENTHS OF ONE PERCENT (0.4%) ON THE FIRST TWENTY MILLION DOLLARS ($20,000,000);

(2) THREE-TENTHS OF ONE PERCENT (0.3%) ON THE NEXT $20,000,000;

(3) TWO-TENTHS OF ONE PERCENT (0.2%) ON THE NEXT $20,000,000; AND

(4) SEVENTY-FIVE THOUSANDTHS OF ONE PERCENT (.075%) ON EACH DOLLAR THEREAFTER.

(B) (1) EXCEPT AS OTHERWISE PROVIDED IN THIS SECTION, A CAPTIVE INSURER SHALL PAY TO THE STATE, ON OR BEFORE MARCH 15 OF EACH YEAR, A TAX ON ASSUMED REINSURANCE PREMIUMS WRITTEN BY THE CAPTIVE ISNURER DURING THE PRECEDING YEAR ENDING DECEMBER 31, AT THE RATE OF:

(I) TWO HUNDRED TWENTY-FIVE THOUSANDTHS OF ONE PERCENT (0.225%) ON THE FIRST $20,000,000;

(II) ONE HUNDRED FIFTY THOUSANDTHS OF ONE PERCENT (0.150%) ON THE NEXT $20,000,000;

(III) FIFTY THOUSANDTHS OF ONE PERCENT (0.050%) ON THE NEXT $20,000,000; AND

(IV) TWENTY-FIVE THOUSANDTHS OF ONE PERCENT (0.025%) ON EACH ADDITIONAL DOLLAR THEREAFTER.

(2) THE TAX ON ASSUMED REINSURANCE PREMIUMS PURSUANT TO THIS SUBSECTION SHALL NOT BE LEVIED ON PREMIUMS FOR RISKS OR PORTIONS OF RISKS, WHICH ARE SUBJECT TO TAXATION ON A DIRECT BASIS PURSUANT TO SUBSECTION (A) OF THIS SECTION.

(3) A CAPTIVE INSURER IS NOT REQUIRED TO PAY A TAX ON ASSUMED REINSURANCE PREMIUM PURSUANT TO THIS SUBSECTION ON REVENUE RELATED TO THE RECEIPT OF ASSETS BY THE CAPTIVE INSURER IN EXCHANGE FOR THE ASSUMPTION OF LOSS RESERVES AND OTHER LIABILITIES OF ANOTHER INSURER THAT IS UNDER COMMON OWNERSHIP AND CONTROL WITH THE CAPTIVE INSURER, IF THE TRANSACTION IS PART OF A PLAN TO DISCONTINUE THE OPERATION OF THE OTHER INSURER AND THE INTENT OF THE PARTIES TO THE TRANSACTION IS TO RENEW OR MAINTAIN SUCH BUSINESS WITH THE CAPTIVE INSURER.

(4) A CAPTIVE INSURER MAY CLAIM A CREDIT AGAINST THE PREMIUM TAX FOR ANY CREDIT AVAILABLE UNDER TITLE 6 SUBTITLE 1 OF THIS ARTICLE.

(C) IF THE SUM OF THE TAXES TO BE PAID BY A CAPTIVE INSURER CALCULATED PURSUANT TO SUBSECTIONS (A) AND (B) OF THIS SECTION IS LESS THAN $7,500 IN ANY GIVEN YEAR, THE CAPTIVE INSURER SHALL PAY A MINIMUM TAX OF $7,500 FOR THAT YEAR.

(D) THE TOTAL TAX PAID BY A CAPTIVE INSURER MAY NOT EXCEED $200,000 IN ANY GIVEN YEAR.

(E) NOTWITHSTANDING ANY SPECIFIC STATUTE TO THE CONTRARY AND EXCEPT AS OTHERWISE PROVIDED IN THIS SUBSECTION, THE TAX PROVIDED FOR BY THIS SECTION CONSTITUTES ALL THE TAXES COLLECTIBLE ON INCOME PURSUANT TO THE LAWS OF THE STATE FROM A CAPTIVE INSURER, AND NO OTHER TAXES MAY BE LEVIED OR COLLECTED FROM A CAPTIVE INSURER BY THE STATE, EXCEPT FOR REAL PROPERTY TAXES AS REQUIRED BY THE TAX-PROPERTY ARTICLE, PERSONAL PROPERTY TAXES AS REQUIRED UNDER THE TAX-PROPERTY ARTICLE OR UNEMPLOYMENT INSURANCE CONTRIBUTIONS AS REQUIRED BY THE LABOR AND EMPLOYMENT ARTICLE.

(F) A CAPTIVE INSURER THAT IS ISSUED A CERTIFICATE OF AUTHORITY DURING THE LAST QUARTER OF THE CALENDAR YEAR MAY FILE A WRITTEN REQUEST WITH THE COMMISSIONER FOR APPROVAL OF A PRO RATA REDUCTION IN THE MINIMUM PREMIUM TAX OBLIGATION CALCULATED PURSUANT TO SUBSECTION (C) OF THIS SECTION.

(G) ONE HUNDRED PERCENT OF THE REVENUES COLLECTED FROM THE TAX IMPOSED PURSUANT TO THIS SECTION SHALL BE CREDITED TO THE

CAPTIVE INSURANCE REGULATORY FUND CREATED PURSUANT TO § 25-5265 OF THIS SUBTITLE.

(H) ON OR BEFORE MARCH 15 OF EACH YEAR, A CAPTIVE INSURER SUBJECT TO TAXATION UNDER THIS SECTION SHALL FILE A REPORT OF ITS NET DIRECT PREMIUM, ASSUMED REINSURANCE PREMIUM, AND ANY ADDITIONAL INFORMATION REQUIRED BY THE COMMISSIONER ON A FORM REQUIRED BY THE COMMISSIONER.

(I) A CAPTIVE INSURER FAILING TO FILE THE TAX REPORT AND MAKING PAYMENT OF ALL TAXES WITHIN THE TIME REQUIRED BY THIS SECTION SHALL BE SUBJECT TO THE PROVISIONS OF § 6-108 OF THIS ARTICLE.

25-520.

THE COMMISSIONER MAY ADOPT REGULATIONS TO CARRY OUT THE PROVISIONS OF THIS SUBTITLE.

25-521.

NO PROVISION OF THIS ARTICLE, OTHER THAN THOSE CONTAINED IN THIS SUBTITLE OR CONTAINED IN SPECIFIC REFERENCES CONTAINED IN THIS SUBTITLE, SHALL APPLY TO CAPTIVE INSURERS.

25-522.

EXCEPT AS OTHERWISE PROVIDED IN THIS SUBTITLE, THE FOLLOWING SECTIONS OF THIS ARTICLE SHALL APPLY TO CAPTIVE INSURERS FORMED UNDER THIS SUBTITLE:

(A) TITLE 9, SUBTITLES 1 AND 2; AND

(B) TITLE 2, SUBTITLE 2, EXCEPT §§2-202, 2-208, 2-209.

25-523.

(A) THE COMMISSIONER MAY ADOPT REGULATIONS SETTING FORTH STANDARDS TO ENSURE THAT A PARENT OR AFFILIATE IS ABLE TO EXERCISE CONTROL OF THE RISK MANAGEMENT FUNCTION OF ANY CONTROLLED UNAFFILIATED BUSINESS ENTITY BEFORE THE CONTROLLED UNAFFILIATED BUSINESS ENTITY MAY BE INSURED BY THE PURE CAPTIVE INSURER.

(B) UNTIL REGULATIONS ARE ADOPTED UNDER THIS SECTION, THE COMMISSIONER MAY APPROVE THE COVERAGE OF THE RISKS OF A CONTROLLED UNAFFILIATED BUSINESS ENTITY BY A PURE CAPTIVE INSURER.

25-524.

(A) A CAPTIVE INSURER WHICH HOLDS A CERTIFICATE OF AUTHORITY OR LICENSE UNDER THE LAW OF ANY OTHER JURISDICTION MAY REDOMESTICATE TO THE STATE BY COMPLYING WITH ALL OF THE REQUIREMENTS OF THIS SUBTITLE RELATIVE TO THE ORGANIZATION AND LICENSING OF A DOMESTIC CAPTIVE INSURER OF THE SAME TYPE.

(B) A REDOMESTICATED CAPTIVE INSURER SHALL BE ENTITLED TO TRANSACT BUSINESS IN THE STATE, AND SHALL BE SUBJECT TO THE AUTHORITY AND JURISDICTION OF THE STATE.

(C) AN INSURANCE CONTRACT IN EXISTENCE AT THE TIME A CAPTIVE INSURER REDOMESTICATES SHALL CONTINUE IN FULL FORCE AND EFFECT UPON THE REDOMESTICATION IF THE CAPTIVE INSURER IS DULY QUALIFIED TO TRANSACT THE SAME TYPE OF BUSINESS IN THE STATE.

(D) A REDOMESTICATED CAPTIVE INSURER SHALL NOTIFY THE COMMISSIONER OF THE DETAILS OF THE PROPOSED REDOMESTICATION AND SHALL FILE PROMPTLY ANY RESULTING AMENDMENTS TO APPLICATION DOCUMENTS FILED OR REQUIRED TO BE FILED WITH THE COMMISSIONER.

(E) A DOMESTIC CAPTIVE INSURER, UPON THE APPROVAL OF THE COMMISSIONER, MAY TRANSFER ITS DOMICILE TO ANY STATE IN WHICH IT IS AUTHORIZED TO TRANSACT BUSINESS AS A CAPTIVE INSURER AND UPON TRANSFER SHALL CEASE TO BE A DOMESTIC CAPTIVE INSURER IN THE STATE.

(F) THE COMMISSIONER SHALL APPROVE ANY PROPOSED REDOMESTICATION UNLESS THE COMMISSIONER DETERMINES THE REDOMESTICATION IS NOT IN THE BEST INTEREST OF THE POLICYHOLDERS.

25-525.

(A) THERE IS A CAPTIVE INSURANCE DIVISION IN THE ADMINISTRATION.

(B) THE CAPTIVE INSURANCE DIVISION SHALL ADMINISTER THE PROVISIONS OF THIS SUBTITLE.

(C) (1) THE HEAD OF THE CAPTIVE INSURANCE DIVISION SHALL BE AN ASSOCIATE COMMISSIONER.

(2) THE DIVISION SHALL HAVE:

(I) A CHIEF EXAMINER;

(II) A CHIEF ADMINISTRATOR; AND

(III) OTHER PERSONNEL AS DEEMED NECESSARY TO CARRY OUT THE DUTIES OF THE DIVISION UNDER THIS SUBTITLE.

(D) THE CAPTIVE INSURANCE DIVISION SHALL CARRY OUT THE DUTIES PRESCRIBED IN THIS SUBTITLE.

(E) FUNDING FOR THE CAPTIVE INSURANCE DIVISION SHALL BE PROVIDED BY THE CAPTIVE INSURANCE REGULATORY FUND ESTABLISHED UNDER § 25-526.

25-526.

(A) THERE IS A CAPTIVE INSURANCE REGULATORY FUND.

(1) THE FUND SHALL PROVIDE FUNDING FOR THE COMMISSIONER TO ADMINISTER THE PROVISIONS OF THIS SUBTITLE.

(2) REASONABLE EXPENSES INCURRED IN PROMOTING THE CAPTIVE INSURANCE INDUSTRY IN THE STATE SHALL BE PAID FROM THE FUND.

(B) THE FUND IS A SPECIAL NONLAPSING FUND THAT IS NOT SUBJECT TO § 7-302 OF THE STATE FINANCE AND PROCUREMENT ARTICLE.

(C) THE TREASURER SHALL SEPARATELY HOLD AND THE COMPTROLLER SHALL ACCOUNT FOR THE FUND.

(D) THE STATE TREASURER SHALL INVEST THE MONEY OF THE FUND IN THE SAME MANNER AS OTHER STATE MONEY MAY BE INVESTED.

(E) ANY INVESTMENT EARNINGS SHALL BE RETAINED TO THE CREDIT OF THE FUND.

(F) THE FUND SHALL BE USED ONLY TO PROVIDE FUNDING FOR THE PURPOSES AUTHORIZED UNDER THIS SUBTITLE.

(G) THE FUND SHALL CONSIST OF:

(1) THE PREMIUM TAXES COLLECTED UNDER § 25-519 OF THIS SUBTITLE;

(2) ALL FEES, PENALTIES, OR INTEREST RECEIVED BY THE ADMINISTRATION PURSUANT TO THE REQUIREMENTS OF THIS SUBTITLE;

(3) INCOME FROM INVESTMENTS OF THE FUND;

(4) MONEY COLLECTED BY THE COMMISSIONER AS A RESULT OF LEGAL OR OTHER ACTIONS TAKEN BY THE COMMISSIONER ON BEHALF OF THE FUND.

SECTION 2. AND BE IT FURTHER ENACTED, THAT

(1) Funding for the organization and development of the Captive Insurance Division shall be in the amount of $________ in FY 2015;

(2) The State shall provide all additional funds needed above the funds deposited in the account under § 25-525 of the Insurance Article in order to maintain a funding level of $ ________ in FY 2016, FY 2017 and FY 2018;

(3) The Governor shall include in the annual budget the amounts specified in (1) and (2) of this Section; and

(4) For fiscal year 2014, in the event this amount is not appropriated through the budget bill, the Governor is authorized to amend the budget through the executive budget amendment process.

SECTION 3. AND BE IT FURTHER ENACTED, THAT the Captive Insurance Division shall begin accepting applications on January 1, 2015.

SECTION 4. AND BE IT FURTHER ENACTED, THAT this Act shall take effect June 1, 2014.