



STATE OF ARIZONA
DEPARTMENT OF INSURANCE

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TO: Insurers, Insurance Trade Associations and Other Interested Persons

FROM: Charles R. Cohen
Director of Insurance

DATE: June 5, 2002

RE: **Arizona Captive Insurance Program**

HB 2116, enacted in 2001 and effective July 1, 2002, allows for the formation of captive insurance companies under Arizona law. The purpose of this Regulatory Bulletin is to describe key elements of the new laws, to discuss the applicability of other insurance laws, and to describe the administrative components of this new program.

The captive insurer laws are set forth at A.R.S. § 20-1098, *et seq.* The article permits the formation of "pure" and "association" captive insurers. A "pure captive insurer" may insure the risks of its affiliates or "controlled unaffiliated business". A.R.S. § 20-1098(8). An "association captive insurer" may insure the risks of the member organizations of the association or their affiliates. A.R.S. § 20-1098(3). A captive insurer must maintain a principal place of business and hold at least one board of directors meeting in Arizona each year. A.R.S. § 20-1098.01(B). It must also establish any necessary business relationships with accountants, banks, attorneys, and other professionals doing business at a location in Arizona. A.R.S. § 20-1098.01(D)(6). A captive insurer must also engage a "captive manager" that resides in Arizona. A.R.S. §§ 20-1098(6), 20-1098.01(D)(5) and 20-1098.14. The article sets forth additional requirements related to the formation, licensing and regulation of captive insurers. A more comprehensive description of the entire article is provided in the Captive Insurance Overview which may be viewed on the Department's website or obtained from the Captive Insurance Administrator, as described below.

Certain elements of the law merit specific description or amplification, as follows:

Fees: A.R.S. § 20-167(H) requires captive insurers to pay certain fees prescribed by the Director. Accordingly, the Department has promulgated A.A.C. R20-6-2002 requiring captive insurers to pay a fee of \$1,000 for issuance of the license, and an annual renewal fee of \$5,500.

Form of Minimum Capital and Surplus: The minimum capital and surplus required by A.R.S. § 20-1098.03 may be in the form of cash or an irrevocable and unconditional letter of credit that satisfies the conditions set forth in the statute.

Annual Report: The Department has developed a recommended form of annual report for captive insurers to satisfy the requirements of A.R.S. § 20-1098.05. The form and instructions are available through the Captive Insurance Administrator, as described below.

Applicability of Title 20: Pursuant to A.R.S. § 20-1098.13, Chapter 2, Article 6 of Title 20, relating to unfair practices and frauds, applies to captive insurers, except for the following provisions which are inappropriate in light of the nature of captive insurance:

- §20-448.C (unfair discrimination, other than life and disability)
- §20-451 (rebates, other than life and disability)
- §20-452 (prohibited inducements)
- §20-460 (free choice of insurance producer)
- §20-465 (fees charged by producers and insurers)
- §20-466 (G) and (H) (fraud referrals, assessments)
- §20-466.03 (fraud statement on claim form)

All other provisions of A.R.S. Title 20 that are not inconsistent with the captive insurer article are applicable to captive insurers, except for the following provisions which are inappropriate in light of the nature of captive insurance:

- §20-156(G) (financial surveillance assessment)
- §20-213 (deposit requirements)
- §20-229 (countersignature requirement)
- Chapter 2
 - Article 4 (rates and rating organizations)
 - Article 4.1 (open competition rates and rating organizations)
 - Article 4.2 (compliance with filed rates)
 - Article 8 (insurance holding company systems)
- §§20-1111 through 20-1117 (policy forms)
- §§20-1120 through 20-1122 (binders; renewal of policy by certificate or endorsement; assignment of policies)
- Chapter 6
 - Article 7 (property insurance)
 - Article 14 (cancellation or non-renewal of commercial insurance)

Other provisions of Title 20 that are inconsistent with express provisions of the captive insurer article are not applicable to captive insurers, although not specified here. The Department may make further determinations as to the applicability of other insurance laws to captive insurers as those issues arise, and will announce those determinations as appropriate.

Premium Tax: Arizona captive insurers are not required to pay state premium taxes. A.R.S. § 20-1098, *et seq.* does not contain premium tax requirements. This omission is crucial because comparison to captive insurance laws in other domiciles, U.S. and alien, plainly shows that when captive insurance premiums are taxed it is according to a schedule specific to that form of insurance rather than at the rates applicable to ordinary commercial insurance business. As evidenced by the legislative history, the Arizona legislature made a deliberate decision to enact a statutory scheme that would not impose premium taxes on these specialized insurers. Laws 2001, Ch. 327 (HB 2116). Specific language describing the constitutional requirement for a two-thirds affirmative vote of the legislature, often referred to as a “Prop. 108 clause”, is required for any legislation that imposes a new tax, fee or assessment. (See Ariz. Const. Art. IX, § 22(D).) The captive insurance bill was enacted without a “Prop. 108 clause.” Moreover, testimony offered during legislative committee hearings concerning the bill demonstrates legislative intent to avoid imposition of premium taxes. (See January 24, 2001 minutes of the House Committee on Financial Institutions and Insurance; March 29, 2001 minutes of the Senate Committee on Banking and Insurance.) Thus, it is not within the Director’s discretion to impose premium taxes on captive insurers by finding that the general premium tax statute (A.R.S. § 20-224) applies to captive insurers.

Earlier this year, the Department established a separate Captive Insurance Division to handle the licensing and regulation of captive insurers, and to work with stakeholders on the development of the captive insurance industry in Arizona. I have appointed Richard P. Marshall as the Department’s Captive Insurance Administrator in charge of the new division and this new program. Mr. Marshall has extensive experience in the private sector directly involved in the development, formation and management of captive insurance programs.

Please visit the Department’s web site (www.state.az.us/id) for additional information on captive insurers. Requests for additional information or questions on forming a captive insurer in Arizona should be directed to Richard P. Marshall, Captive Insurance Administrator, at (602) 912-8420 or rmarshall@id.state.az.us. The Department will accept applications from prospective captive insurers starting July 1, 2002.