

BILL ANALYSIS

Senate Research Center
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H.B. 1944
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Engrossed

AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

In 2013, the Texas Legislature for the first time authorized captive insurance companies, which have also been authorized in 37 other states. In its simplest form, a captive is a wholly owned subsidiary created to provide insurance to its noninsurance parent company (or companies). Captive insurance companies are established to meet the risk and financial management needs of the owners or members. They are essentially a form of self-insurance because the insurer is wholly owned by the insured. The captive insures no public risk, only the risks of its parent and/or affiliates.

Because the key purpose of insurance regulation is to protect policyholders, captives are regulated differently than traditional insurance companies that serve the public.

The bill passed by the legislature in 2013 was fairly limited in its scope, suitable mostly for very large companies. The statute was amended in 2015, opening up additional opportunities for a greater number of Texas companies. As more captive insurance companies have been formed in Texas, the need for further refinements of the Texas statute to provide more options for more Texas businesses have become evident.

H.B. 1944 will make several changes to align regulatory oversight with captive regulation in other states to make it easier for Texas companies to form captives in Texas (rather than another state), by:

1. Allowing capital and surplus to be held in the form of Texas county or municipal bonds.
2. Waiving the requirement to provide an actuarial report with the captive's annual filing under certain circumstances.
3. Eliminating the requirement that the captive have a licensed claims adjuster if the claims are limited to first party claims of the parent and/or affiliates of the captive.
4. Allowing a captive insurance company to insure life insurance benefits for employee benefits subject to ERISA (Employee Retirement Income Security Act of 1974).
5. Authorizing a Texas captive insurance company to take credit for reinsurance ceded to a non-affiliated reinsurer when specific requirements are met.
6. Authorizing a Texas captive insurance company to be formed as a reciprocal insurance exchange.
7. Simplifying the corporate formation processes between the secretary of state and the Department of Insurance.

H.B. 1944 amends current law relating to captive insurance companies.

RULEMAKING AUTHORITY

This bill does not expressly grant any additional rulemaking authority to a state officer, institution, or agency.

SECTION BY SECTION ANALYSIS

ARTICLE 1. REGULATION OF CAPTIVE INSURANCE COMPANIES

SECTION 1.01 Amends Section 964.001(a), Insurance Code, by adding Subdivisions (1-a), (1-b), and (8) and amending Subdivision (2) to define "attorney in fact," "captive exchange," and "subscriber" and redefine "captive insurance company" to include a captive exchange.

SECTION 1.02. Amends Section 964.051(b), Insurance Code, to provide that a captive insurance company (CIC) may not issue life insurance, except to insure employee benefits that are subject to the Employee Retirement Income Security Act of 1974 (29 U.S.C. Section 1001 et seq.).

SECTION 1.03. Amends Section 964.052, Insurance Code, by adding Subsection (f), as follows:

(f) Authorizes a CIC to cede risks to or take credit for reserves on risks ceded to a nonaffiliated reinsurer if the reinsurer:

- (1) holds a certificate of authority to transact insurance or reinsurance in a jurisdiction that meets certain criteria;
- (2) maintains minimum capital and surplus, or the equivalent, of \$250 million as of the end of the preceding year; and
- (3) maintains a financial strength rating of B+ or its equivalent from certain national or international rating agencies.

SECTION 1.04. Amends Sections 964.053(a), (c), (d), and (e), Insurance Code, as follows:

(a) Requires that a CIC, other than a captive exchange, or an attorney in fact, rather than requires that a CIC, be formed for a certain purpose by filing an appropriate application with the Texas secretary of state (SOS).

(c) Requires that the certificate of formation of a CIC, other than a captive exchange, or an attorney in fact comply with the applicable requirements of the Business Organizations Code. Authorizes the name of the CIC or attorney in fact in the certificate of formation to include certain words indicating that the purpose of the CIC or attorney in fact is to operate as an insurance company or attorney in fact under this chapter (Captive Insurance Companies). Deletes existing text requiring that the certificate of formation include the name of the CIC and certain other information.

(d) Requires that the principal office of the attorney in fact, if the CIC is a captive exchange, be in this state.

(e) Requires that the certificate of formation, bylaws, or governing document, rather than certificate of formation or bylaws, of a CIC authorize a quorum of the board of directors or governing body to consist of a certain percentage.

SECTION 1.05. Amends Section 964.055(a), Insurance Code, to authorize a CIC, when permitted by its certificate of formation or governing document, rather than by its certificate of formation, to apply for a certificate of authority under this chapter.

SECTION 1.06. Amends Section 964.056, Insurance Code, as follows:

Sec. 964.056. New heading: CAPITAL AND SURPLUS OR EQUIVALENT REQUIREMENTS. (a) Prohibits the Texas Department of Insurance (TDI) from issuing a certificate of authority to a CIC unless the CIC possesses and maintains unencumbered capital and surplus, or the equivalent, rather than possesses and maintains unencumbered

capital and surplus, in an amount determined by the commissioner of insurance (commissioner).

(b) Makes a conforming change.

(c) Requires that the capital and surplus, or the equivalent, rather than the capital and surplus, required by Subsection (a) be in certain forms, including bonds of this state or a county or municipality of this state, rather than bonds of this state.

SECTION 1.07. Amends Section 964.057(a), Insurance Code, as follows:

(a) Requires the incorporators or organizers, after forming a CIC, rather than to obtain a certificate of authority for a CIC, other than a captive exchange or an attorney in fact, to pay to the commissioner an application fee and file with the commissioner an application for a certificate of authority for a CIC, which is required to include:

(1) and (2) makes no changes to these subdivisions;

(3) the CIC's certificate of formation, or other documentation demonstrating the valid formation of the CIC, other than a captive exchange, or the attorney in fact, rather than the CIC's certificate of formation;

(4) makes conforming changes; and

(5) makes no changes to this subdivision.

SECTION 1.08. Amends Section 964.058(a), Insurance Code, to make conforming changes.

SECTION 1.09. Amends Sections 964.059(a) and (d), Insurance Code, as follows:

(a) Requires the commissioner to determine whether:

(1) the capital and surplus, or the equivalent, rather than the capital structure, of the applicant meets the requirements of this chapter. Makes a nonsubstantive change;

(2) the officers or members of the applicant's governing body, rather than the officers or directors of the applicant, meet certain conditions related to the probable success of the CIC;

(3) and (4) makes no changes to these subdivisions.

(d) Includes issuing to the applicant a certificate of authority to engage in business as provided for in the applicant's certificate of formation or other governing document, rather than in the applicant's certificate of formation, in the list of required actions by the commissioner, if the commissioner does not deny the application in a certain manner.

SECTION 1.10. Amends Section 964.060, Insurance Code, by adding Subsection (d), as follows:

(d) Authorizes the commissioner to waive the requirement for a CIC to file an actuarial report with the CIC's annual report if the commissioner determines that the CIC has less than \$1 million of net written premium or reinsurance assumed or has been in operation for less than six months as of the end of the previous calendar year.

SECTION 1.11. Amends Section 964.061(b), Insurance Code, to make a conforming change.

SECTION 1.12. Amends Section 964.062, Insurance Code, as follows:

Sec. 964.062. New heading: AMENDMENTS TO CERTIFICATE OF FORMATION OR GOVERNING DOCUMENT. Makes a conforming change.

SECTION 1.13. Amends the heading to Section 964.063, Insurance Code, to read as follows:

Sec. 964.063. DIVIDENDS AND DISTRIBUTIONS.

SECTION 1.14. Amends Section 964.063(a), Insurance Code, to require a CIC to notify the commissioner in writing when issuing policyholder dividends or distributions to policyholders, rather than issuing policyholder dividends.

SECTION 1.15. Amends Section 964.065, Insurance Code, as follows:

Sec. 964.065. SUSPENSION OR REVOCATION OF CERTIFICATE OF AUTHORITY. Authorizes the commissioner, after notice and an opportunity for hearing, to revoke or suspend the certificate of authority of a CIC for:

- (1) makes a conforming change;
- (2) makes no changes to this subdivision;
- (3) failure to comply with the provisions of its own charter, bylaws, rules, or other governing document, rather than its own charter or bylaws;
- (4) through (9) makes no changes to these subdivisions.

SECTION 1.16. Amends Section 964.070, Insurance Code, by amending Subsection (a) and adding Subsection (d), as follows:

(a) Provides that any information filed with the commissioner, rather than any information filed, by an applicant or CIC under this chapter is confidential and privileged for all purposes.

(d) Authorizes SOS to index in the public record any document filed with SOS by an applicant or CIC.

SECTION 1.17. Amends Subchapter B, Chapter 964, Insurance Code, by adding Section 964.073, as follows:

Sec. 964.073. ADJUSTER LICENSE NOT REQUIRED; EXCEPTION. (a) Provides that, except as provided by Subsection (b), a CIC is not required to use a person licensed as an adjuster under Chapter 4101 (Insurance Adjusters) to adjust losses.

(b) Requires a CIC to use a person licensed as an adjuster under Chapter 4101 to adjust a claim that a person that is not an affiliated company or an insured controlled unaffiliated business makes against an affiliated company insured by the CIC.

ARTICLE 2. CAPTIVE EXCHANGES

SECTION 2.01. Amends Chapter 964, Insurance Code, by adding Subchapter C, as follows:

SUBCHAPTER C. CAPTIVE EXCHANGES

Sec. 964.101. APPLICABILITY OF OTHER LAW. (a) Provides that a CIC is subject to this chapter and Sections 942.051 (Appointment of Attorney in Fact; Approval by Department of Power of Attorney or Other Authorization Required), 942.053 (Subscriber Declaration), and 942.054 (Name of Exchange).

(b) Provides that, to the extent of a conflict, this chapter controls over other law applicable to a captive exchange under this section.

Sec. 946.102. STATUS OF CAPTIVE EXCHANGES. Provides that a captive exchange is formed as an exchange as provided by this subchapter and, except as provided by this subchapter, is required to operate as a CIC as provided by this chapter.

Sec. 946.103. SUBSCRIBER REQUIREMENTS. Requires each subscriber of the captive exchange, on and after the date of the captive exchange's formation, to have an existing affiliation with each other subscriber or satisfy the definition of a controlled unaffiliated business regardless of any affiliation relationship created by the captive exchange.

Sec. 964.104. ATTORNEY IN FACT REQUIREMENTS. Requires the attorney in fact of a captive exchange to:

- (1) be a corporation organized in this state or be a limited liability company organized in this state;
- (2) on the date the captive exchange's formation, have and maintain a power of attorney with all subscribers of the captive exchange;
- (3) have its principal offices in this state; and
- (4) have at least three members in the governing body of the attorney in fact, and at least one of those members is required to be a resident of this state.

Sec. 964.105. ATTORNEY IN FACT POWERS AND DUTIES. (a) Requires the attorney in fact of a captive exchange to:

- (1) supervise the finances of the captive exchange;
- (2) supervise the captive exchange's operations to ensure the captive exchange's conformity with the captive exchange's subscriber declaration and power of attorney; and
- (3) obtain, as necessary, an audit of the account and records of the attorney in fact at the expense of the captive exchange.

(b) Provides that the attorney in fact of a captive exchange has any additional powers and duties conferred by the captive exchange's subscriber declaration and power of attorney.

Sec. 964.106. SUBSCRIBER DECLARATION. Requires a captive exchange to file with TDI a subscriber declaration that includes the information described by Section 942.053, the amount of the captive exchange's initial surplus, and a provision to authorize a certain manner for establishing a quorum of the governing body of the captive exchange's attorney in fact.

ARTICLE 3. TRANSITION AND EFFECTIVE DATE

SECTION 3.01. Provides that the change in law made by this Act to Section 964.070, Insurance Code, applies only to information filed with SOS on or after September 1, 2017. Provides that information filed with SOS before September 1, 2017, is governed by the law applicable to the information immediately before the effective date of this act, and that law is continued in effect for that purpose.

SECTION 3.02. Effective date: upon passage or September 1, 2017.