



Insurance Law Alert

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The Ohio Captive Insurance Company Law A Captivating Tool for Risk Management Programs

Ohio is positioning to be one of the next states to allow the formation of captive insurance companies. House Bill 117 was passed by the Ohio House on June 4, 2013, and is now before the Ohio Senate for passage. All signs indicate the bill will be signed by the Governor this year. Attorneys at Porter Wright were instrumental in drafting the initial language for the bill and addressing issues raised by the Ohio Department of Insurance (ODI) and other interested parties as the bill gained footing. House Bill 117 provides for the formation of pure captives and protected cell captive insurance companies.

The Ohio captive insurance company bill represents an alternative to traditional insurance for Ohio companies or companies doing business in Ohio. Previously, Ohio-domiciled captives were not an option for Ohio companies who were instead forced to establish their captives in foreign jurisdictions. Captive formation in other jurisdictions is not without risk and a number of administrative burdens.

Pure captives authorized under the Ohio bill will be able to underwrite the risks of their parent and affiliates' insurance needs. Protected cell captive insurance companies are captives consisting of separate cells, and each cell owns particular liabilities and has assets associated with those liabilities. A cell is not liable for the liabilities associated with another cell's assets or the protected cell captive's general assets.

Though large corporations have benefitted from operating captives for many years, smaller, closely held companies are now learning that captives can provide substantial benefits as part of a risk management program. Some of the benefits of a well-managed captive insurance company include:

- Tax deduction for the parent or affiliates for the insurance premium paid to the captive;
- Greater policyholder control over its risk management programs;
- Other tax savings opportunities, such as gift and estate tax savings;
- Opportunity to accumulate wealth in a tax-favored vehicle;
- Asset protection from the claims of business and personal creditors;
- Opportunity for stabilized or reduced insurance costs;
- Access to worldwide reinsurance markets; and
- Insuring risks that would otherwise be uninsurable or cost prohibitive.

Pure captives will be the focus of most Ohio companies or companies doing



business in Ohio. Highlights of the proposed Ohio captive insurance company bill relating specifically to pure captives include:

Permitted lines of insurance – A captive may only offer the following types of insurance coverage:

1. Commercial multiple peril
2. Ocean marine
3. Inland marine
4. Medical malpractice
5. Workers compensation (to the extent permitted by Ohio law but only for the purpose of indemnifying a self-insuring employer)
6. Commercial auto liability
7. Commercial auto physical damage
8. Fidelity
9. Surety
10. Any other line that the ODI superintendent permits

Distinct regulatory scrutiny – The bill requires pure captives to maintain minimum capital and surplus of \$250,000. Capital and surplus must be in the form of cash, marketable securities or irrevocable, unconditional and automatically renewable letters of credit. The captive’s board of directors will determine appropriate investments for the captive by adhering to a prudent-person standard of investment, employing a strategy that seeks to preserve capital and is not overly speculative. A captive may make a loan to, or an investment in, its parent or an affiliate only with the approval of the ODI superintendent. Captives are prohibited from joining or contributing financially to any guaranty or insolvency fund in Ohio and are prohibited from being required to join a rating organization. Generally, captives will be governed only by the Ohio captive statute and only such other provisions of the Ohio Insurance Code specified in the Ohio captive statute.

Greater confidentiality of information – Documents submitted to the ODI related to an application for a captive license or to material changes to insurance products offered by a captive are confidential and are not subject to a public records request made under Ohio’s Public Records Law. The authority of the ODI to share a captive’s confidential information is more limited than that obtained from traditional insurers.

Premium tax payments – The Ohio bill requires captives to pay fees based on premium collected, in an amount equal to 0.35 percent of net-direct premiums and 0.15 percent of revenue from assumed reinsurance premiums. A captive must pay an annual minimum aggregate fee of \$7,500 and an annual maximum aggregate fee of \$250,000.

Redomestication of foreign captives – A captive formed under the laws of another state or jurisdiction may become an Ohio domestic captive by complying with the requirements of the Redomestication Model Act.

For the premium payment to the captive to be deductible as an insurance expense, the captive must be able to prove it is a valid insurance company (payments for self-insurance generally are not deductible). Insurance for tax purposes must include elements of risk transfer, e.g., transfer of specific risks in exchange for a reasonable premium, and risk distribution, e. g., combining particular risks in a pool with other, independently insured risks. In addition, for a captive to be considered an insurance company for federal purposes, more than 50 percent of its total revenue must be from the issuance of insurance. The Internal Revenue Service has formulated “safe harbor” rules to permit the proper structuring and management of captives for federal tax purposes. A captive will be evaluated based on its individual facts and circumstances but the safe harbor rules allow for the proper structuring of captives to adhere to the principles of risk transfer and risk distribution.

If you have questions regarding House Bill 117 or the formation, benefits and risks of captive insurance companies, please contact **Mark Koogler** or **Cassandra Mendoza**.

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