

BILL ANALYSIS

C.S.H.B. 1944
By: Murphy
Insurance
Committee Report (Substituted)

BACKGROUND AND PURPOSE

Interested parties have expressed a need to refine statutory provisions relating to captive insurance companies and to provide more options for more Texas businesses. C.S.H.B. 1944 seeks to provide for that refinement and to align the state's regulatory oversight of captive insurance companies with regulatory oversight in other states.

CRIMINAL JUSTICE IMPACT

It is the committee's opinion that this bill does not expressly create a criminal offense, increase the punishment for an existing criminal offense or category of offenses, or change the eligibility of a person for community supervision, parole, or mandatory supervision.

RULEMAKING AUTHORITY

It is the committee's opinion that this bill does not expressly grant any additional rulemaking authority to a state officer, department, agency, or institution.

ANALYSIS

C.S.H.B. 1944 amends the Insurance Code to provide for the formation of a captive exchange as a reciprocal or interinsurance exchange, to require a captive exchange to operate as a captive insurance company, and to specify that a captive exchange is considered a captive insurance company for purposes of statutory provisions governing such companies. The bill subjects a captive exchange to those statutory provisions and certain statutory provisions relating to the formation and structure of reciprocal and interinsurance exchanges and establishes that, to the extent of a conflict, provisions governing captive insurance companies, including provisions added by the bill relating to captive exchanges, control over other law applicable to a captive exchange. The bill requires each subscriber, defined by the bill as an affiliated company or controlled unaffiliated business that enters into a reciprocal contract of insurance with an attorney in fact as a subscriber of a 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.

C.S.H.B. 1944 requires an attorney in fact that acts for subscribers of a captive exchange by issuing reciprocal or interinsurance contracts to be a limited liability company organized in Texas or a corporation organized in Texas, to have and maintain on the date of the captive exchange's formation a power of attorney with all subscribers of the captive exchange, to have its principal office in Texas, and to have at least three members in the governing body of the attorney in fact, at least one of whom is a Texas resident. The bill requires the attorney in fact of a captive exchange to supervise the finances of the captive exchange, 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 obtain, as necessary, an audit of the account and records of the attorney in fact at the expense of the captive exchange. The bill establishes

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. The bill requires a captive exchange to file a subscriber declaration with the Texas Department of Insurance and prescribes information required to be included in the declaration.

C.S.H.B. 1944 provides an exception for employee benefits subject to the federal Employee Retirement Income Security Act of 1974 to the prohibition against a captive insurance company issuing life insurance. The bill authorizes a captive insurance company to cede risks to or take credit for reserves on risks ceded to a nonaffiliated reinsurer if the reinsurer holds a certificate of authority to transact insurance or reinsurance in a jurisdiction that is on the list of qualified jurisdictions of the National Association of Insurance Commissioners and is acceptable to the commissioner of insurance, maintains minimum capital and surplus or the equivalent of \$250 million as of the end of the preceding year, and maintains a financial strength rating of B+ or its equivalent from a national or international rating agency that meets certain criteria. The bill excludes a captive exchange from the formation requirements applicable to a captive insurance company and extends the applicability of those requirements to an attorney in fact of a captive exchange. The bill specifies that the manner by which a captive insurance company or an attorney in fact is formed for the purpose of engaging in the business of insurance under statutory provisions governing captive insurance companies is by filing an appropriate application with the secretary of state, requires a captive insurance company or an attorney in fact to comply with the applicable requirements of the Business Organizations Code, and revises certain certificate of formation information. The bill requires the principal office of the attorney in fact of a captive insurance company that is a captive exchange to be in Texas.

C.S.H.B. 1944 includes bonds of a Texas county or municipality as alternative authorized forms of the capital and surplus a captive insurance company must possess and maintain to be eligible for a certificate of authority and gives a captive insurance company the option of possessing and maintaining the equivalent of unencumbered capital and surplus in an amount determined by the commissioner as an alternative to possessing and maintaining unencumbered capital or surplus in that amount to be eligible for a certificate of authority. The bill excludes a captive exchange from the application requirements for a certificate of authority applicable to a captive insurance company and extends the applicability of those requirements to an attorney in fact for a captive exchange. The bill authorizes the commissioner to waive the requirement for a captive insurance company to file an actuarial report with the company's annual report if the commissioner determines the company 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. The bill requires a captive insurance company to notify the commissioner in writing when issuing distributions to policyholders. The bill authorizes the secretary of state to index in the public record any document filed with the secretary by an applicant or captive insurance company on or after September 1, 2017, and specifies that the information filed by an applicant or captive insurance company under statutory provisions governing such companies that is confidential and privileged applies to any information filed with the commissioner by an applicant or captive insurance company under those provisions. The bill establishes that a captive insurance company is not required to use a licensed insurance adjuster to adjust losses, but requires a captive insurance company to use a licensed insurance adjuster 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 captive insurance company.

EFFECTIVE DATE

On passage, or, if the bill does not receive the necessary vote, September 1, 2017.

COMPARISON OF ORIGINAL AND SUBSTITUTE

While C.S.H.B. 1944 may differ from the original in minor or nonsubstantive ways, the following comparison is organized and formatted in a manner that indicates the substantial

differences between the introduced and committee substitute versions of the bill.

INTRODUCED

No equivalent provision.

SECTION 1. Section 964.001(a), Insurance Code, is amended by adding Subdivision (1-a) to read as follows:

No equivalent provision.

(1-a) "Captive exchange" means a reciprocal or interinsurance exchange formed under this chapter. The term includes the attorney in fact as defined by Section 942.001 through which a reciprocal or interinsurance contract as defined by that section is exchanged.

No equivalent provision.

SECTION 2. Section 964.051(b), Insurance Code, is amended

SECTION 3. Section 964.052, Insurance Code, is amended

SECTION 4. Sections 964.053(b), (d), and (e), Insurance Code, are amended to read as follows:

No equivalent provision.

HOUSE COMMITTEE SUBSTITUTE

ARTICLE 1. REGULATION OF CAPTIVE INSURANCE COMPANIES

SECTION 1.01. Section 964.001(a), Insurance Code, is amended by adding Subdivisions (1-a), (1-b), and (8) and amending Subdivision (2) to read as follows:

(1-a) "Attorney in fact" means a firm or corporation that, under a power of attorney or other appropriate authorization of the attorney in fact, acts for subscribers of a captive exchange by issuing reciprocal or interinsurance contracts.

(1-b) "Captive exchange" means a reciprocal or interinsurance exchange formed under this chapter. The term includes the attorney in fact through which a reciprocal or interinsurance contract, as defined by Section 942.001, is exchanged.

(2) "Captive insurance company" means a company that holds a certificate of authority under this chapter to insure the operational risks of the company's affiliates or risks of a controlled unaffiliated business. The term includes a captive exchange.

(8) "Subscriber" means an affiliated company or controlled unaffiliated business that enters into a reciprocal contract of insurance with an attorney in fact as a subscriber of a captive exchange.

SECTION 1.02. Same as introduced version.

SECTION 1.03. Same as introduced version.

SECTION 1.04. Sections 964.053(a), (c), (d), and (e), Insurance Code, are amended to read as follows:

(a) A captive insurance company, other

than a captive exchange, or an attorney in fact must be formed for the purpose of engaging in the business of insurance under this chapter by filing an appropriate application with the secretary of state.

No equivalent provision.

(b) A captive insurance company may be formed and operated as a captive exchange in accordance with Subchapter C or in any form of business organization authorized under the Business Organizations Code except a risk retention group or general partnership. A captive exchange [insurance company] may only be formed as a nonprofit corporation if it is controlled by a nonprofit corporation.

No equivalent provision.

(c) The certificate of formation of a captive insurance company, other than a captive exchange, or an attorney in fact must comply with the applicable requirements of the Business Organizations Code. The [must include:

[(1) the] name of the company or attorney in fact in the certificate of formation may include the words "insurance," "company," or similar words indicating that the purpose of the company or attorney in fact is to operate as an insurance company or attorney in fact under this chapter [~~which may not be the same as, deceptively similar to, or likely to be confused with or mistaken for any other existing business name registered in this state;~~

[(2) the location of the company's principal business office;

[(3) the type of insurance business in which the company proposes to engage;

[(4) the number of directors or members of the governing body of the company;

[(5) the number of authorized shares and the par value of the company's capital stock for a captive insurance company formed as a corporation;

[(6) the amount of the company's initial capital and surplus; and

[(7) any other information required by the commissioner as necessary to explain the company's objectives, management, and control].

(d) The board of directors or governing body of a captive insurance company formed in this state must have at least three members, and at least one of the members

(d) The board of directors or governing body of a captive insurance company formed in this state must have at least three members, and at least one of the members

must be a resident of this state. If the captive insurance company is a captive exchange, the principal office of the attorney in fact must be in this state.

(e) The certificate of formation, ~~[or]~~ bylaws, or governing document of a captive insurance company must authorize a quorum of the board of directors or governing body to consist of not fewer than one-third of the fixed number of directors or members of the governing body.

SECTION 5. Section 964.055(a), Insurance Code, is amended

SECTION 6. Section 964.056(c), Insurance Code, is amended to read as follows:

No equivalent provision.

No equivalent provision.

(c) The capital and surplus required by Subsection (a) must be in the form of:

(1) United States currency;

must be a resident of this state. If the captive insurance company is a captive exchange, the principal office of the attorney in fact must be in this state.

(e) The certificate of formation, ~~[or]~~ bylaws, or governing document of a captive insurance company must authorize a quorum of the board of directors or governing body to consist of not fewer than one-third of the fixed number of directors or members of the governing body.

SECTION 1.05. Same as introduced version.

SECTION 1.06. Section 964.056, Insurance Code, is amended to read as follows:

Sec. 964.056. CAPITAL AND SURPLUS OR EQUIVALENT REQUIREMENTS.

(a) The department may not issue a certificate of authority to a captive insurance company unless the company possesses and maintains unencumbered capital and surplus, or the equivalent, in an amount determined by the commissioner after considering:

- (1) the amount of premium written by the captive insurance company;
- (2) the characteristics of the assets held by the captive insurance company;
- (3) the terms of reinsurance arrangements entered into by the captive insurance company;
- (4) the type of business covered in policies issued by the captive insurance company;
- (5) the underwriting practices and procedures of the captive insurance company; and
- (6) any other criteria that has an impact on the operations of the captive insurance company determined to be significant by the commissioner.

(b) The amount of capital and surplus, or the equivalent, determined by the commissioner under Subsection (a) may not be less than \$250,000.

(c) The capital and surplus, or the equivalent, required by Subsection (a) must be in the form of:

(1) United States currency;

- (2) an irrevocable letter of credit, in a form approved by the commissioner and not secured by a guarantee from an affiliate, naming the commissioner as beneficiary for the security of the captive insurance company's policyholders and issued by a bank approved by the commissioner;
- (3) bonds of this state or a county or municipality of this state; or
- (4) bonds or other evidences of indebtedness of the United States, the principal and interest of which are guaranteed by the United States.

SECTION 7. Section 964.057(a), Insurance Code, is amended to read as follows:

(a) ~~To obtain a certificate of authority for a captive insurance company, the incorporators or organizers must pay to the commissioner an application fee and file with the commissioner an application for the certificate of authority, which must include:~~

- (1) a financial statement certified by two principal officers;
- (2) a plan of operation and projections, which must include an actuarial report prepared by a qualified independent actuary;
- (3) the captive insurance company's certificate of formation or other documentation demonstrating the captive insurance company's valid formation;
- (4) an affidavit by the incorporators, organizers, or officers of the captive insurance company stating that:
 - (A) the capital and surplus are the bona fide property of the company; and
 - (B) the certificate of formation or other documentation demonstrating the captive insurance company's valid formation is true and correct; and
- (5) if the application provides for the issuance of shares of stock or other type of equity instrument without par value, a certificate authenticated by the incorporators or officers stating:
 - (A) the number of shares or other type of equity instrument without par value that are

- (2) an irrevocable letter of credit, in a form approved by the commissioner and not secured by a guarantee from an affiliate, naming the commissioner as beneficiary for the security of the captive insurance company's policyholders and issued by a bank approved by the commissioner;
- (3) bonds of this state or a county or municipality of this state; or
- (4) bonds or other evidences of indebtedness of the United States, the principal and interest of which are guaranteed by the United States.

SECTION 1.07. Section 964.057(a), Insurance Code, is amended to read as follows:

(a) ~~After forming~~ ~~[To obtain a certificate of authority for]~~ a captive insurance company, other than a captive exchange, or an attorney in fact, the incorporators or organizers must pay to the commissioner an application fee and file with the commissioner an application for a ~~the~~ certificate of authority for a captive insurance company, which must include:

- (1) a financial statement certified by two principal officers;
- (2) a plan of operation and projections, which must include an actuarial report prepared by a qualified independent actuary;
- (3) the captive insurance company's certificate of formation or other documentation demonstrating the valid formation of the captive insurance company, other than a captive exchange, or the attorney in fact;
- (4) an affidavit by the incorporators, organizers, or officers of the captive insurance company stating that:
 - (A) the capital and surplus, or the equivalent, are the bona fide property of the company; and
 - (B) the certificate of formation or other documentation demonstrating the captive insurance company's or attorney in fact's valid formation is true and correct; and
- (5) if the application provides for the issuance of shares of stock or other type of equity instrument without par value, a certificate authenticated by the incorporators or officers stating:
 - (A) the number of shares or other type of equity instrument without par value that are

subscribed; and
(B) the actual consideration received by the captive insurance company for those shares or other type of equity instrument.

No equivalent provision.

SECTION 8. Sections 964.059(a) and (d), Insurance Code, are amended to read as follows:

(a) The commissioner shall determine whether:

(1) the capital structure of the applicant meets the requirements of this chapter;

(2) the officers or members [directors] of the applicant's governing body [applicant] have sufficient insurance experience, ability, standing, and good record to make success of the captive insurance company probable;

(3) the applicant is acting in good faith; and

(4) the applicant otherwise satisfies the requirements of this chapter.

(d) If the commissioner does not deny the application under Subsection (c), the commissioner shall approve the application and:

(1) issue 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;

(2) certify and file the approved document with the department; and

(3) issue a certified copy of the certificate of authority to the applicant's incorporators or officers.

subscribed; and
(B) the actual consideration received by the captive insurance company for those shares or other type of equity instrument.

SECTION 1.08. Section 964.058(a), Insurance Code, is amended to read as follows:

(a) After the application and application fee for a certificate of authority under Section 964.057 are filed with the department and the applicant has complied with all legal requirements, the commissioner shall conduct an examination of the applicant to determine whether:

(1) the minimum capital and surplus, or the equivalent, requirements of Section 964.056 are satisfied;

(2) the capital and surplus, or the equivalent, are the bona fide property of the applicant; and

(3) the applicant has fully complied with applicable insurance laws.

SECTION 1.09. Sections 964.059(a) and (d), Insurance Code, are amended to read as follows:

(a) The commissioner shall determine whether:

(1) the capital and surplus, or the equivalent, [structure] of the applicant meet [meets] the requirements of this chapter;

(2) the officers or members [directors] of the applicant's governing body [applicant] have sufficient insurance experience, ability, standing, and good record to make success of the captive insurance company probable;

(3) the applicant is acting in good faith; and

(4) the applicant otherwise satisfies the requirements of this chapter.

(d) If the commissioner does not deny the application under Subsection (c), the commissioner shall approve the application and:

(1) issue 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;

(2) certify and file the approved document with the department; and

(3) issue a certified copy of the certificate of authority to the applicant's incorporators or officers.

SECTION 9. Section 964.060, Insurance Code, is amended by adding Subsection (d) to read as follows:

(d) A captive insurance company is exempt from the requirement to file an actuarial report with the company's annual report if the company:

- (1) has less than \$1 million of total direct written premium or reinsurance assumed; or
- (2) has been in operation for less than six months as of the end of the previous calendar year.

No equivalent provision.

SECTION 10. Section 964.062, Insurance Code, is amended

SECTION 11. The heading to Section 964.063, Insurance Code, is amended

SECTION 12. Section 964.063(a), Insurance Code, is amended

SECTION 13. Section 964.065, Insurance Code, is amended to read as follows:

Sec. 964.065. SUSPENSION OR REVOCATION OF CERTIFICATE OF AUTHORITY. The commissioner, after notice and an opportunity for hearing, may revoke or suspend the certificate of authority of a captive insurance company for:

- (1) insolvency or impairment of required capital or surplus to policyholders;
- (2) failure to submit an annual report, as

SECTION 1.10. Section 964.060, Insurance Code, is amended by adding Subsection (d) to read as follows:

(d) The commissioner may waive the requirement for a captive insurance company to file an actuarial report with the company's annual report if the commissioner determines that the company:

- (1) has less than \$1 million of net written premium or reinsurance assumed; or
- (2) has been in operation for less than six months as of the end of the previous calendar year.

SECTION 1.11. Section 964.061(b), Insurance Code, is amended to read as follows:

(b) A captive insurance company may make loans to its affiliates with the prior approval of the commissioner. Each loan must be evidenced by a note approved by the commissioner. A captive insurance company may not make a loan of the minimum capital and surplus funds, or the equivalent, required by this chapter.

SECTION 1.12. Same as introduced version.

SECTION 1.13. Same as introduced version.

SECTION 1.14. Same as introduced version.

SECTION 1.15. Section 964.065, Insurance Code, is amended to read as follows:

Sec. 964.065. SUSPENSION OR REVOCATION OF CERTIFICATE OF AUTHORITY. The commissioner, after notice and an opportunity for hearing, may revoke or suspend the certificate of authority of a captive insurance company for:

- (1) insolvency or impairment of required capital or surplus, or the equivalent, to policyholders;
- (2) failure to submit an annual report, as

- required by Section 964.060;
- (3) failure to comply with the provisions of its own charter, [ø] bylaws, rules, or other governing document;
 - (4) failure to submit to examination, as required by Chapter 401;
 - (5) failure to pay the cost of examination, as required by Chapter 401;
 - (6) failure to pay any tax or fee required by this code;
 - (7) removal of its principal office or books and records from this state without prior approval of the commissioner;
 - (8) use of practices that render its operation detrimental to the public or its condition unsound; or
 - (9) failure to otherwise comply with the laws of this state.

No equivalent provision.

SECTION 14. Subchapter B, Chapter 964, Insurance Code, is amended by adding Section 964.073 to read as follows:

Sec. 964.073. ADJUSTER LICENSE NOT REQUIRED.

Notwithstanding Section 4101.051, a person who acts as an adjuster, as defined by Section 4101.001, solely on behalf of a captive insurance company in adjusting a claim of an affiliate or controlled unaffiliated business insured by the company is not required to hold a license under Chapter 4101.

- required by Section 964.060;
- (3) failure to comply with the provisions of its own charter, [ø] bylaws, rules, or other governing document;
 - (4) failure to submit to examination, as required by Chapter 401;
 - (5) failure to pay the cost of examination, as required by Chapter 401;
 - (6) failure to pay any tax or fee required by this code;
 - (7) removal of its principal office or books and records from this state without prior approval of the commissioner;
 - (8) use of practices that render its operation detrimental to the public or its condition unsound; or
 - (9) failure to otherwise comply with the laws of this state.

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

(a) Any information filed with the commissioner by an applicant or captive insurance company under this chapter is confidential and privileged for all purposes, including for purposes of Chapter 552, Government Code, a response to a subpoena, or evidence in a civil action. Except as provided by Subsections (b) and (c), the information may not be disclosed without the prior written consent of the applicant or captive insurance company to which the information pertains.

(d) The secretary of state may index in the public record any document filed with the secretary by an applicant or captive insurance company.

SECTION 1.17. Subchapter B, Chapter 964, Insurance Code, is amended by adding Section 964.073 to read as follows:

Sec. 964.073. ADJUSTER LICENSE NOT REQUIRED; EXCEPTION.

(a) Except as provided by Subsection (b), a captive insurance company is not required to use a person licensed as an adjuster under Chapter 4101 to adjust losses.

(b) A captive insurance company shall 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 captive insurance company.

No equivalent provision.

SECTION 15. Chapter 964, Insurance Code, is amended by adding Subchapter C to read as follows:

SUBCHAPTER C. CAPTIVE EXCHANGES

Sec. 964.101. DEFINITIONS. In this subchapter, a term defined by Section 942.001 has the meaning assigned by that section.

Sec. 964.102. APPLICABILITY OF OTHER LAW.

Sec. 964.103. STATUS OF CAPTIVE EXCHANGES.

Sec. 964.104. ATTORNEY IN FACT REQUIREMENTS. The attorney in fact of a captive exchange must:

(1) be:

(A) a corporation organized in this state in accordance with Section 942.051; or

(B) a limited liability company organized in this state;

(2) on the date of the captive exchange's formation, have an existing affiliation with all subscribers of the captive exchange regardless of any affiliation relationship created by the captive exchange;

(3) have its principal office 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 must be a resident of this state.

Sec. 964.105. ATTORNEY IN FACT POWERS AND DUTIES.

Sec. 964.106. RELATIONSHIP REQUIREMENTS. (a) On the date of the captive exchange's formation, each subscriber of a captive exchange must have an existing affiliation with each other

ARTICLE 2. CAPTIVE EXCHANGES

SECTION 2.01. Chapter 964, Insurance Code, is amended by adding Subchapter C to read as follows:

SUBCHAPTER C. CAPTIVE EXCHANGES

Sec. 964.101. APPLICABILITY OF OTHER LAW.

Sec. 964.102. STATUS OF CAPTIVE EXCHANGES.

Sec. 964.104. ATTORNEY IN FACT REQUIREMENTS. The attorney in fact of a captive exchange must:

(1) be:

(A) a corporation organized in this state; or

(B) a limited liability company organized in this state;

(2) on the date of the captive exchange's formation, have and maintain a power of attorney with all subscribers of the captive exchange;

(3) have its principal office 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 must be a resident of this state.

Sec. 964.105. ATTORNEY IN FACT POWERS AND DUTIES.

Sec. 964.103. SUBSCRIBER REQUIREMENTS. On and after the date of the captive exchange's formation, each subscriber of the captive exchange must:

(1) have an existing affiliation with each

subscriber regardless of any affiliation relationship created by the captive exchange.

(b) On the date of the captive exchange's formation, a controlled unaffiliated business of the captive exchange must have an existing contractual relationship with an affiliate that qualifies as a subscriber.

Sec. 964.107. SUBSCRIBER DECLARATION.

No equivalent provision.

No equivalent provision.

SECTION 16. This Act takes effect September 1, 2017.

other subscriber; or

(2) satisfy the definition of a controlled unaffiliated business regardless of any affiliation relationship created by the captive exchange.

Sec. 964.106. SUBSCRIBER DECLARATION.

ARTICLE 3. TRANSITION AND EFFECTIVE DATE

SECTION 3.01. The change in law made by this Act to Section 964.070, Insurance Code, applies only to information filed with the secretary of state on or after September 1, 2017. Information filed with the secretary of state 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. This Act takes effect immediately if it receives a vote of two-thirds of all the members elected to each house, as provided by Section 39, Article III, Texas Constitution. If this Act does not receive the vote necessary for immediate effect, this Act takes effect September 1, 2017.