



# Arizona State Senate Issue Brief

August 3, 2018

## Note to Reader:

The Senate Research Staff provides nonpartisan, objective legislative research, policy analysis and related assistance to the members of the Arizona State Senate. The *Research Briefs* series is intended to introduce a reader to various legislatively related issues and provide useful resources to assist the reader in learning more on a given topic. Because of frequent legislative and executive activity, topics may undergo frequent changes. Nothing in the Brief should be used to draw conclusions on the legality of an issue.

## CAPTIVE INSURANCE

### INTRODUCTION

Self-insurance is a risk management tool. Instead of paying premiums and assigning the risk to a commercial insurer, an entity sets aside an appropriate amount of money (pays premiums to itself) and retains that risk.

Captive insurance is a form of self-insurance where a captive insurer (captive) is created by a company or group of companies to insure the specific risks associated with those companies that formed the captive. It is a way for a business or group of businesses to maintain an insurance policy (through the captive) without relying on products sold by a commercial insurer in the open market. This enables the company or companies to save money on expenses and premiums, because, in theory, they are better able to assess their own risks than the market as a whole. Captives can be formed by companies and corporations, insurance companies or agencies, trade associations, or groups of professionals. Traditionally, captives cover property and casualty insurance, including insurance for general liability, professional liability, officers and directors, and property.

Captives are formed for many economic reasons in that they provide the parent or affiliate company with direct control over coverage, pricing, loss control and administration. For example, premium pricing can be based on the company's own risk class and patterns, not on the entire industry. Higher control of earnings through favorable tax rules, lower deductibles and increased investment income are other reasons for the formation of a captive. Again, prices and deductibles are typically more predictable for captives, allowing more accurate budget forecasting. Captives also cover risks that may be unique to certain companies, for which the market rate is considered exorbitant or for coverage that is unavailable through the traditional market. According to the Insurance Information Institute (III), there are 29 captive domiciles in the United States, including 28 states and the District of Columbia, that permit captive insurance companies in their jurisdiction.<sup>1</sup>

<sup>1</sup> III – Captives By State, 2016-2017

## ARIZONA CAPTIVE INSURANCE

In 2001, legislation establishing a Captive Insurance Program (Program) within the Arizona

Department of Insurance (DOI) was enacted, permitting and regulating the formation of pure captive insurers and group captive insurers. Captives were prohibited from insuring hospital and medical service organizations, health care service organizations (HMO), prepaid dental plan organizations, prepaid legal insurance contracts, title insurance businesses, mortgage guaranty insurance, workers' compensation and motor vehicle or homeowners' insurance. Other requirements and restrictions were also imposed.<sup>2</sup>

Legislation passed in 2003 expanded the Program to allow additional captive insurers to be licensed and operate in the state, including agency captives, protected cell captives and expanded forms of group captives. The 2003 legislation also allowed pure captives to provide direct coverage of workers' compensation or employers' liability insurance.<sup>3</sup> In 2004, the Program was again expanded to allow nonprofit corporations to form group and pure captive insurers.<sup>4</sup> Statutory changes in 2005 allowed captive insurers more freedom to establish essential business relationships with professionals outside of Arizona and required an annual actuarial opinion on the adequacy of a captive insurer's loss reserves and loss expense reserves.<sup>5</sup>

Legislation passed in 2007 allowed for the creation of branch captive insurers, while also modifying existing requirements and restrictions on the entire industry. Changes included allowing captives to insure commercial motor vehicle insurance policies, requiring captive managers to do business within the state and altering captive reporting and audit requirements.<sup>6</sup>

In 2008, the Legislature further amended captive insurance statutes by allowing captives to directly insure employment practices liability risk. Major changes also included the ability of branch captives to offer the same lines of coverage as are statutorily permissible to pure captives and the ability for pure captives to form as a limited liability company.<sup>7</sup>

In 2013, the Legislature added clarifications relating to captive insurer reporting requirements. Specifically, financial statements issued by captive insurers were required to be in compliance with statutory provisions and procedures applicable to other insurers, and annual reports were required to be based on the types of risks insured and meet either: 1) statutory requirements for insurers relating to life and health actuarial opinions and memoranda; 2) statutory requirements for insurers relating to property and casualty actuarial opinions; or 3) actuarial provisions of the National Association of Insurance Commissioners health annual statement instructions.<sup>8</sup>

Every year, licensing fees paid by captive insurers operating in Arizona are deposited into the Captive Insurance Regulatory and Supervision Fund (Fund). At the end of the fiscal year, all unencumbered monies exceeding \$100,000 in the fund are reverted back into the state General Fund, and the Director of DOI (Director) is authorized to use the \$100,000, or whatever amount is available, to promote Arizona's captive insurance industry. As of August 9, 2017, an additional \$100,000 may be retained in the Fund every year, allowing the Director to utilize up to \$200,000 annually to promote the captive insurance industry in Arizona.<sup>9</sup>

The most recent changes to the captive insurance statutes were enacted in 2018, when the Legislature allowed agency captive insurers to directly insure certain life or disability insurance

<sup>2</sup> [Laws 2001, Chapter 327, A.R.S. § 20-1098](#)

<sup>3</sup> [Laws 2003, Chapter 242, A.R.S. §§ 20-1098.01; 20-1098.05; 20-1098.06](#)

<sup>4</sup> [Laws 2004, Chapter 32, A.R.S. § 20-1098.04](#)

<sup>5</sup> [Laws 2005, Chapter 165, A.R.S. §§ 20-1098.04; 20-1098.07](#)

<sup>6</sup> [Laws 2007, Chapter 122, A.R.S. § 20-1098](#)

<sup>7</sup> [Laws 2008, Chapter 213, A.R.S. §§ 20-1098.01; 20-1098.19](#)

<sup>8</sup> [Laws 2013, Chapter 35, A.R.S. §§ 20-1098.07, 20-1098.15](#)

<sup>9</sup> [Laws 2017, Chapter 281, A.R.S. § 20-1098.18](#)

risks, subject to approval by the Director, and established applicable regulatory criteria that must be met in order to insure these risks. Such criteria include the requirement that an agency captive insurer have its financial statements audited by an independent certified public accountant and that each insurance policy and certificate contain conspicuous disclosure that the policy is being issued by an insurer who is not an Arizona Insurance Guaranty Fund member. An agency captive insurer is one that is owned by one or more business entities that are licensed in any state as insurance producers or managing general agents and that only insure risks on policies placed through their owners. The 2018 legislation limited the types of life or disability insurance risks that an agency captive insurer may insure directly to employer group term life insurance, employer group disability income insurance and reimbursement of employer health plan deductibles.<sup>10</sup>

According to DOI, there were 121 active captive insurers operating in Arizona as of April 30, 2018.<sup>11</sup>

### **ADDITIONAL RESOURCES**

- Arizona Department of Insurance  
100 N. 15<sup>th</sup> Avenue, Suite 102  
Phoenix, AZ 85007  
602-364-4490  
<https://insurance.az.gov/>
- Captive Insurers Statutes: [Arizona Revised Statutes, Title 20, Chapter 4, Article 14](#)
- Arizona Captive Insurance Association: [www.azcia.org](http://www.azcia.org)

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<sup>10</sup> [Laws 2018, Chapter 273, A.R.S. § 20-1098.01; A.R.S. § 20-1098.17](#)

<sup>11</sup> [AZDOI – Captive Insurance Facts and Stats](#)