

**CHAPTER 6. CAPTIVE INSURANCE**  
**28 TAC §§6.1, 6.2, 6.101 - 6.105, 6.201 - 6.203, 6.301 - 6.307,  
6.401 - 6.410, 6.501, 6.601, and 6.701**

**1. INTRODUCTION.** The Texas Department of Insurance proposes adding new Chapter 6 and 28 Texas Administrative Code §§6.1, 6.2, 6.101 - 6.105, 6.201 - 6.203, 6.301 - 6.307, 6.401 - 6.410, 6.501, 6.601, and 6.701 to implement Insurance Code Chapter 964 enacted under Senate Bill 734, 83rd Legislature, 2013, effective June 14, 2013. These sections are grouped into eight subchapters that concern: (i) general matters related to the implementation of these sections; (ii) registration of captive management companies; (iii) issuance of a certificate of authority to a captive insurance company; (iv) maintenance of the captive insurance company's certificate of authority; (v) financial reporting for the captive insurance company; (vi) workers' compensation insurance; (vii) captive insurance company tax waivers; and (viii) disciplinary actions.

The proposed sections are flexible enough to accommodate the various structures, risks, and management approaches for captive insurance companies while also meeting the statutory requirements that captive insurance companies must be financially stable, maintain adequate reserves to service the risks that they insure, and retain experienced management to make success of the entity probable. The following discussion provides a general overview of the sections.

**Subchapter A. General Matters.** This subchapter addresses definitions and submission requirements applicable to the chapter.

**§6.1. Definitions.** This section incorporates the definitions established in Insurance Code §964.001 and establishes additional defined terms.

Insurance Code §964.001 defines the terms “captive insurance companies” and “captive management companies.” Insurance Code §964.001 defines a captive management company as an entity, and Insurance Code §964.053(b) provides that a captive insurance company may be formed and operated as any type of business organization authorized under the Business Organizations Code. The terms are used throughout Insurance Code Chapter 964, but the reference neither creates a requirement that these entities must be corporations nor does the reference only apply to entities formed as corporations. Subsection (a) incorporates the statutory definitions into these sections.

The term “annual report” incorporates the three required component parts of the report. As stated in the definition, these component parts are addressed in other sections and the adopted Texas Captive Annual Report form and its instructions.

The term “certificate of filing” is used in these sections instead of the term “certificate of formation.” The term “certificate of filing” has been offered by the Secretary of State to better track the terminology for the document the Secretary of State will issue when the captive insurance company entity is formed.

The term “general partnership” is defined to include a general partnership designated as a limited liability partnership. This is based on information from the Secretary of State that a limited liability partnership is not a separate type of entity, but a designation that a general partnership or limited partnership may hold. This distinction

is necessary because Insurance Code §964.053(b) prohibits formation of a captive insurance company as a general partnership.

The term “governing body” is also defined for the purpose of implementing Insurance Code Chapter 964, because it may have different meanings between its use in the formation of certain entities under the Business Organizations Code and the department’s interpretation of its use in Insurance Code Chapter 964. Specifically, the Business Organizations Code may allow for the governing body of certain entities to be other entities. Insurance Code §964.053(d) and (e) require the captive insurance company to designate individuals as a members of a governing body for the purpose of performing acts necessary to comply with Insurance Code Chapter 964 and these sections. The term “governing body” in these sections applies to those individuals, and not to formation of the entity. These sections are not intended to create or amend any formation or submission requirements used by the Secretary of State.

**§6.2. Submissions and Notifications to the Commissioner and Department.** This section provides instructions for delivering submissions and notices to the commissioner and department.

**Subchapter B. Captive Management Companies.** This subchapter addresses the registration of captive management companies, the duration of the registration, the designation of the responsible party, contracting with the captive insurance company, and requirements of a contract with the captive insurance company.

**§6.101. Registration of Captive Management Companies.** Registered captive management companies may provide administrative services to captive insurance companies. As provided in subsection (a), the commissioner must approve the captive management company's registration prior to providing administrative services. The sections do not prohibit a captive management company from seeking registration approval at the same time the captive insurance company submits its application. However, the department will not approve the captive insurance company's application if the registration is not approved and the unregistered captive management company continues to be listed as providing administrative services to the captive insurance company.

Subsection (b) establishes that individuals may not provide administrative services to a captive insurance company except as an employee of a captive insurance company or a captive management company. This requirement is based on the language in Insurance Code §964.001 defining "captive management company" and the registration requirement in Insurance Code §964.067. Administrative services are defined in §6.1.

Subsection (c) establishes the information that the captive management company must provide the department when registering as a captive management company. This includes information about the captive management company and the captive management company's designated responsible party. The designated responsible party will be the primary source of contact for the department. Information related to the designated responsible party is listed in §6.103. While the department

may provide a registration form that registrants may submit, the department has chosen not to establish a requirement that the registrant must use a specific form to submit the required information.

The department considers this level of review both necessary and authorized by statute. Insurance Code §964.067 requires a captive management company to register with the department and provide information required by the commissioner. This is a legislative direction that provides the ability to set some standard for registering and maintaining that registration. The department is concerned that captive insurance companies will have varying levels of resources and sophistication to independently evaluate solicitations from these third party contractors.

To the extent that some captive insurance companies may place weight on a department registration, some level of review is warranted before the registration is granted. However, the captive management company is not a risk bearing entity, and it is limited to providing administrative services within the scope of a contract with a captive insurance company that is limited under Insurance Code Chapter 964 to insuring its affiliate's risks and unaffiliated controlled business risks. The department has proposed a limited level of review focused on information about the captive management company's designated responsible party, in addition to basic contact and identification information.

Because the captive management company may have the required information in another format for another jurisdiction, the department has chosen not to establish a

requirement that the registrant must use a specific Texas form to submit the required information.

**§6.102. Maintenance and Duration of the Registration.** Subsection (a) provides that a captive management company must notify the department of changes in its registration information within 30 days of the change. Subsection (b) establishes that the captive management company must replace a designated responsible party within 30 days or it may no longer operate as a captive management company. This is because this person is the identified representative of the captive management company and operating without a designated responsible party does not comply with this chapter. While the department prefers that the captive management company not have any gap in a designated responsible party, the 30-day period allows the captive management company time to comply following an unexpected event without an immediate disruption in its operations and the captive insurance company's operations.

Subsection (c) provides that a captive management company's registration will expire if the entity is not actively providing administrative services to a captive insurance company for more than 90 days. This is necessary to ensure that registered captive managers are active participants in the Texas market and not simply seeking a designation. Further, the requirement for reentry into the market is extremely low, and the sections do not prohibit a captive management company from applying for a registration at the time a captive insurance company that it will manage begins the more extensive process of seeking a certificate of authority.

Subsection (d) establishes that a captive management company with an expired registration must resubmit its registration. The subsection also provides that the commissioner may waive requirements for certain information if requested by the registrant and the department determines that the information is unnecessary.

**§6.103. Designated Responsible Party.** Subsection (a) specifies the qualification for an individual to be designated a responsible party and the information that must be provided about the designated individual. This includes identifying information, professional background information, criminal history, and, unless exempt, a criminal history background check using the procedure under §1.509 of this title as authorized by Government Code §411.106.

If the designated responsible party has submitted a set of fingerprints to the department for a license that is currently active, the individual is not required to submit another set of fingerprints under §1.504(b)(1). Otherwise, fingerprint background checks will be conducted using established department processes specified in §1.509. Electronic fingerprinting is preferred and is done through the Texas Department of Public Safety's (DPS) vendor. The print is electronically determined to be usable at the time of collection, forwarded to the DPS and FBI for review, and the results are made available securely to the department within a few days. Persons may also submit paper fingerprint cards. However, reprints are often required if the DPS determines after it receives the prints that they are unsuitable for scanning into an electronic format. Payment of fees is required under §1.509. The vendor, DPS, and the FBI establish fee and payment requirements.

The designated responsible party must not have a prior criminal history that would bar the person from licensure under §1.502 of this title.

**§6.104. Administrative Services Contracts.** This section addresses administrative service contracts between captive management and captive insurance company or other captive management companies. The captive insurance company may elect to perform administrative service functions in-house, directly contract with separate captive management companies to perform different administrative service functions, contract with a captive management company that will then contract with other captive management companies, or some combination of these structures.

Subsection (a) provides that the captive insurance company may contract with a number of captive management companies. Subsection (b) provides that captive management companies may contract with other captive management companies if the captive insurance company approves.

However, as addressed in subsection (c), regardless of the contractual relationships, the captive insurance company remains responsible for compliance with all statutory and regulatory requirements. The captive insurance company is the entity obligated on the risk, and it has a duty to manage that risk in compliance with the law. Subsection (d) provides that subsection (c) does not limit the duty of the captive management company to also comply with statutes and regulations. The department intends to allow for flexible structures; however, compliance cannot be avoided by attempting to shift blame for a violation between the entities.



The Insurance Code and other laws require persons performing certain functions to have a license. For example, adjusters require a license. To the extent the entity or the employee performing a function is required to have a license, subsection (e) requires them to hold the license. A captive management company registration does not authorize the captive management company or its employees to perform a licensed service without the required license.

**§6.105. Agreements to Provide Administrative Services.** This section establishes certain provisions that must be incorporated into a captive management contract. Insurance Code §964.059(b)(3) and (5) authorize the commissioner to consider the overall soundness of the captive insurance company's plan of operations and factors relevant to determining whether the captive insurance company will be able to meet its policyholder obligations. The requirements are basic, but have presented impediments to insurers fulfilling their obligations in the department's regulatory experience.

Further, as provided in Insurance Code §964.055, books and records are subject to Insurance Code Chapter 803. Insurance Code §803.005 requires that the books, records, accounts, or offices of a domestic company must be under the company's direct supervision, management, and control. Section 803.008 authorizes the commissioner to adopt rules to authorize a domestic company to maintain its books and records with a nonaffiliated entity other than an agency. This section establishes contracting requirements.

**Subchapter C. Captive Insurance Company Application Process.** This subchapter establishes the procedure for submitting a captive insurance company certificate of authority application and the information the department will require to process that application. The procedure is intended to minimize delay and create a reasonable and flexible process within the scope of the statute. Further, while not required by these sections, an applicant may request an initial meeting and cursory business plan review prior to filing an application, to expedite the process. Because the department's financial evaluation and qualifying examination of the proposed captive insurance company may require significantly more time than the Secretary of State's review and issuance of a certificate of filing, the sections do not require the company to be formed prior to the department commencing its review.

**§6.201. Captive Insurance Company Certificate of Authority Required.** This section requires an applicant to submit an application providing the information in §6.202 of this title and the required fee to apply for a certificate of authority. The department has chosen not to require or adopt a specific form or format for submitting the information, because the applicant, in particular those applicants redomesticating to Texas from other domiciles, may have the required information on other forms and in other formats. The department seeks to work with these applicants in minimizing the cost, delay, and effort required in applying for a Texas certificate of authority.

Until January 1, 2019, Insurance Code §964.057(d) establishes an application fee of \$1,500. Insurance Code §964.057(c) requires the commissioner to set an application fee of not less than \$1,500 by rule for applications commencing on and after

January 1, 2019. Establishing the fee at this time eliminates the need to have another proposal simply to set that fee. If the department determines that a greater fee is necessary for applications commencing on and after January 1, 2019, a subsequent proposal will be necessary.

#### **§6.202. Captive Insurance Company Certificate of Authority Application**

**Contents and Process.** This section lists the information an applicant for a certificate of authority must submit and describes the application process. The application requirements in subsections (a) - (d), including a plan of operation, certifications, and verifications, are authorized under Insurance Code §964.057 and necessary to evaluate the applicant under Insurance Code §964.059. To retain some flexibility in this new licensing area, subsection (g) provides that the commissioner may waive the submission of certain information if warranted. Further, the department has not proposed to adopt and require a specific application form. Subsection (d) will allow the applicant to use forms and formats from other jurisdictions or other recipients that provide the required information.

Subsection (a)(1) - (10) lists general information requirements about the captive insurance company applicant. The required information includes biographical affidavits on certain persons listed in §6.303 of this title, unless the function that person is performing has or will be contracted to a captive management company. This review is authorized under Insurance Code §964.059(b)(2). Fingerprints are not required under this section for these individuals. In the situation of pure captives and to some extent

controlled unaffiliated business captives, these persons are not managing an unrelated third party's risk.

Subsection (a)(11) lists the requirements for a plan of operation. The department considers this information to be critical in assessing the viability and soundness of the captive insurance company. Subsection (b) lists additional requirements that apply to captive insurance company applicants that are redomesticating to Texas. Subsection (c) lists additional requirements that apply to captive insurance company applicants that will be operating with unaffiliated controlled businesses.

As described in subsection (e), the department will review the submitted information. In discussions with the department or during the process of the examination, the applicant entity may amend its information without restarting the application process. Following completion of the review, either the department will issue a certificate of general good, or the commissioner will deny the application. Denial of the application will trigger administrative rights the applicant has under Insurance Code §964.059. The statute does not require a certificate of general good; however, this section establishes that the department will provide written confirmation to the applicant that the application is acceptable.

As described in subsection (f), the department will then consider a certificate of filing from the Secretary of State as the next step in the process of issuing the certificate of authority. As to whether the Secretary of State will consider the certificate of general good in its review is a matter solely within the discretion of the Secretary of State. The

certificate of filing must be accompanied by the affidavits and information required under Insurance Code §964.057.

### **§6.203. Issuance of Captive Insurance Company Certificate of Authority**

**Application.** This section provides that when the department has received the required information under §6.202 and certificate of filing as required under §6.202, the department will conduct a final review of the documents to determine if a certificate of authority should be issued. This review will satisfy the qualifying examination requirement under Insurance Code §964.058 for start-up captive insurance companies and the commissioner's determination requirement under Insurance Code §964.071 for redomestications. The department anticipates that in most cases the entity documentation will be submitted to the Secretary of State within days after the certificate of general good is issued and that the certificate of filing will be provided to the department within a few days of that submission. However, if a significant period of time has elapsed following the issuance of the certificate of general good, or some irregularity appears, the department may request updated projections or other information. Communication throughout the application process, especially of any foreseen or unforeseen difficulties, will enhance the process for all parties.

**Subchapter D. Maintenance of a Captive Insurance Company's Certificate of Authority.** This subchapter establishes the requirements for maintenance of a captive insurance company's certificate of authority. In addition, §6.302 and §6.303 address the captive insurance company's governing body and persons required to submit biographical information that are also referenced in the application process.

**§6.301. Ongoing Requirements.** Subsection (a) of this section lists the basic requirements for maintenance of the captive insurance company's certificate of authority. This includes maintenance of its corporate structure and payment of related fees. The department will work with captive insurance companies to assure compliance, including a return to compliance. However, failure to meet these requirements may subject a captive insurance company to disciplinary action as described in §6.701.

**§6.302. Governing Body.** As required under Insurance Code §964.059, the captive insurance company must have officers or directors with "sufficient insurance experience, ability, standing, and good record to make success of the captive insurance company probable." The department considers meeting this standard to require both individuals overseeing the operation and individuals with technical skill. Rather than attempt to define a management structure for each captive insurance company to include directors and officers regardless of its business structure, the proposed sections simply require the captive insurance company to have a governing body. The term governing body is defined in §6.2 of this title as the individuals "who comprise the ultimate decision-making body of a captive insurance company, including directors and officers."

This section establishes that the persons comprising the governing body collectively must have the experience and ability to oversee the operations of the captive insurance company as part of the fulfillment of the requirement under Insurance Code §964.059. This oversight responsibility is further described in subsection (b).

The technical skills necessary to operate the captive insurance company may be provided by members of the governing body, other managers, or captive management companies.

**§6.303. Captive Insurance Company Biographical Information.** This section specifies the individuals who must provide biographical information for certain individuals. The biographical information will be used to evaluate the individual's experience, ability, standing, and good record as required under Insurance Code §964.059. This section includes persons responsible for managing technical operations that the captive insurance company has chosen to perform in-house, members of the governing body, and other corporate officers. Individuals with technical management responsibilities and corporate officers may be members of the governing body. The section does not require captive insurance companies to employ individuals to perform these technical and administrative functions. The captive insurance company is not required to provide biographical information if the function is performed by a captive management company.

Subsection (b) sets forth the biographical information that will be required. As addressed in regard to the application requirement in §6.202, fingerprints are not required for these individuals because in the situation of pure captives and to some extent controlled unaffiliated business captives, these persons are not managing an unrelated third party's risk.

**§6.304. Material Change in the Plan of Operations.** This section requires that the captive insurance company notify the department if it has material changes in its

plan of operation. The section defines a material change as a “change in operations of the captive insurance company that results in a significant modification in the risk profile of the captive insurance company” and lists eight examples. This requirement is not a report of the captive insurance company’s financial condition, but maintenance of the information supporting its certificate of authority. Because the plan of operation was approved in the decision to grant the captive insurance company’s certificate of authority, changes to the plan require prior commissioner approval.

As required in subsection (c), the captive insurance company must provide updated financial projections if the change in the plan of operation will result in a variation in the most recently filed projections equal to an amount greater than 15 percent of projected net equity. The updated projections must be submitted with the notice of the material change.

Further, as provided in subsection (d), the department will evaluate if a change in the plan of operations may necessitate a change in the captive insurance company’s minimum capital and surplus requirements. In considering the change and its effect on capital and surplus, the department may require the captive insurance company to provide an actuarial analysis.

**§6.305. Sale of a Covered Affiliate.** Insurance Code §§964.051 and 964.052 limit captive insurance companies to insuring and reinsuring the operational risks of the captive insurance company’s affiliates. This section clarifies that the captive insurance company may no longer provide insurance coverage for a former affiliate effective the date the affiliation ends, unless the captive insurance company provides information



acceptable to the commissioner that the coverage provided meets the requirements to be categorized as controlled unaffiliated business.

**§6.306. Books and Records.** Insurance Code §964.055 requires that a captive insurance company maintain its books and records within this state unless commissioner authorizes the captive insurance company to locate them outside of the state. This section clarifies the requirement primarily for the purpose of handling electronic records and addresses the difference between maintenance and location of the records. The department recognizes that while some entities may use physical records, many will use electronic records that can be accessed from almost any location, rendering the location of the record somewhat elusive. However, maintenance of the records involves individuals performing data entry, requiring a physical location. This section specifies that the captive insurance company must give notice where the records are maintained and seek approval of the commissioner if that location is outside of the state. This section does not require all persons maintaining the records to be at the same physical location; however, all of the locations must be known to the department. Subsection (c) sets forth the information that must be submitted to the commissioner to request permission to locate or maintain records outside of the state.

Section 6.306(d) - (g) establishes the condition of the books and records to enable the department to examine the captive insurance company, particularly for electronic records. Insurance Code §964.002(a)(3) provides that Insurance Code Chapter 401 applies to captive insurance companies. Insurance Code Chapter 401,

Subchapter B establishes an examination requirement and its application to captive insurance companies is referenced in Insurance Code §964.065. These standards include a means of recovering records and data. The department has not specified a means of performing this function. Rather, the captive insurance company must demonstrate or document how it can recover its information in the event of a failure in its information storage system. That system is a business decision of the captive insurance company.

**§6.307. Changes to Formation Documents.** This section establishes a procedure for captive insurance companies to request the commissioner's approval for changes in their formation documents so that they may comply with Insurance Code §964.062.

**Subchapter E. Financial Information and Reporting.** This subchapter establishes requirements for annual reports and providing notices of certain financial events, including changes in financial projections, loans to affiliates, letters of credit, and policyholder dividends.

**§6.401. Annual Report.** The Texas Captive Annual Report form and instructions are adopted by reference. The final annual report will include formulas in the document; however, the data and calculation requirements are shown in the proposed form. As defined in §6.1, the annual report consists of three parts: (1) the captive insurance company's financial statements, including disclosures and supporting schedules; (2) an actuarial opinion completed by a qualified actuary that provides an opinion relating to policy reserves and other actuarial items for risks insured; and (3)

financial projections every third year, as required under §6.406. The submission deadlines for the annual report follow the requirements established in Insurance Code §964.060. If the captive insurance company uses a fiscal year end other than a calendar year end, the deadlines in §6.404 will apply.

**§6.402. Basis of Accounting.** This section clarifies that the requirement to use generally accepted accounting principles in Insurance Code §964.054(c) means that captive insurance company financial statements in this chapter will be based on generally accepted accounting principles issued by the Financial Accounting Standards Board for use in the United States.

**§6.403. Audited Financial Statements.** As required under Insurance Code §964.060(b)(2), the captive insurance company must file with the department by June 1 of each year, a report of the captive insurance company's financial condition at last year end. Insurance Code §964.002(a)(3) provides that the captive insurance companies are also subject to the requirements of Insurance Code Chapter 401. Insurance Code Chapter 401, Subchapter A, applies to audited financial statements. The department considers this to include the filing exemption in Insurance Code §401.006 for insurers with less than \$1 million in written premium.

Subsection (a) provides that the Insurance Code §964.060(b)(2) requirement is subject to Insurance Code Chapter 401, Subchapter A. Subsection (b) further provides the Insurance Code §964.060(b)(2) requirement that the report must include a qualified accountant's opinion of the captive insurance company's financial condition and establishes that the qualified accountant's opinion must meet the requirements

established in Insurance Code Chapter 401, Subchapter A, and §7.85 and §7.88 of this title.

**§6.404. Captive Insurance Companies Using Other Than Calendar Year**

**Fiscal Years.** This section establishes the procedure for requesting permission to use a fiscal year other than a calendar year. If the request is granted, the captive insurance company must submit the annual report using the schedule established in Insurance Code §964.060, which is set forth in subsection (c) for convenience.

For premium tax purposes, however, the captive insurance company must comply with Insurance Code §964.060(c)(3) and submit certain information before March 1 of each year. Subsection (b) establishes that the information required to be submitted for premium tax purposes must be in the annual report format established in the Texas Captive Annual Report form adopted under §6.401. Subsection (b) refers to the asset page and liability, capital, and surplus page rather than the “balance sheet” because that is the terminology used in the Texas Captive Annual Report form.

**§6.405. Capital and Surplus Requirements.** Because captive insurance companies cover a broad variety of risks and have various business models, this section does not propose specific capital and surplus requirements. Rather, the commissioner will consider factors that are relevant to the specific risk profile and business model of each captive insurance company. The section also points to three factors that should be relevant in almost all situations: (1) net writings to policyholders’ surplus ratio, (2) net reserves to policyholders’ surplus ratio; and (3) net retention of an individual loss per occurrence as a percentage of policyholders’ surplus.

**§6.406. Financial Projections.** This section establishes that the captive insurance company must provide financial projections covering the next four years of operations. In general, the captive insurance company will be required to submit projections upon application and with its annual report every third year. Updated financial projections are also required if the captive insurance company reports a material change in operations that will result in a variation in the most recently filed projections equal to an amount greater than 15 percent of projected net equity, or if requested by the department. Subsection (b) requires the financial projections to include a projected asset page; liability, capital, and surplus page; income statement page; and cash flow page in the same format as the annual report.

Subsection (c) creates exceptions to the annual report requirement in subsection (a), if the captive insurance company has already submitted updated financial projections during the third year or if the department agrees to waive the requirement. Subsection (e) provides that the commissioner will evaluate the captive insurance company's minimum capital and surplus when there is an update to the captive insurance company's financial projections. The department may also require an actuarial opinion on the effect of the change in the financial projections.

**§6.407. Loans to Affiliates.** The section establishes the standards for approval of a loan to an affiliate. Subsections (a) - (c) establish requirements for a loan if the insurer is not part of an insurance holding company system subject to Insurance Code §823 under Insurance Code §964.002. To expedite processing, the submission will be labeled as "Loans to Affiliates – Captives."

Insurance Code §964.002 provides that if a captive insurance company is affiliated with another insurance company that is part of a holding company subject to Insurance Code Chapter 823, the captive insurance company is also subject to Insurance Code Chapter 823. Because the holding company requirements differ from the requirements in subsections (a) - (c), subsection (d) clarifies that a captive insurance company subject to Insurance Code Chapter 823 must comply with Insurance Code Chapter 823 and the holding company rules as addressed in §6.410.

**§6.408. Letters of Credit.** Insurance Code §964.056(c)(2) authorizes a captive insurance company to recognize a letter of credit as an asset that is acceptable for meeting minimum capital and surplus requirements. The commissioner must approve the letter of credit. Subsection (a) provides the standards for an acceptable letter of credit. Using a letter of credit as an asset may be a departure from generally accepted account principles.

Subsection (a) does not apply to the use of a letter of credit in a reinsurance transaction. As provided in Insurance Code §964.052(d), captives may take credit on reserves for risks ceded to reinsurers under Subchapter C, Insurance Code Chapters 492 and Subchapter C, and Insurance Code Chapter 493. Section 7.610 sets standards for a suitable letter of credit under those chapters. Subsection (b) clarifies that a letter of credit used for reinsurance purposes by a captive insurance company must meet the §7.610 requirements.

**§6.409. Policyholder Dividends.** Insurance Code §964.063 requires the captive insurance company to notify the commissioner when issuing a policyholder dividend. The notice must be given within 30 days of issuing the dividend.

**§6.410. Application of Holding Company Rules.** Insurance Code §964.002(c) provides that Insurance Code Chapter 823 applies to a captive insurance company that is affiliated with another insurance company that is part of a holding company subject to Insurance Code Chapter 823. A captive insurance company in this circumstance is also subject to the regulations and requirements that implement Insurance Code Chapter 823, including the holding company rules in 28 TAC Chapter 7, Subchapter B.

This chapter does not provide an exclusive listing of the regulations that could apply to a captive insurance company that is subject to Insurance Code Chapter 823 under Insurance Code §964.002(c). However, the department does not anticipate that Insurance Code Chapter 823 and its implementing regulations will affect the requirements in this chapter, except as provided in §6.407(d).

**Subchapter F. Workers' Compensation.** This subchapter clarifies in §6.501 that captive insurance companies are subject to workers' compensation insurance statutes in the Insurance Code and the Labor Code.

**Subchapter G. Taxes.** This subchapter establishes in §6.601 a procedure for a foreign or alien captive insurance company redomesticating from another jurisdiction to request that the commissioner postpone or waive the imposition of any tax or fee under the Insurance Code. The request may be for a waiver of all or part of the maintenance

tax, the premium tax, or licensing fees. The commissioner may grant or deny the waiver request in whole or in part in the commissioner's sole discretion.

**Subchapter H. Disciplinary Action.** This subchapter clarifies in §6.701 that disciplinary action may be taken for violations of statute and this chapter, including violations of section §6.501 addressing workers' compensation insurance and Labor Code §401.011.

**2. FISCAL NOTE.** Jamie Walker, associate commissioner of the Financial Regulation Division, Licensing Services Section, has determined that for each year of the first five years the proposed sections will be in effect, there will be no fiscal impact to state and local governments as a result of the enforcement or administration of the proposal. There will be no measurable effect on local employment or the local economy as a result of the proposal.

The waiver of taxes and fees is discussed in §6.601. However, the proposal does not establish a waiver requirement or limit the commissioner's statutory authority to waive taxes and fees. The proposal establishes a registration fee for applications commencing on and after January 1, 2019. Because January 1, 2019, is expected to be beyond the first five-year period that these sections are in effect, the establishment of the fee after that date is not considered in this analysis. Prior to January 1, 2019, the application fee is established under Insurance Code §964.057(d) and not as a result of this proposal.



**3. PUBLIC BENEFIT/COST NOTE.** Ms. Walker also has determined that for each year of the first five years the proposed sections are in effect, there will be public benefits resulting from the proposal and there will be costs to persons required to comply with the proposal.

**Anticipated public benefits.** The department anticipates that a primary public benefit resulting from the proposal will be the implementation of SB 734 and a flexible procedure for the licensing and regulation of captive insurance companies designed to make success of the captive insurance company probable.

**Estimated costs for persons required to comply with the proposal.** The proposal establishes requirements and related costs on captive management companies and captive insurance companies.

Captive management companies. Insurance Code §964.067 requires captive management company to register with the commissioner by providing the information required by the commissioner. It is a business decision of the captive management company to choose to subject itself to these regulations by electing to register to do business in Texas. Sections 6.101 - 6.103 address the registration of captive management companies, the maintenance of the registration, and information that must be submitted by a captive management company's designated responsible party. Section 6.101 requires the captive management company to provide four pieces of information with its registration. Of these, the requirement in §6.101 and §6.103 for a fingerprint background check on the designated responsible party will result in an additional cost unless the individual is exempt under §1.504. The DPS vendor collects

the fingerprints and processing fees. If the fingerprints are collected electronically at a vendor site, the current fee is \$41.45.

If electronic collection is not available or practical, fingerprints can be collected on paper cards and mailed to the DPS vendor to be scanned for electronic processing with payment of the vendor's fee. The fingerprints must be captured by a law enforcement agency. The DPS vendor fee for this service remains \$41.45, however, the applicant may be required to pay additional amounts for capturing the fingerprints and will be required to incur postal charges.

The department estimates the capture fee to be \$10 per set of fingerprints; however, it is not feasible to estimate the exact amount because the jurisdiction capturing the fingerprint will determine the amount. The Texas Legislature has established a charge of \$10 in Human Resources Code §80.001(b). However, individuals in Texas would be better served by the using the DPS vendor's electronic services. The charges for capturing fingerprints in other states will vary. The department estimates postal charges for mailing in the fingerprint card would be less than \$1. Additional postal services, such as certified or overnight mail, would increase this amount but are not required by the proposal.

The total costs for fingerprints are estimated to range between \$41.45 and \$62.45. A captive management company would be required to incur a similar cost if it changed its designated responsible party or was required to reinstate its registration under §6.102, unless the requirement was waived by the commissioner.

The required registration information should otherwise be readily available to the captive management company and should result in no additional costs to obtain. The requirement to submit the registration is imposed by statute and not as a result of this proposal. The department considers the requirement to register as a requirement to maintain the information when it changes, so the requirement to provide updated information under §6.102 does not create an additional submission cost. Even if the registration requirement is an additional requirement, the new information should be readily available at no cost to the captive management company. The department estimates the cost of making an electronic submission to be minimal and impossible to reasonably estimate and the cost of a mail submission to be less than \$5 in aggregate for postage, envelope, paper, and mail preparation.

The department does not anticipate that the requirements in §6.104 and §6.105 create additional costs for the captive management companies. These sections place contractual requirements on the captive insurance company, which will pay for the cost of the service. The decision to enter into the contract will be a business decision of the captive management company. The captive management company can set its fees at a sufficient level to cover the requirements of the contract.

Captive insurance companies. The proposal establishes requirements for the captive insurance company's certificate of authority application, maintenance of its certificate of authority and operations, and the annual report to implement Insurance Code Chapter 964. The decision to apply for a certificate of authority to act as a captive insurance company is a business decision of the applicant and not a requirement of this proposal.

The cost for captive insurance companies will vary for many reasons, including size, structure, and prior experience. While it is not feasible to determine the actual cost of each activity for all captive insurance companies, the department has provided factors that will generate costs under this proposal. It is a business decision of the captive insurance company to hire staff or contract for services through a captive management company. Contracting for the service does not eliminate the cost because it will be reflected in the contract price. The department has not applied these costs to captive management companies, even though they must also comply with the requirements in this chapter.

The department has received estimated ranges of costs from industry. The industry cost estimates appear to refer to the overall anticipated cost and do not distinguish costs arising under the statute, additional costs from this proposal, and other costs that may occur but are not based on a requirement.

Application. Insurance Code §964.057 requires an application for a captive insurance company that includes “a financial statement” and “a plan of operation and financial projections,” including an actuarial report. Insurance Code §964.059 requires the commissioner to determine from the application that “the capital structure of the applicant meets the requirements of the chapter; and the officers and directors of the applicant have sufficient insurance experience, ability, standing and good record to make success of the captive insurance company probable.” The commissioner is also required to consider the amount and liquidity of the applicant’s assets relative to the risk to be assumed, the overall soundness of the applicant’s plan of operation and the

projections contained in that plan, and the adequacy of the expertise, experience, and character of each individual who will manage the applicant. Sections 6.202, 6.303, 6.401, 6.405, 6.407, and 6.408 establish the documents necessary to meet the legislative requirements.

The costs of submitting an application and demonstrating that the applicant meets the statutory requirements for a certificate of authority is a result of statute and not as a result of the adoption or enforcement of this proposal. Section 6.202 lists the requirements for an application. Information required under §6.202(a)(1) - (10) should be readily available to the captive insurance company applicant and not result in an additional cost. This includes information required for redomesticating captive insurance companies under §6.202(b) and captive insurance companies with unaffiliated controlled businesses under §6.202(d). This information is necessary for the commissioner to complete the analyses of officers, directors, and managers required under Insurance Code §964.059.

Section 6.202(a)(11) lists the requirements for the plan of operation that must be included with the application under Insurance Code §964.057. Each captive insurance company's actual costs to prepare a plan of operation will depend on its size and organization, and may require the services of actuaries, accountants, and lawyers. It is a business decision of the captive insurance company to hire staff or contract for services through a captive management company. While it is not feasible to determine the actual cost of the employees for all captive insurance companies, the United States Department of Labor, Bureau of Labor Statistics' *May 2012, Occupational Employment*

*Statistics* report indicates that the average hourly wages for these professions in Texas are: \$52.58 for actuaries (see <http://www.bls.gov/oes/current/oes152011.htm#st>); \$34.54 for accountants and auditors (see <http://www.bls.gov/oes/current/oes132011.htm#nat>); and \$62.27 for lawyers (see <http://www.bls.gov/oes/current/oes231011.htm>).

The proposal does not require captive insurance companies to hire these professional staff, and captive insurance companies may contract with captive management companies for administrative services under this proposal. It is not feasible to estimate the cost of contracting for each service for all captive insurance companies. The method of compliance and ultimate cost of compliance is a business decision of the insurance company and not a requirement of this proposal.

Insurance Code §964.053 requires a captive insurance company to be formed and operated as a business organization authorized under the Texas Business Organizations Code. The costs of forming a captive insurance company, including any requirements to redomesticate it, result from the statute and are not a result of this proposal.

The industry estimated overall application costs for both redomestications and start-up captive insurance companies. Industry did not allocate costs between statute, the proposal, and other anticipated costs. Thus, these costs are not entirely the result of this proposal, but include amounts required to comply with statute and other costs that are anticipated but not required for compliance. Estimated costs for general legal assistance (for example, organizational document filings) for a redomestication range

from \$5,000 to \$25,000; while estimated legal costs range from \$2,500 to \$15,000 for a start-up. Industry estimated costs for actuarial services (for example, feasibility reports and actuarial opinions) range from no additional cost to \$50,000 for a redomestication, and range from \$2,500 to \$50,000 for a start-up.

Industry-estimated accounting and auditing costs for financial statements, audit reports, and related projections, as part of an application process range from no additional cost to \$25,000 for a redomestication, and range from no additional cost to \$100,000 for a start-up. Industry also estimated other costs, such as travel expenses and meetings with regulators ranging from \$250 to \$12,000 for a redomestication and ranging from \$250 to \$15,000 for a start-up.

Maintenance and Operation. Section 6.301(6) and §6.303(b) require the captive insurance company to notify the commissioner and request prior approval of any material changes in the captive insurance company's plan of operations. The notice may be transmitted electronically at minimal cost, or by mail at a cost estimated to be less than \$5 in aggregate for postage, envelope, paper, and mail preparation. The information related to the change in the plan of operation should be readily available to the captive insurance company applicant and not result in an additional cost.

Section 6.304(c) requires the captive insurance company to provide updates to financial projections if the change in the plan of operation will result in a change in the projected net equity of greater than 15 percent when compared to the most recent financial projections. Each captive insurance company's actual costs to prepare updated financial projections will depend on the extent and complexity of the change in

the plan of operation and the operational structure of the captive insurance company, and may require the services of accountants. It is a business decision of the captive insurance company to hire staff or contract for services through a captive management company. While it is not feasible to determine the actual cost of employees for all captive insurance companies, the United States Department of Labor, Bureau of Labor Statistics' *May 2012, Occupational Employment Statistics* indicates that the average hourly wage in Texas is \$34.54 for accountants and auditors. It is not feasible to estimate the cost of contracting for each service for all captive insurance companies. The method of compliance and ultimate cost of compliance is a business decision of the insurance company and not a requirement of this proposal.

Section 6.304(d) requires the captive insurance company to provide an actuarial opinion on the effect of the change in the plan of operation if requested by the department. Each captive insurance company's actual costs to prepare an actuarial opinion will depend on the extent and complexity of the change in the plan of operation and the operational structure of the captive insurance company, and will require the services of actuaries. It is a business decision of the captive insurance company to hire staff or contract for services through a captive management company. While it is not feasible to determine the actual cost of such employees for all captive insurance companies, the United States Department of Labor, Bureau of Labor Statistics' *May 2012, Occupational Employment Statistics* indicates that the average hourly wage in Texas is \$52.58 for actuaries. It is not feasible to estimate the cost of contracting for each service for all captive insurance companies. The method of compliance, and



ultimate cost of compliance, is a business decision of the insurance company and not a requirement of this proposal.

Section 6.301(8) also requires the captive insurance company to notify the department of any change to the information provided in the application. The notice may be transmitted electronically at minimal cost or by mail at a cost estimated to be less than \$5 in aggregate for postage, envelope, paper, and mail preparation. The information related to the change in the plan of operation should be readily available to the captive insurance company applicant and not result in an additional cost.

The proposal requires the captive insurance company to notify the department of material changes to its plan of operation, notify the department of changes to the information provided in the captive insurance company's application, maintain its books and records, and contract with captive management companies that will maintain the captive management company's books and records.

Insurance Code §964.055(b)(3) requires captive insurance companies to request the commissioner's authority to maintain the captive insurance company's books at a location outside of the state. The department considers the word "maintain" to include the preparation of the records. The requirement in §6.306(a) - (c) for the captive insurance company to obtain the commissioner's permission to maintain records outside of Texas does not result in an additional cost to the captive insurance company. The content of the required notice should be readily available to the captive insurance company applicant and not result in an additional cost. The captive insurance company

may transmit the notice electronically at minimal cost or by mail at a cost estimated to be less than \$5 in aggregate for postage, envelope, paper, and mail preparation.

Section 6.306(d) - (g) establish the condition of the books and records to enable the department to examine the captive insurance company, particularly for electronic records. Insurance Code §964.002(a)(3) provides that Insurance Code Chapter 401 applies to captive insurance companies. Insurance Code Chapter 401, Subchapter B establishes an examination requirement. The application of the examination provision to captive insurance companies is also referenced in Insurance Code §964.065. The department expects that any insurer would maintain at least these limited record-keeping standards as a matter of good businesses practices; however, that may not always be the situation.

Each captive insurance company using electronic record keeping must develop and maintain a system under which the insurer maintains its records. This will require hardware and software. Section 6.306 requires the records to then have an audit trail, be accessible in Texas, and be recoverable. Each captive insurance company's actual costs will depend on the captive insurance company's existing record keeping system, location, transmission requirements, and existing staff. To analyze the captive insurance company's current systems and develop the necessary features to comply with the proposal, the insurer may need the services of systems software engineers for computer applications and software development, computer programmers, and accountants.

While it is not feasible to determine the actual cost of employees for all insurers, the United States Department of Labor, Bureau of Labor Statistics' *May 2012, Occupational Employment Statistics* indicates that the average hourly wages for these professions in Texas are: \$47.80 for software engineers, (<http://www.bls.gov/oes/current/oes151133.htm#st>); \$37.78 for computer programmers (<http://www.bls.gov/oes/current/oes151131.htm#st>); and \$34.54 for accountants and auditors. It is not feasible to estimate the cost of contracting for each service for all captive insurance companies. The method of compliance, and ultimate cost of compliance, is a business decision of the insurance company and not a requirement of this proposal.

Insurance Code §964.056(c)(2) authorizes a captive insurance company to report as an asset a letter of credit in a form that has been approved by the commissioner and issued by a bank that has been approved by the commissioner. Section 6.409(a) establishes requirements for an acceptable letter of credit and issuing bank. Obtaining an acceptable letter of credit may require the services of accountants and lawyers. It is a business decision of the captive insurance company to hire staff or contract for services through a captive management company. While it is not feasible to determine the actual cost of employees for all captive insurance companies, the United States Department of Labor, Bureau of Labor Statistics' *May 2012, Occupational Employment Statistics* indicates that the average hourly wages for these professions in Texas are \$34.54 for accountants and auditors and \$62.27 for lawyers. It is not feasible to estimate the cost of contracting for each service for all captive insurance

companies. The method of compliance, and ultimate cost of compliance, is a business decision of the insurance company and not a requirement of this proposal.

Insurance Code §964.052(d) authorizes a “credit for reserves on risks or portions of risks ceded to reinsurers under Subchapter C, [Insurance Code] Chapter 492, and Subchapter C, [Insurance Code] Chapter 493.” Those subchapters and the regulations implementing them reference acceptable letters of credit for reinsurance purposes. Section 6.409(b) restates the statutory requirement and refers users to applicable regulations. The requirement in Insurance Code §964.052(d) and the adopted rules implementing Insurance Code Chapter 492, Subchapter C, and Insurance Code Chapter 493, Subchapter C are not a cost arising from the adoption or enforcement of the proposal.

Insurance Code §964.002(c) provides that Insurance Code “Chapter 823 applies to a captive insurance company only if the company is affiliated with another insurer that is subject to Chapter 823.” Section 6.410 restates that requirement and refers users to applicable regulations. The requirement stated in Insurance Code §964.002(c) and the adopted rules implementing that chapter are not a cost arising from the adoption or enforcement of the proposal.

The industry estimates for maintenance costs did not distinguish between costs related to the annual report and costs related to other operations. These estimates will be discussed after the following section of annual reports.

Annual report. Insurance Code §964.060 requires each captive insurance company to annually submit an annual statement on its financial condition and a report

of financial condition with an independent certified public accountant's opinion of the company's financial condition. Insurance Code §964.056 requires the commissioner to determine the capital and surplus that the captive insurance company must maintain. Section 6.401 adopts the Texas Captive Annual Report form and instructions by reference. Captive insurance companies must annually submit financial statements and an actuarial opinion relating to policy reserves and other actuarial items. The actuarial report is necessary to determine the adequacy of the captive insurance company's capital and surplus. Additionally, §6.401 and §6.407 require the captive insurance company to include updated financial projections in every third annual report.

Each captive insurance company's actual costs to prepare an annual report will depend on its size and organization, will require the services of actuaries and accountants, and may require legal assistance. It is a business decision of the captive insurance company to hire staff or contract for services through a captive management company. While it is not feasible to determine the actual cost of employees for all captive insurance companies, the United States Department of Labor, Bureau of Labor Statistics' *May 2012, Occupational Employment Statistics* indicates that the average hourly wages for these professions in Texas are \$52.58 for actuaries, \$34.54 for accountants and auditors, and \$62.27 for lawyers. It is not feasible to estimate the cost of contracting for each service for all captive insurance companies. The method of compliance, and ultimate cost of compliance, is a business decision of the insurance company and not a requirement of this proposal.

The annual report will require a copy of Microsoft Excel to be completed, and access to an Internet connection to download and submit. A single license of Microsoft Office Professional is currently available from Microsoft for download at a listed price of \$399.99. Transfer of data from a proprietary system would be included in the costs of services for preparing the annual report. An Internet connection is considered a standard business utility and not likely an additional cost resulting from this proposal.

The industry estimated overall annual maintenance costs to include the annual report, audit reports, and actuarial reports; however, industry did not allocate costs to specific requirements. Industry also did not allocate costs to specific items, such as allocating costs of implementing the statute, the proposal, and other anticipated costs. The department determined industry's estimated costs here are not entirely the result of this proposal, but include amounts required to comply with the statute and other costs that are anticipated but not required for compliance. Industry's annual cost estimates for accounting and auditing services range from \$15,000 to \$150,000, for actuarial services estimated costs range from \$2,500 to \$60,000, and for legal services estimated costs range from \$250 to \$15,000. Industry also estimated unspecified "other" costs that would range from \$250 to \$15,000 annually.

Insurance Code §964.060(b)(2) requires the report of financial condition with an independent certified public accountant's opinion of the company's financial report. Insurance Code §964.002(a)(3) provides that the captive insurance companies are also subject to the requirements of Insurance Code Chapter 401. Insurance Code Chapter 401, Subchapter A applies to audited financial statements. Sections 7.85 and 7.88 are

adopted to implement Insurance Code Chapter 401, Subchapter A. Costs associated with these rules are not a requirement resulting from the adoption or implementation of this proposal.

Government Code §2006.001(2) defines “small business” as a legal entity, including a corporation, partnership, or sole proprietorship, that is formed for the purpose of making a profit; is independently owned and operated; and has fewer than 100 employees or less than \$6 million in annual gross receipts. Government Code §2006.001(1) defines “micro business” similarly to “small business” but specifies that a micro business may not have more than 20 employees. The department anticipates that, with few exceptions, almost all captive management companies and captive insurance companies subject to this proposal will be small or micro businesses based solely on the employment criteria. For this reason, Ms. Walker does not expect a disproportionate economic impact on small or micro businesses.

#### **4. ECONOMIC IMPACT STATEMENT AND REGULATORY FLEXIBILITY ANALYSIS**

**FOR SMALL AND MICRO BUSINESSES.** Government Code §2006.002(c) provides that if a proposed rule may have an economic impact on small businesses, state agencies must prepare, as part of the rulemaking process, an economic impact statement that assesses the potential impact of the proposed rule on these businesses and a regulatory flexibility analysis that considers alternative methods of achieving the purpose of the rule. Government Code §2006.001(2) defines “small business” as a legal entity, including a corporation, partnership, or sole proprietorship, that is formed

for the purpose of making a profit; is independently owned and operated; and has fewer than 100 employees or less than \$6 million in annual gross receipts. Government Code §2006.001(1) defines “micro business” similarly to “small business,” but specifies that a micro business may not have more than 20 employees.

As specified in the Public Benefit/Cost Note section of this proposal, the proposal has an economic impact on captive management companies and captive insurance companies.

Captive management companies. Because the proposal regulates a new type of registrant, no captive management companies are currently registered in Texas. The department anticipates that, with a few exceptions, captive management companies that will register under these rules will be small or micro businesses based solely on the employment criteria.

The department has determined that §§6.101 - 6.103 may have an adverse economic effect on insurers operating as small or micro businesses. So the department, to comply with the Government Code §2006.002(c-1), has considered the following alternative methods of achieving the purpose of the proposed rule while reducing costs to insurers operating as small and micro businesses.

The department considered using a different means of background check for designated responsible parties instead of the fingerprint requirement. The fingerprint requirement cost is approximately \$41.45 to \$63. The department has received information that the costs of third-party verification services can range from \$220 to \$265 depending on the number of names to be searched for an individual. Because of



the significantly greater costs of the third-party verification service, the department determined that it is not practical or cost effective to substitute third-party verification for the fingerprint requirement.

The department also considered eliminating or waiving the fingerprint requirement; however, eliminating this requirement would effectively eliminate the primary background check on registrants. The department considers the legislature's general grant of authority to include allowing the department to require background information with the registration that is necessary to reasonably vet the registrant. The department is concerned that the registration alone creates the appearance for the public that the registrant has been vetted; but without fingerprinting, a minimal background check cannot be done. Because most, if not all, captive management companies are small or micro businesses, waiving or eliminating the fingerprint requirement for small and micro businesses effectively eliminates the requirement. For these reasons the department determined that it is not practical to eliminate or waive the initial fingerprint requirement.

The department also recognizes that to re-establish a lapsed registration a full registration application may not be necessary in all situations. Section 6.102 provides that the commissioner may waive certain registration requirements if the commissioner determines that the requirement or information is not applicable or provides no additional value in reviewing the registration submission. This could include waiving the fingerprint requirement in some instances.

Captive insurance companies. Because the proposal regulates a new type of insurer, no captive insurance companies currently have a certificate of authority in Texas. The department anticipates that nearly all captive insurance companies that receive a certificate of authority under these rules will be small or micro businesses based solely on the employment criteria. The proposal was drafted based on that consideration.

To accommodate applicants the proposal allows applicants for a certificate of authority to submit documents and work with the department to have an acceptable plan of operation prior to forming and funding an entity, which could tie up large amounts of the applicant's funds. The department included a provision in §6.202(g) to allow for the waiver of application requirements, if warranted. Further, under §6.202(d) the department has not proposed to adopt and require that applicants use a specific application form. Applicants will not have to create forms just for the application if the required information has already been prepared for other jurisdictions or recipients. Also, the department has interpreted Insurance Code §964.060(b)(2) to provide that the annual audited statement is subject to the exemption found in Insurance Code §401.006.

Insurance Code §§964.054, 964.056, 964.059, 964.060, and 964.065 impose requirements that, in summary, require the department to monitor captive insurance companies to ensure they are operating in a sound condition. For these reasons the department has determined that it is not practical to eliminate or waive other registration requirements in this proposal.

**5. TAKINGS IMPACT ASSESSMENT.** The department has determined that this proposal affects no private real property interests and that this proposal does not restrict or limit an owner's right to property that would otherwise exist in the absence of government action, and so does not constitute a taking or require a takings impact assessment under the Government Code §2007.043.

**6. REQUEST FOR PUBLIC COMMENT.** To have your comments considered, you must submit written comments on the proposal no later than 5:00 p.m. on December 23, 2013, to the Office of Chief Clerk, Mail Code 113-2A, Texas Department of Insurance, P. O. Box 149104, Austin, Texas 78714-9104. A copy of your comments must be simultaneously submitted to Ms. Jamie Walker, Associate Commissioner, Financial Regulation Division, Mail Code 305-2A, Texas Department of Insurance, P.O. Box 149104, Austin, Texas 78714-9104.

The commissioner will consider the adoption of the proposed amendments and new sections in a public hearing under Docket No. 2758 scheduled for December 9, 2013, at 9:00 a.m. in Room 100 of the William P. Hobby, Jr. State Office Building, 333 Guadalupe Street, Austin, Texas. The commissioner will consider written and oral comments presented at the hearing.

**7. STATUTORY AUTHORITY.** The department proposes the new sections under the Government Code §§411.083, 411.087, and 411.106, and Insurance Code §§401.002, 401.006, 401.051, 803.005, 803.008, 964.002, 964.051 - 964.060, 964.062,

964.063, 964.065 - 964.067, 964.069, 964.071, and 36.001. Government Code §411.106 authorizes the department to receive criminal history information from DPS regarding insurance company principals and officers and applicants for any entity holding or seeking a license, certificate, permit, registration, or other authorization issued by the department to engage in a regulated activity under the Insurance Code. Government Code §411.083 and §411.087 authorize the department to obtain, through DPS, criminal history information from the FBI on those individuals described in Government Code §411.106.

Section 401.002 provides that the purpose of Insurance Code Chapter 401 Subchapter A is to require an annual audit by an independent certified public accountant of the financial statements, reporting on the financial condition and the results of operations, of each insurer or health maintenance organization. Section 401.006 provides for a procedure to obtain an exemption from the requirement to file an audited financial report if the insurer has less than \$1 million in direct premiums written in this state during a calendar year. Section 401.051 establishes the department's duty to examine insurers under Insurances Code Chapter 401, Subchapter B.

Section 803.005 requires the books, records, accounts, or offices of a domestic company to be under the company's direct supervision, management, and control. Section 803.008 authorizes the commissioner to adopt rules to authorize a domestic company to maintain its books and records with a nonaffiliated entity other than an agency.

Section 964.002 provides that a captive insurance company is subject to Insurance Code Chapters 401 and 823. Further, the section provides that Insurance Code Chapter 823 applies to a captive insurance company only if the company is affiliated with another insurer that is subject to Chapter 823.

Section 964.051 provides that a captive insurance company may only insure the operational risks of the company's affiliates and risks of a controlled, unaffiliated business. The section further provides that a captive insurance company is authorized to issue a contractual reimbursement policy to an affiliated certified self-insurer authorized under Chapter 407, Labor Code, or an affiliate that is insured by a workers' compensation insurance policy with a negotiated deductible endorsement.

Insurance Code §964.052 provides the types of reinsurance that the captive insurance company may write, including workers' compensation insurance and employer liability policies issued to affiliates, if the insurer that directly issues workers' compensation insurance and employer's liability policies or its licensed, if required by law, administrator or adjuster services all claims incurred during the policy period, and complies with all requirements for an insurer under the Insurance Code, including Chapter 462, and under Title 5, Labor Code. The section further allows a credit for reserves on risks or portions of risks ceded to reinsurers under Chapter 492, Subchapter C, and Chapter 493, Subchapter C.

Section 964.053 provides that a captive insurance company may be formed and operated in any form of business organization authorized under the Business Organizations Code except as a risk retention group or general partnership. The

section further provides that the captive insurance company must have a board of directors or governing body. Section 964.054 requires the captive insurance company to use generally accepted accounting principles as an accounting basis, except that a captive insurance company that is required to hold a certificate of authority under another jurisdiction's insurance laws must use statutory accounting principles.

Section 964.055 provides that a captive insurance company may not engage in business as a captive insurance company domiciled in this state unless it holds a certificate of authority issued by the department to act as a captive insurance company. The section further provides that the captive insurance company must maintain its principal office and books and records in this state, unless the commissioner grants an application to relocate the entity's books and records under Chapter 803.

Section 964.056 requires the commissioner to determine the amount of the captive insurance company's capital and surplus based on the factors listed in this section and any other criteria that has an impact on the operations of the captive insurance company determined to be significant by the commissioner. The section further provides the amount of capital and surplus determined by the commissioner may not be less than \$250,000.

Section 964.056 also provides that the capital and surplus required by Subsection (a) may be in the form of 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.

Section 964.057 establishes the requirements for an application to obtain a certificate of authority for a captive insurance company, including a fee of \$1,500.

Section 964.058 requires the commissioner to conduct an examination of the applicant to determine whether the minimum capital and surplus requirements of §964.056 are satisfied, the capital and surplus are the bona fide property of the applicant, and the applicant has fully complied with applicable insurance laws.

Section 964.059 requires the commissioner to determine if the certificate of authority will be issued. The commissioner may consider the factors listed in the section and any other factors the commissioner considers relevant to determine whether the applicant will be able to meet its policy obligations. The section establishes an appeal process if the application is denied.

Section 964.060 requires a captive insurance company to file with the commissioner on or before March 1 of each year, a statement of the company's financial condition, verified by two of its executive officers and filed in a format prescribed by the commissioner; and on or before June 1 of each year, a report of its financial condition at last year end with an independent certified public accountant's opinion of the company's financial condition. The section further allows for the captive insurance company to request filing its annual report required under this section at its fiscal year end. The section provides that a captive insurance company using a fiscal year end must provide its balance sheet, income statement, and statement of cash flows, verified by two of its executive officers, before March 1 of each year to provide sufficient detail to support a premium tax return.

Section 964.062 requires the commissioner to approve in advance any amendments to the captive insurance company's certificate of formation.

Section 964.063 requires a captive insurance company to notify the commissioner in writing when issuing policyholder dividends.

Section 964.065 provides that the commissioner, after notice and an opportunity for hearing, may revoke or suspend the certificate of authority of a captive insurance company.

Section 964.066 provides that the commissioner may adopt rules establishing standards to ensure that an affiliated company is able to exercise control of the risk management function of any controlled unaffiliated business to be insured by the captive insurance company.

Section 964.067 requires captive management companies to register with the commissioner before providing administrative services to a captive insurance company by providing the required registration information on a form adopted by the commissioner.

Section 964.069 authorizes the commissioner to adopt reasonable rules as necessary to implement the purposes and provisions of this chapter.

Section 964.071(a) provides that an authorized foreign or alien captive insurance company licensed under laws of any jurisdiction may become a domestic captive insurance company in this state on a determination by the commissioner that the captive insurance company has complied with the requirements of Insurance Code Chapter 964. Section 964.071(c) provides that the commissioner may postpone or



waive the imposition of any fees or taxes under this code for a period not to exceed two years for any foreign or alien captive insurance company redomesticating to this state.

Section 36.001 provides that the commissioner of insurance may adopt any rules necessary and appropriate to implement the powers and duties of the Texas Department of Insurance under the Insurance Code and other laws of the state.

**8. CROSS REFERENCE TO STATUTE.** The proposal affects the following statutes:

Rule	Statute
§6.1	Insurance Code §§401.002, 401.011, 964.001, 964.053, 964.057, 964.059, 964.060
§6.2	Insurance Code §§964.052, 964.053, 964.055, 964.056, 964.057, 964.062, 964.063, 964.067, and 964.071
§§6.101 - 6.103	Government Code §411.106 and Insurance Code §964.067
§6.104	Insurance Code §§964.057 and 964.065
§6.105	Insurance Code §§803.005, 803.008, 964.055, 964.059, and 964.065
§6.201	Insurance Code §964.055
§6.202	Insurance Code §§964.057, 964.059, 964.066, and 964.071
§6.203	Insurance Code §§964.057, 964.058, 964.059, and 964.071
§6.301	Insurance Code §§964.056, 964.057, 964.059, 964.065
§§6.302 - 6.304	Insurance Code §§964.056, 964.057 and 964.059
§6.305	Insurance Code §§964.051 and 964.052
§6.306	Insurance Code §§803.005, 964.002, and 964.055
§6.307	Insurance Code §964.062
§6.401	Insurance Code §964.060
§6.402	Insurance Code §964.054
§6.403	Insurance Code §§401.006, 964.002, and 964.060
§6.404	Insurance Code §964.060

§6.405	Insurance Code §964.056
§6.406	Insurance Code §§964.057, 964.059, and 964.060
§6.407	Insurance Code §964.056
§6.408	Insurance Code §§964.002 and 964.056
§6.409	Insurance Code §964.063
§6.410	Insurance Code §964.002
§6.501	Insurance Code §§964.051 and 964.052
§6.601	Insurance Code §964.071
§6.701	Insurance Code §964.065

## 9. TEXT

### CHAPTER 6. CAPTIVE INSURANCE

#### SUBCHAPTER A. GENERAL MATTERS

##### §6.1. Definitions.

(a) The definitions in Insurance Code §964.001 apply to this chapter.

(b) The following words and terms when used in this chapter have the following meanings unless the context clearly indicates otherwise:

(1) Administrative services--Insurance-related services necessary for the operation of a captive insurance company, including: claims adjustment; underwriting; accounting; investment advice; risk management; regulatory compliance; compiling statistics and preparing premium, loss, and tax reports; maintaining books and records; handling reinsurance matters; and processing premiums.

(2) Annual report--The annual report includes the following information, as required in the Texas Captive Annual Report form and instructions adopted under §6.401 of this title (relating to Annual Report):

(A) the captive insurance company's financial statements, including disclosures and supporting schedules;

(B) an actuarial opinion completed by a qualified actuary that provides an opinion relating to policy reserves and other actuarial items for risks insured; and

(C) financial projections every third year, as required under §6.406 of this title (relating to Financial Projections).

(3) Captive management company--A legal entity, not an individual, that provides any administrative service to a captive insurance company.

(4) Certificate of filing--Evidence of the acceptance and filing of an instrument authorized to be filed with the Texas Secretary of State under the Business Organizations Code, Insurance Code Chapter 964, and this chapter.

(5) General partnership--The term includes a general partnership designated as a limited liability partnership. The term does not include a limited partnership, including a limited partnership designated as a limited liability partnership.

(6) Generally accepted accounting principles--Current and future generally accepted accounting principles issued by the Financial Accounting Standards Board for use in the United States as provided in §6.402 of this title (relating to Basis of Accounting).

(7) Governing body--The individuals designated by the captive insurance company who comprise the ultimate decision-making body of a captive insurance company, including a board of directors or officers of the captive insurance company.

This definition applies to the use of the term in this chapter and the relationship of the captive insurance company to the department. To the extent that the term has a different meaning under the Business Organizations Code related to the formation of entities and filings with the Texas Secretary of State, this definition does not apply.

(8) Licensed attorney--A person licensed and eligible to practice law.

(9) Qualified accountant--An independent certified public accountant or accounting firm that meets the requirements of Insurance Code §401.011.

(10) Qualified actuary--A person who meets the basic education, experience, and continuing education requirements set forth in the Qualification Standards for Actuaries Issuing Statements of Actuarial Opinion in the United States, promulgated by the American Academy of Actuaries, and is either:

(A) a member of the American Academy of Actuaries who has demonstrated actuarial competence to the satisfaction of the commissioner; or

(B) a member of the Casualty Actuarial Society.

(11) Qualified United States financial institution--An institution that:

(A) is organized under the laws of the United States or any state of the United States;

(B) is regulated, supervised, and examined by a federal or state authority that has regulatory authority over banks and trust companies; and

(C) is approved by the commissioner.

(12) Service providers--Captive management companies that provide administrative services and individuals or entities providing legal, actuarial, or auditing services.

(13) Texas Captive Annual Report--The forms, instructions, and requirements adopted by reference in §6.401 of this title that are necessary for completing the annual report and other submissions under this chapter.

(14) Ultimate controlling person--Person or persons who control a captive insurance company and who are not controlled by another person.

**§6.2. Submissions and Notifications to the Commissioner and Department.**

Except as otherwise provided in this chapter or the Texas Captive Annual Report, all submissions to the commissioner or the department referenced in this chapter must be sent:

(1) to the address and by the means specified in the applicable department form; or

(2) if the address is not specified:

(A) electronically, to [Captives@tdi.texas.gov](mailto:Captives@tdi.texas.gov);

(B) by hand delivery, to Captives, Texas Department of Insurance, 333 Guadalupe, Mail Code 305-2C, Austin, Texas 78701; or

(C) by mail, to Captives, Texas Department of Insurance, P.O. Box 149104, Mail Code 305-2C, Austin, Texas 78714-9104.

## **SUBCHAPTER B. CAPTIVE MANAGEMENT COMPANIES**

### **§6.101. Registration of Captive Management Companies.**

(a) A captive management company may not provide administrative services to a captive insurance company prior to obtaining the commissioner's written approval of its registration as a captive management company.

(b) Unless the individual is an employee of the captive insurance company, an individual may not provide administrative services or be registered to provide such services.

(c) To register as a captive management company, the entity must submit the following information to the department in manner that is acceptable to the department:

(1) the name of the entity;

(2) the entity's federal employer identification number;

(3) information regarding the location and means of contacting the entity;

and

(4) the name and biographical information, including fingerprints, of a designated responsible party, who qualifies under §6.103 of this title (relating to Designated Responsible Party), and who will be the contact for the department.

(d) The department may provide a form the registrant can use to comply with this section.

### **§6.102. Maintenance and Duration of the Registration.**

(a) The captive management company must notify the department of changes to the information required for registration not later than 30 days after the change.

(b) A captive management company may not operate without a designated responsible party except as provided in this subsection. If a designated responsible party leaves a captive management company, the captive management company must notify the department of a replacement designated party and provide all information required under §6.103 of this title (relating to Designated Responsible Party) within the 30 day period specified in subsection (a) of this section.

(c) The captive management company's registration will expire if the captive management company does not provide administrative services to at least one Texas domestic captive insurance company for a period of more than 90 days.

(d) If a captive management company's registration expires, the captive management company must submit a new registration to the department, which must be approved in writing by the commissioner before the entity can act as a captive management company. The captive management company may submit a written request for the commissioner to waive any portion of the registration requirement under this section. At the commissioner's sole discretion, the commissioner may grant the waiver in writing if the commissioner determines that the requirement or information is not applicable or provides no additional value in reviewing the registration submission.

**§6.103. Designated Responsible Party.** A designated responsible party must:

(1) be an individual;

(2) provide the designated responsible party's current name and any names the individual may have used in the past, social security number, date of birth, and current mailing addresses, phone numbers, and email addresses;

(3) provide professional background information and criminal history information;

(4) a complete set of fingerprints using the procedures set forth in §1.509 of this title (relating to Fingerprint Format and Complete Application), unless the individual meets the exemption in §1.504(b)(1) of this title (relating to Fingerprint Requirement); and

(5) be eligible for licensure based on the guidelines established in §1.502 of this title (relating to Licensing Persons with Criminal Backgrounds).

#### **§6.104. Administrative Services Contracts.**

(a) A captive insurance company through its governing body may retain one or more captive management companies registered under this chapter to provide administrative services and implement the governing body's policies.

(b) With the written consent of the captive insurance company, a captive management company may contract with another captive management company to provide administrative services.

(c) The captive insurance company retains ultimate accountability and responsibility for compliance with all statutory and regulatory requirements. The captive insurance company may not enter into an agreement with a captive



management company or other person that in any way limits, or may be construed to limit, the captive insurance company's ultimate accountability and responsibility for compliance with all statutory and regulatory requirements.

(d) Subsection (c) of this section does not limit the captive management company's obligations under any contract or the captive management company's duty to comply with all statutory and regulatory requirements.

(e) If an administrative service requires a license or certificate of authority under the Insurance Code or other law, a captive management company must have the required license or certificate of authority to provide the service.

#### **§6.105. Agreements to Provide Administrative Services.**

(a) An agreement with a captive management company described in §6.104 of this title (relating to Administrative Services Contracts) must be in writing and include the following:

(1) a requirement that all parties to the agreement must comply with the applicable requirements of the Insurance Code and department rules, including holding the appropriate licenses or certificates of authority;

(2) a requirement that the captive management company must permit the commissioner or the captive insurance company to examine at any time:

(A) the financial solvency of the captive management company;

and

(B) the captive management company's ability to perform its responsibilities under the written agreement;

(3) a description of the duties or services that the captive management company is to provide;

(4) a provision relating to continuation of services following termination and the transfer of the books and records of a captive insurance company from one captive management company to another captive management company;

(5) a requirement that the books and records of the captive insurance company:

(A) remain the property of the captive insurance company at all times;

(B) are available to the captive insurance company or its designee at any time while in the custody of a captive management company; and

(C) will be timely transferred to the captive insurance company or its designee:

(i) upon request of the captive insurance company;

(ii) at the termination or cancellation of a written agreement entered into by a captive management company; and

(iii) in compliance with all applicable statutory and rule requirements;

(6) a requirement that the books and records must be maintained as required in §6.306 of this title (relating to Books and Records); and

(7) a provision that the captive management company has no automatic right to terminate the agreement if all terms of the agreement are being met and the captive insurance company is placed in receivership under Insurance Code Chapter 443.

(b) Under this chapter, a written agreement includes an agreement that is prepared, signed, or stored electronically.

### **SUBCHAPTER C. CAPTIVE INSURANCE COMPANY APPLICATION PROCESS**

#### **§6.201. Captive Insurance Company Certificate of Authority Required.**

(a) A person seeking a certificate of authority to act as a captive insurance company must submit an application and payment of the application fee in a format acceptable to the department and provide the information required in §6.202 of this title (relating to Captive Insurance Company Certificate of Authority Application Contents and Process).

(b) The application fee is \$1,500.

(c) The department may provide forms that an applicant can use for submitting its application.

#### **§6.202. Captive Insurance Company Certificate of Authority Application Contents and Process.**

(a) An applicant seeking to redomesticate an existing captive insurance company or to form a new captive insurance company must provide the following information to the department:

(1) the name of the entity, the entity's federal employer identification number, and the location and means of contacting the entity;

(2) the physical location of the books and records and means of maintaining the books records;

(3) the registered agent for service;

(4) a list of the service providers that the captive insurance company will use, including qualified accountants, qualified actuaries, and licensed attorneys;

(5) biographical affidavits for the individuals described in §6.303 of this title (relating to Captive Insurance Company Biographical Information) who provide necessary functions to operate and govern the captive insurance company;

(6) the name of the ultimate controlling person;

(7) proposed organizational documents for the captive insurance company;

(8) a description of how the captive insurance company fits into the affiliated group's risk management plan and the group's significant operations in the State of Texas;

(9) if the application is for the redomestication of a captive insurance company, information listed in subsection (b) of this section;

(10) if the applicant proposes to insure controlled unaffiliated business, the information listed in subsection (c) of this section;

(11) a plan of operation, including:

(A) the asset page; liability, capital, and surplus page; income statement page; and cash flow page for the applicant from the Texas Captive Annual Report that are certified by two principal officers who have submitted biographical affidavits and:

(i) four years of financial projections, with a disclosure of the assumptions the applicant is using to develop the projected financial statements; and

(ii) if applicable, the most recent three years of operational results, in United States dollars; however, if the applicant has not been in operation for three or more years, the applicant must submit operational results, in United States dollars, for each year it has been in operation;

(B) a description of the lines of business and perils that the captive insurance company proposes to cover and the limits of coverage;

(C) a list of the affiliates that the applicant proposes to insure;

(D) a description of the reinsurance programs proposed including the lines of business that are affected, limits of reinsurance coverage, and the counterparties that will be involved;

(E) an organizational chart listing all affiliates of the applicant's affiliated group;

(F) agreements with any captive management companies the applicant proposes to use;

(G) a copy of the applicant's investment strategy;

(H) an explanation of how the applicant intends to handle profits, including a statement about how dividends will be evaluated;

(I) an independent actuarial report that evaluates the feasibility of the applicant's plan of operation;

(J) details of how the parent entity will maintain and support the captive insurance company, including ensuring compliance with Texas statutes and rules; and

(K) evidence of the financial wherewithal of the affiliate group, including affiliated persons, to retain the risk using the captive insurance company; and

(12) an affidavit by two principal officers or members of the governing committee who have submitted biographical affidavits that the information provided in paragraphs (1) - (11) of this subsection is true and correct.

(b) An application for a redomestication must include:

(1) the current domicile jurisdiction;

(2) the date of last examination;

(3) a copy of the most recent examination report,

(4) information required in §6.407 and §6.408 of this title (relating to

Loans to Affiliates and Letters of Credit) for existing loans to affiliates; and

(5) a letter of no objection or release from the captive insurance company's current domicile.

(c) If the applicant proposes to insure a controlled unaffiliated business, the following documentation must be provided with the application:

(1) copies of the agreement(s) that evidence an existing contractual relationship between parties, one of which must be a captive insurance company affiliate;

(2) a description and any supporting documentation that evidences the captive insurance company affiliate bears the risk of a potential financial loss associated with the contract beyond the affiliate having to pay a fee; and

(3) a description and any supporting policies that document that a captive insurance company affiliate controls the risk management function of the controlled unaffiliated business.

(d) The department may accept similar information prepared in a similar format for a nonaffiliated third party, including a regulator, bank, or similar user, to the extent that the information satisfies one or more of the requirements in subsections (a) - (c) of this section to the satisfaction of the commissioner.

(e) The department will review the information submitted under subsections (a) - (d) of this section. The applicant may submit amended documents and information during the review process.

(1) If the department determines that the documents and information meet the standards required for a certificate of authority under Insurance Code

§964.059 and this chapter, the department will issue a certificate of general good to the applicant. The certificate of general good does not bind the Texas Secretary of State to accept any subsequent filing by the applicant, nor does it bind the department to issue a certificate of authority.

(2) If the commissioner determines that the documents and information do not to meet the standards required for a certificate of authority under Insurance Code §964.059 and this chapter, the commissioner will deny the application. Following denial of the application, the applicant may proceed under Insurance Code §964.059(c).

(f) If the applicant receives a certificate of general good, the applicant must submit the following documentation to the department to proceed with the licensing process:

(1) a certificate of filing from the Texas Secretary of State indicating that the entity has been formed or redomesticated to Texas as an entity under the Business Organizations Code, except a risk retention group or general partnership, for the purpose of providing captive insurance;

(2) an affidavit satisfactory to the commissioner from 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 filing is true and correct; and



(3) if necessary, an affidavit by the incorporators, organizers, or officers of the captive insurance company 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.

(g) The applicant may submit a written request for the commissioner to waive any portion of the application or information required under this section. At the commissioner's sole discretion, the commissioner may grant the waiver in writing, if the commissioner determines the requirement or information is not applicable or provides no additional value in reviewing the application.

### **§6.203. Issuance of Captive Insurance Company Certificate of Authority.**

(a) Following submission of the information and documentation described under §6.202 of this title (relating to Captive Insurance Company Certificate of Authority Application Contents and Process) the commissioner will review the certificate of filing and the certificate general good for compliance with Insurance Code Chapter 964 and this chapter. If requested, the applicant must provide the commissioner with updated information during this review.

(b) If the commissioner determines that the applicant meets the requirements for issuance of a certificate of authority, the commissioner will issue the certificate as described in Insurance Code §964.059(d).

(c) If the commissioner determines that the applicant has not met the requirements for issuance of a certificate of authority under Insurance Code §964.059 and this chapter, the commissioner will deny the application. Following denial of the application, the applicant may proceed under Insurance Code §964.059(c).

## **SUBCHAPTER D. MAINTENANCE OF A CAPTIVE INSURANCE COMPANY'S**

### **CERTIFICATE OF AUTHORITY**

**§6.301. Ongoing Requirements.** A captive insurance company must comply with Insurance Code Chapter 964, the Business Organizations Code, and this chapter, including:

- (1) providing biographical information as required under §6.303 of this title (relating to Captive Insurance Company Biographical Information);
- (2) writing an annual premium amount of at least \$100,000;
- (3) having an affiliate or ultimate controlling person with the financial wherewithal to continue placing the risk in the captive insurance company;
- (4) complying with §6.306 and §7.1403 of this title (relating to Books and Records and Service on Domestic Insurance Companies Licensed by the State Board of Insurance and on Related Entities Authorized To Conduct Business in Texas);
- (5) submitting annual reports and audited financial statements as described in §§6.401, 6.403, and 6.404 of this title (relating to Annual Report, Audited Financial Statements, and Captive Insurance Companies Using Other Than Calendar Year Fiscal Years);

(6) notifying the department of any material change in the captive insurance company's plan of operation, as described in §6.304 of this title (relating to Material Change in the Plan of Operations);

(7) maintaining minimum capital and surplus as established by the department;

(8) except as provided in paragraph (6) of this section, notifying the department of any change to the information provided in the application within 30 days following the change; and

(9) timely payment of all required fees and registrations, including payments required by the Texas Secretary of State to maintain the captive insurance company in good standing.

**§6.302. Governing Body.**

(a) The captive insurance company must designate individuals to form a governing body. Collectively, the members of the governing body must have the ability and experience necessary to oversee the captive insurance company's operations. The ability and experience needed will vary with the size and complexity of the captive insurance company's operations.

(b) The governing body is responsible for the following:

(1) establishing and documenting the internal control procedures used by the captive insurance company; if a captive insurance company uses an affiliate's

procedures, the governing body must review the procedures for appropriateness and modify where needed;

(2) documenting a conflict-of-interest policy and procedure, and monitoring it to verify compliance;

(3) overseeing all entities providing captive management services to the captive insurance company;

(4) monitoring counterparty risk, which could include banking institutions and reinsurers;

(5) setting the captive insurance company investment policy; and

(6) managerial control, insurance information, and compliance with the Insurance Code and department rules.

### **§6.303. Captive Insurance Company Biographical Information.**

(a) With the initial captive insurance company application, and within 30 days of employment, contract, or other association with the captive insurance company, the following individuals must complete a biographical affidavit and submit it to the department:

(1) with the exception of functions provided by a captive management company, individuals who oversee the management of the captive insurance company, including the following functions, must complete a biographical affidavit addressing:

(A) risk management;

(B) financial reporting;

(C) underwriting;

(D) claims; and

(E) investments;

(2) members of the governing body; and

(3) corporate officers.

(b) Biographical affidavits required of individuals under subsection (a) of this section must include the following information and disclosures:

(1) the affiant's current name and any names the individual may have used in the past, social security number, date of birth, and current mailing addresses, phone numbers, email addresses;

(2) the name and address of the captive insurance company;

(3) the affiant's position or title at the captive insurance company;

(4) information regarding the affiant's education, memberships in professional organizations, and any professional, occupational, or vocational licenses held;

(5) the previous 10 years of the affiant's employment history; and

(6) the affiant's fidelity bond coverage history, criminal history, and ownership or control of entities involved in the business of insurance.

**§6.304. Material Change in the Plan of Operations.**

(a) A material change in the plan of operations involves a change in operations of the captive insurance company that results in a significant modification in the risk profile of the captive insurance company, including:

(1) adding one or more new lines of business or perils;

(2) modifying policy limit(s) or policy coverage(s);

(3) changing captive management companies;

(4) entering into new reinsurance programs including loss portfolio

transfers;

(5) modifying reinsurance programs, including:

(A) changing counterparties;

(B) changing the attachment point or amount of business ceded or

assumed; and

(C) changing limits of coverage;

(6) changing the captive insurance company's ultimate controlling

person;

(7) any changes to the information associated with controlled unaffiliated

business submitted under §6.202(c) of this title (relating to Captive Insurance Company Certificate of Authority Application Contents and Process); and

(8) entering into a runoff mode or eliminating one or more lines of

business or perils, including winding up operations.

(b) All material changes to the plan of operation require prior approval of the commissioner.

(c) The captive insurance company must provide updated financial projections if a material change in the plan of operation will result in a variation in the most recently filed projections equal to an amount greater than 15 percent of projected net equity. The updated financial projections must be submitted with the notice of a material change.

(d) The department will reassess the captive insurance company's minimum capital and surplus when there is an update to the captive insurance company's plan of operations. The captive insurance company must provide an actuarial opinion on the effect of the change in the plan of operation if requested by the department.

**§6.305. Sale of a Covered Affiliate.**

(a) Except as provided in subsection (b) of this section, a captive insurance company is prohibited from providing insurance coverage to a former affiliate or reinsurance to an insurer covering the operational risks of the former affiliate after the effective date on which the affiliation ceases, including the effective date of the sale of the affiliate.

(b) The captive insurance company may provide insurance coverage to the former affiliate if the captive insurance company provides information acceptable to the commissioner that the coverage being provided meets the requirements to be categorized as a controlled unaffiliated business under §6.202(c) of this title (relating to Captive Insurance Company Certificate of Authority Application Contents and Process).

**§6.306. Books and Records.**

(a) The books and records of a captive insurance company must be located and maintained within the United States and its territories at all times. The books and records of a captive insurance company must be located and maintained within the State of Texas, unless the commissioner authorizes in writing that the books and records may be located or maintained outside the state. A captive insurance company may not locate or maintain records outside of the state until after the captive insurance company receives the commissioner's written authorization, and then may only locate or maintain those records outside of the state in the manner and to the extent that the commissioner has authorized.

(b) The captive insurance company must provide the department with a complete list of all of the locations where its records are located or maintained. Record location and maintenance locations outside of the state must comply with the commissioner's authorization described in subsection (a) of this section.

(c) A captive insurance company must make a written request for authorization from the commissioner to locate or maintain records outside of the state. The written request must:

(1) identify the specific physical address outside the State of Texas where the captive insurance company's books and records will be located or maintained;

(2) identify the types of books and records that will be located or maintained outside the state, including books and records in an electronic format;



(3) if applicable, identify the vendor of a leased or purchased software or electronic platform that will provide services to the captive insurance company related to the maintenance of the captive insurance company's books and records; and

(4) if applicable, include the captive insurance company's continuity plan in the event of cancellation or termination of the arrangement with a vendor identified by the captive insurance company under paragraph (3) of this subsection.

(d) All books and records of a captive insurance company must be:

(1) electronically or physically accessible to the department upon the department's request; and

(2) maintained in a manner that provides an audit trail between the captive insurance company's general ledger and the captive insurance company's source documents.

(e) A captive insurance company's books and records must be maintained with reasonable controls to ensure the integrity, accuracy, and reliability of the storage system and to prevent the deterioration of the books and records.

(f) A captive insurance company must ensure that it can recover its electronic books and records up to one week before the loss of its primary source of records.

(g) A captive insurance company must be able to access a complete and current set of its electronic books and records or a complete and current recovery of its electronic books and records from a location within the state at all times.

**§6.307. Changes to Formation Documents.** To comply with Insurance Code §964.062, the captive insurance company must submit any proposed change of information in its formation documents to the department and request approval of the change in advance. If the commissioner approves the change, the department will notify the captive insurance company in writing. Submission to the department is not a filing with the Texas Secretary of State, and the commissioner's approval does not constitute acceptance or affect any review of the proposed amendment by the Texas Secretary of State.

#### **SUBCHAPTER E. FINANCIAL INFORMATION AND REPORTING**

**§6.401. Annual Report.**

(a) The department adopts the Texas Captive Annual Report, including all forms, instructions, and requirements by reference. The adopted forms and instructions will be available on the department's website.

(b) Except as provided in §6.404 of this title (relating to Captive Insurance Companies Using Other Than Calendar Year Fiscal Years), on or before March 1 of each year, a captive insurance company must electronically submit its annual report of the captive insurance company's financial condition as of December 31 of the prior year using the adopted Texas Captive Annual Report form and instructions.

**§6.402. Basis of Accounting.** Under Insurance Code §964.054(c), the basis of accounting for captive insurance company financial statements is current and future

generally accepted accounting principles issued by the Financial Accounting Standards Board for use in the United States.

**§6.403. Audited Financial Statements.**

(a) As required in Insurance Code §964.060(b)(2) and subject to the filing requirements of Insurance Code Chapter 401, Subchapter A, the captive insurance company must file with the department by June 1 of each year, a report of the captive insurance company's financial condition at last year end. The report must include a qualified accountant's opinion of the captive insurance company's financial condition.

(b) The opinion must meet the requirements of Insurance Code Chapter 401, Subchapter A, and §7.85 and §7.88 of this title (relating to Audited Financial Reports and Independent Audits of Insurer and HMO Financial Statements and Insurer and HMO Internal Control over Financial Reporting).

**§6.404. Captive Insurance Companies Using Other Than Calendar Year Fiscal Years.**

(a) A captive insurance company may submit a written request to the commissioner for permission to use a fiscal year end other than a calendar year end. The commissioner may grant the request in writing at the commissioner's sole discretion. A captive insurance company may not use a fiscal year other than a calendar year without the commissioner's written authorization.

(b) As required under Insurance Code §964.060(c)(3), to support the premium tax return due March 1 of each year, a captive insurance company granted a fiscal year end date other than December 31, must submit the asset page and liability, capital, and surplus page; income statement, and statement of cash flow, as verified by two executive officers, on or before March 1 of each year for the prior calendar year and in the annual report format established in the Texas Captive Annual Report adopted under §6.401 of this title (relating to Annual Report). The executive officers verifying the report must have submitted biographical affidavits under §6.303 of this title (relating to Captive Insurance Company Biographical Information).

(c) Under Insurance Code §964.060(c), a captive insurance company granted a fiscal year end date other than December 31 must:

(1) not later than the 60th day after the captive insurance company's fiscal year end, submit to the department the captive insurance company's annual report for the prior fiscal year using the Texas Captive Annual Report form and instructions under §6.401 of this title; and

(2) not later than the 150th day after the date the annual report is due, submit to the department the captive insurance company's audited financial statements as required under §6.403 of this title (relating to Audited Financial Statements).

**§6.405. Capital and Surplus Requirements.**

(a) Capital and surplus requirements will be determined by the commissioner under Insurance Code §964.056. In addition to the factors listed in Insurance Code §964.056, the commissioner may consider any factor the commissioner deems relevant in making this determination, including:

- (1) net writings to policyholders' surplus ratio;
- (2) net reserves to policyholders' surplus ratio; and
- (3) net retention of an individual loss per occurrence as a percentage of policyholders' surplus.

(b) Following the captive insurance company's submission of the annual report or any material change in the plan of operation, the commissioner may require increased capital and surplus after considering factors in Insurance Code §964.056 and this section.

#### **§6.406. Financial Projections.**

(a) A captive insurance company must provide financial projections covering the next four years of operations:

- (1) with its application under §6.202 of this title (relating to Captive Insurance Company Certificate of Authority Application Contents and Process);
- (2) as required under §6.304(c) of this title (relating to Material Change in the Plan of Operations);
- (3) not later than 30 days after a request by the department; and

(4) with its annual report every third year, except as provided in subsection (b) of this section.

(b) The financial projections must be in the format required for the annual report and include the projected:

- (1) asset page;
- (2) liability, capital, and surplus page;
- (3) income statement page; and
- (4) cash flow page.

(c) A captive insurance company is not required to submit financial projections under subsection (a)(4) of this section if:

(1) the captive insurance company provides the department with financial projections covering the next four years of operations during the calendar or fiscal year that will be covered by the annual report described in subsection (a)(4) of this section;  
or

(2) the department waives the requirement in writing.

(d) The captive must note the reason for not including the financial projections in its annual report as requested under subsection (a)(4) of this section.

(e) The department will reassess the captive insurance company's minimum capital and surplus when there is an update to the captive insurance company's projections. The captive insurance company must provide an actuarial opinion on the effect of the change in the projections if requested by the department.

**§6.407. Loans to Affiliates.**

(a) Except as provided in subsection (d) of this section, the captive insurance company must submit a written request to the commissioner for prior approval of a loan agreement with an affiliate.

(b) Terms of the loan agreement under subsection (a) of this section must:

(1) be fair and equitable;

(2) prohibit advancement of funds by the captive insurance company to the affiliate except as defined in the agreement;

(3) include standards for termination of the agreement with and without cause; and

(4) specify that, if the captive insurance company is placed in receivership or seized by the commissioner under Insurance Code Chapter 443:

(A) all of the rights of the captive insurance company under the agreement extend to the receiver or commissioner; and

(B) all books and records will immediately be made available to the receiver or the commissioner and must be turned over to the receiver or commissioner immediately upon the receiver or the commissioner's request.

(c) The request under subsection (a) of this section must be labeled as "Loans to Affiliates - Captives" and include the following information:

(1) the name of the captive insurance company and affiliate;

(2) the home office address of affiliate;

(3) the relationship of the affiliate to the captive insurance company, for example, parent entity or affiliate;

(4) a description of the loan, including:

(A) a statement of the nature of the loan and the reasons for entering into or changing the loan;

(B) a statement of how the loan complies with subsection (b) of this section;

(C) the proposed effective date of the loan;

(D) the financial impact of the loan on the captive insurance company;

(E) a description of the maximum amount the captive insurance company will be obligated to make available under the loan, the date on which the loan will terminate, and any provisions for the accrual or deferral of interest; and

(F) a description of the amount and source of funds or any other assets for the loan.

(d) If the captive insurance company is affiliated with an insurer that is part of an insurance holding company system and subject to Insurance Code Chapter 823, the captive insurance company must comply with the requirements under §6.410 of this title (relating to Application of Holding Company Requirements).

**§6.408. Letters of Credit.**



(a) A letter of credit must comply with this subsection to be reported as an asset of the captive insurance company.

(1) The letter of credit cannot be supported or collateralized by a guaranty of an affiliate.

(2) The beneficiary of the letter of credit must be the commissioner as beneficiary for the security of the captive insurance company's policyholders.

(3) The letter of credit must:

(A) be clean, irrevocable, and unconditional, and issued by a qualified United States financial institution;

(B) contain an issue date and must stipulate that the beneficiary (the commissioner) need only draw a draft under the letter of credit and present it to obtain funds and that no other document need be presented;

(C) show only one amount on the letter of credit;

(D) be readily available for viewing by the department upon request, including at any time to the department in conducting an examination under Insurance Code Chapter 401;

(E) indicate that it is not subject to any condition or qualifications outside of the letter of credit. In addition, the letter of credit itself must not contain reference to any other agreements, documents, or entities;

(F) contain a statement to the effect that the obligation of the qualified United States financial institution under the letter of credit is in no way contingent upon reimbursement; and

(G) state that it is subject to and governed by either the laws of the State of Texas, or the laws of the state of domicile of the issuing bank, and in the event of any conflict must specify whether the laws of Texas or the laws of the state in which the issuing bank is domiciled will apply, and all drafts drawn on the letter of credit will be presentable at an office in the United States of a qualified United States financial institution;

(4) The letter of credit must not:

(A) have a schedule of periodic payments;

(B) name any beneficiary other than the commissioner; and

(C) in aggregate of all letters of credit issued to any one captive insurer by one financial institution, exceed 10% of the financial institution's total equity capital, as shown in its most recent report of condition as filed with the appropriate federal or state financial institution regulatory agency.

(5) The term of the letter of credit must be for at least one year and must contain an evergreen clause that prevents the expiration of the letter of credit without written notice from the issuer. The evergreen clause will provide for a period of no less than 30 days' written notice to the commissioner prior to expiry date or nonrenewal.

(6) In the event a letter of credit is not renewed or replaced, the commissioner must not be precluded from withdrawing the balance of the letter of credit and placing such sums in trust to secure continuing obligations until a renewal letter of credit or a substitution in lieu thereof has been received.

(7) In the event that a letter of credit is not renewed, replaced, or is suspended, the captive insurance company and the issuing bank must give immediate notice to the commissioner of such nonrenewal, replacement, or inactive status.

(b) A letter of credit used for reinsurance purposes must meet the requirements of §7.610 of this title (relating to Letter of Credit Qualified under Insurance Code, Article 3.10, §(d)(3), or Article 5.75-1, §(d)(3)).

**§6.409. Policyholder Dividends.** A captive insurance company must notify the commissioner of a policyholder dividend within 30 days of issuing the dividend.

**§6.410. Application of Holding Company Requirements.** A captive insurance company must comply with Insurance Code Chapter 823 and regulations implementing that chapter if the captive insurance company is affiliated with another insurance company that is part of a holding company and subject to Insurance Code Chapter 823. The regulations include §§7.201 - 7.205 and §§7.209 - 7.214 of this title (relating to Forms Filings, Definitions, Registration of Insurers; Transactions Subject to Prior Notice; Acquisition or Divestiture Statements--Filing Requirements, Form A, Form B, Form C, Form D, Form E, and Form F).

## **SUBCHAPTER F. WORKERS' COMPENSATION**

**§6.501. Workers' Compensation.**

(a) A captive insurance company may not write, issue, or provide any form of workers' compensation insurance coverage to policyholders.

(b) A captive insurance company that issues a reimbursement policy for claims paid under a workers' compensation insurance policy written and issued by an authorized insurance company, may not participate in the adjudication, settlement, or payment of any claims made under that workers' compensation insurance policy.

(c) Claims incurred by a certified self-insured employer may not be paid directly by a captive insurance company, but must continue to be paid by a qualified claims servicing contractor as required in Labor Code §407.061.

(d) The existence of a contractual reimbursement policy issued by a captive insurance company to an affiliate does not alter any statutory requirements related to workers' compensation insurance, including the statutory requirement under Insurance Code §2053.203 that:

(1) the insurance company writing a workers' compensation policy with a negotiated deductible is required to pay all benefits, including those benefits payable, wholly or partly, from the deductible amount; and

(2) the policyholder must make reimbursements to the insurance company writing the workers' compensation policy with a negotiated deductible periodically, rather than at the time claim costs are incurred.

## **SUBCHAPTER G. TAXES**

### **§6.601. Waiver of Taxes.**

(a) A foreign or alien captive insurance company redomesticating from another jurisdiction may request that the commissioner postpone or waive the imposition of any tax or fee under the Insurance Code for a period not to exceed two tax reporting years from the date of redomestication.

(b) The request must be in writing and submitted to the department with the application.

(c) The request must state and provide support of the benefit that licensing the captive insurance company will have for Texas, including, as applicable, employment of Texas residents, the development of real estate in Texas, economic activity in Texas, and additional taxes that will be paid in Texas.

(d) The commissioner may in writing grant or deny the waiver request in whole or in part at the commissioner's sole discretion, including granting a waiver for all or part of the two-year period and all or part of one or more of the following taxes or fees:

(1) the maintenance tax;

(2) the premium tax; or

(3) licensing fees.

#### **SUBCHAPTER H. DISCIPLINARY ACTION**

**§6.701. Disciplinary Action.** Disciplinary action may be taken against a captive insurance company, captive insurance manager, or other person if, after notice and opportunity for hearing, it is determined that the captive insurance company, captive

insurance manager, or other person has violated the Insurance Code, or other law subject to department enforcement, or regulation by the department, including:

(1) a captive insurance company that violates §6.501 of this title (relating to Workers' Compensation); and

(2) an insurance carrier, as defined by Labor Code §401.011, if it allows an employer, other than a certified self-insured employer, to dictate the methods by which and the terms on which a claim is handled and settled in violation of statute.

**10. CERTIFICATION.** This agency certifies that legal counsel has reviewed the proposal and found it to be within the agency's authority to adopt.

Issued at Austin, Texas on November 8, 2013.



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Sara Waitt  
General Counsel  
Texas Department of Insurance