

Department of Legislative Services
Maryland General Assembly
2013 Session

FISCAL AND POLICY NOTE
Revised

House Bill 1205
Economic Matters

(Delegate Rudolph)

Finance

Study of Captive Insurers

This bill requires the Maryland Insurance Administration (MIA) to examine methods to establish and properly regulate a captive insurer industry in the State. MIA may hire an outside consultant to assist in the study. A report with findings and recommendations is due by December 31, 2013.

The bill takes effect June 1, 2013.

Fiscal Summary

State Effect: No effect in FY 2013. Significant increase in special fund expenditures in FY 2014 for MIA to hire an outside consultant to conduct the study. No impact on special fund revenues.

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary: MIA must 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 professions 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 MIA considers relevant to assessing the possibility of establishing a captive insurance industry in the State.

MIA must also make recommendations for whether Maryland should establish a captive insurance industry and, if so, how to establish, promote, and regulate the industry.

Current Law/Background: Captive insurance companies are not allowed to domicile in the State.

The simplest definition of captive insurance is a type of alternative risk financing in which the insurance company is owned by the insured. The initial funding and coverage is limited to either one company or a particular enterprise. An insurance captive's services are not available to the general public. However, it is important to note that a captive is not in opposition to a traditional insurance company. Often, the owner of a captive will still work with a large insurer in order to cover large losses.

There are several different types of captive insurance companies:

- Pure Captive – The captive is formed to provide insurance to a parent company or its subsidiaries.
- Association Captive – The captive is formed by an industry, trade, or service group strictly for the benefit of its members.
- Group Captive – The captive is formed by a group of companies to provide insurance for a shared need.

- Agency (or Reinsurance) Captive – The captive is formed by an insurance company to provide reinsurance to their clients.
- Rent-a-captive – The captive “rents” its facilities to another company, most likely smaller, that lacks the resources to create a captive. This captive is an arrangement in which a captive insurer “rents” its facilities to an outside organization, thereby providing the benefits that captives offer without the financial commitments that captives require. In return for a fee (usually a percentage of the premium paid by the renter), certain captives agree to provide underwriting, rating, claims management, accounting, reinsurance, and financial expertise to unrelated organizations.
- Protected Cell Company (or Segregated) Captive – Essentially rent-a-captives, protected cell company captives allow renters to protect their capital and surplus from other renters as long as the rent-a-captive’s owner remains solvent.

In 1986, there were 100 captives domiciled in the United States. According to *Business Insurance*, in the past 25 years, there has been a dramatic increase. This increase is indicative of the numerous benefits a captive brings its creator. Forming a captive can offer its creator lower and more stable insurance premiums than those offered by a traditional insurer because a captive has no marketing expenses and lower personnel and overhead expenses and is not intent on making a profit. Companies may also form a captive because finding a traditional insurer to insure certain types of risks, such as sensitive product liability, environmental impairment, or pharmaceutical liability, can be extremely difficult or prohibitively expensive. In these instances, captives provide an opportunity for insureds to meet certain legal or contractual obligations. Captives also improve the cash flow of a company’s premium payments. By retaining premiums and paying insured losses only as they arise, the parent company can gain investment income from the premiums.

Currently, more than 30 states and the District of Columbia allow captives. Vermont, Hawaii, Utah, South Carolina, and the District of Columbia are the jurisdictions with the most domiciled captives.

State Expenditures: MIA advises that it is highly likely that an outside consultant will be needed to assist in achieving the stated goals of the study. The hiring of an outside consultant is reasonable – given the quick turnaround from the bill’s June 1, 2013 effective date to its December 31, 2013 reporting date, the complexity of the issues to be studied by MIA, the research required to review other states’ regulatory models, and the bill’s authorization to hire the consultant. Despite the bill’s June 1, 2013 effective date, it is assumed that MIA will not be able to hire an outside consultant until early July 2013.

MIA advises that it may cost as much as \$400,000 to hire the consultant and prepare the report. The Department of Legislative Services is unable to verify this estimate, but any increase in special fund expenditures to hire an outside consultant is expected to be significant.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Maryland Insurance Administration, *Business Insurance*, www.PropertyCasualty360.com, www.vermontcaptive.com, www.irmi.com, Department of Legislative Services

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