

Delaware's New Captive Insurance Law

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INTRODUCTION

On July 12, 2005, Governor Ruth Ann Minner signed into law the Delaware Revised Captive Insurance Company Act, which substantially rewrites Delaware's captive insurance company law.* The main objective of the new statute is to enhance Delaware's appeal as a domicile for captive insurance companies. This goal is to be achieved primarily by: (1) building on Delaware's stellar reputation for *responsiveness* to business needs; (2) regulating captive insurance companies in a rigorous but *sensible* fashion, consistently with their nature and purpose; and (3) providing *flexibility* to captive insurance companies. The new law creates unique opportunities especially for captive insurance companies and those who can benefit from utilizing them. The Delaware Revised Captive Insurance Company Act also fosters economic development in Delaware, by cultivating the growth of the captive insurance industry in the State.

The new statute arises from a unique collaboration. The Offices of the Governor, the Secretary of State and the Insurance Commissioner of the State of Delaware, together with Delaware legislators and private sector groups (including existing Delaware captive insurance companies and other insurers, captive managers, banks, accountants, and lawyers), joined in a cooperative effort to update and improve Delaware's captive insurance company statute. The result of this partnership is the Delaware Revised Captive Insurance Company Act.

BUILDING ON THE "DELAWARE ADVANTAGE"

Delaware enjoys a reputation as the foremost United States jurisdiction for organizing a business. More than half of all U.S. publicly-traded companies and "Fortune 500" companies call Delaware their legal home. Delaware provides modern and flexible business laws, a sophisticated judiciary with a reputation for excellence and fairness, and a business-friendly state government. These traditional "Delaware advantages" provide significant benefits to any business entity, including a captive insurance company. Delaware's new captive insurance law aims to build on this sturdy platform. Coupled with other factors such as knowledgeable and responsive state regulators dedicated exclusively to captive insurance companies, the new statute

* Captive insurance is a non-traditional form of insurance that can offer advantages such as reduced premium costs and other financial advantages, and access to otherwise unavailable coverage. A captive insurance company is a special type of insurance company that provides such insurance. The Delaware captive insurance statute is located at Chapter 69 of Title 18 of the Delaware Code. It was initially enacted in 1984 and was amended periodically thereafter. The Delaware Revised Captive Insurance Company Act represents the first major revision of the statute.

makes Delaware all the more attractive as a jurisdiction for organizing and operating a captive insurance company.

An important feature of the Delaware Revised Captive Insurance Company Act is its provision for funding the Delaware Insurance Commissioner's administration of the captive insurance company law. Captive insurance company premium tax payments and other revenues initially are to be devoted exclusively to supporting the Commissioner's staffing and other requirements for appropriate regulatory attention to Delaware captives under the new statute. It is anticipated that this focus on providing sufficient resources for a dedicated captive insurance company group within the Insurance Commissioner's office will foster experienced, knowledgeable, and responsive regulatory treatment of captive insurance companies in Delaware.

HIGHLIGHTS OF THE NEW STATUTE

The most significant features of Delaware's new captive insurance company law include:

Flat, capped premium taxes

The new Delaware captive insurance company statute imposes premium taxes that compare quite favorably overall to those applicable in other leading onshore captive domiciles. Unlike the reverse-graduated premium tax scales applied in other jurisdictions, Delaware's new law adopts a flat rate premium tax structure. This approach simplifies calculation of premium tax payable by a captive insurance company. Moreover, the tax rate applicable to captive insurance companies with modest premium receipts is relatively lower in Delaware than elsewhere (0.2% premium tax rate on direct premiums and 0.1% premium tax rate on assumed reinsurance premiums). Accordingly, Delaware's flat rate approach is not only easier to administer, but for smaller captives also may offer premium tax savings over competing jurisdictions. In addition, the new statute imposes annual caps on premium tax payments (premium tax on direct premiums would be capped annually at \$125,000, premium tax on assumed reinsurance premiums would be capped annually at \$75,000, with aggregate annual premium taxes thereby capped at \$200,000). These caps generally will result in tax-neutral treatment of larger captives in Delaware as compared to the premium tax burdens that apply in other leading U.S. captive domiciles. The new statute also offers opportunities for further savings by treating two or more captive insurance companies under "common ownership and control" as a single company for premium tax purposes, and by capping at \$50,000 the aggregate premium tax payable by any captive that has 25 or more full-time employees in Delaware throughout a given tax year. (See also "Cost advantages," below.)

Calibrated, responsible regulation

The new Delaware statute vests in the Delaware Insurance Commissioner regulatory authority designed to balance the need for responsible governmental supervision and oversight with the unique requirements and purposes of captive insurance companies. Accordingly, for example, the Commissioner has power to suspend or revoke a captive's certificate of authority for a cause such as insolvency or non-compliance with law. Moreover, a licensed captive insurance company is required to provide to the Commissioner prompt notice of a material change in its

financial condition or management and advance notice of material transactions such as dissolution, sale of substantially all assets, or merger. At the same time, the Commissioner is vested with considerable regulatory flexibility and it is expected that the new law's provision for funding of regulatory staff dedicated to captive insurance companies will foster a knowledgeable, nuanced, and responsive approach to the implementation of the Commissioner's oversight function. (See also "Variety of captive types permitted," "Flexibility as to minimum capital and surplus," and "Investment opportunities," below.)

Cost advantages

The new Delaware statute compares favorably to the laws of other leading domestic jurisdictions in terms of application, licensing and examination charges imposed on captive insurance companies. Under the new law, each applicant for a captive insurance company license will pay a \$200 application fee and a \$3,000 processing fee. Each licensed captive insurance company will pay a \$300 annual license fee; there is no additional filing, review, processing or other fee or charge imposed in regard to the annual report that must be submitted to the Delaware Insurance Commissioner. Expenses and charges of the Commissioner's periodic examination of a licensed captive insurance company are payable by the company, but such examinations need only take place once every three years, and there is no separate examination fee imposed by the statute. Notably, the new statute offers cost-saving opportunities to captive insurance companies that are under "common ownership and control" by treating them as a single captive insurance company for purposes of the application fee and annual license fee. (See also "Flat, capped premium taxes," above.)

Variety of captive types permitted

Delaware's new captive insurance company statute permits licensing of a captive insurance company that falls into one of the following familiar categories:

- *pure* captive insurance company;
- *association* captive insurance company;
- *industrial insured* captive insurance company;
- *risk retention group* ("RRG");
- *sponsored* captive insurance company (i.e., a "protected cell captive" or "rent-a-captive").

One advantage of the new statute, however, is its recognition of an additional type of captive insurance company. If a prospective licensee is unable to obtain a certificate of authority as a traditional type of captive insurance company (e.g., as a consequence of its structure, the proposed insureds, or the nature of the risks to be insured, or for some other reason), the Delaware Insurance Commissioner is vested with the discretion to license the entity as a *special purpose* captive insurance company.

Expanded entity choices

Under the new statute, Delaware provides more flexibility than any other onshore jurisdiction with respect to the legal form of organization that a captive insurance company may take. Depending on the particular type of captive insurance company involved, just about any domestic, foreign or alien corporation, limited liability company, partnership, limited partnership, statutory trust, reciprocal insurer or other entity could apply for a certificate of

authority to act as a Delaware captive insurance company. This flexibility regarding choice of entity offers new planning opportunities in regard to management, operations, and other important matters.

Range of permitted insureds and lines of insurance

Captive insurance companies licensed under the new statute will be able to provide a wide range of insurance coverages to a broad array of insureds. In particular, and in contrast to the statutes of other leading U.S. jurisdictions, Delaware's new captive insurance law expands the ability of captive insurance companies to insure risks of unrelated third parties: in addition to allowing a pure captive insurance company to insure risks of controlled unaffiliated businesses, the Delaware statute permits an association captive insurance company to insure risks of persons other than the association members and their affiliated companies and permits an industrial insured captive insurance company to insure risks of others besides the industrial insureds and their affiliated companies.

Flexibility as to minimum capital and surplus

Minimum capital and surplus amounts under Delaware's new captive insurance statute are comparable to those required by other leading U.S. jurisdictions. Minimum capital and surplus must be maintained in Delaware. The Delaware Insurance Commissioner has the discretion to prescribe additional minimum capital and surplus based upon the type, volume, and nature of the insurance business transacted by a particular captive insurance company. The new statute affords further flexibility by providing that minimum capital and surplus may take the form of cash, an irrevocable letter of credit, or any other assets as may be approved by the Commissioner.

Investment opportunities

Delaware's new captive insurance company statute places but one restriction on the investments that might be made by a pure or industrial insured captive insurance company: any investment that threatens the solvency or liquidity of the company may be prohibited or limited by the Delaware Insurance Commissioner. The new law generally requires association, industrial insured, and special purpose captive insurance companies and risk retention groups to comply with investment restrictions ordinarily imposed on insurers under Delaware's insurance code; the statute does provide flexibility, however, in that the Insurance Commissioner in a given case may approve other investments.

Focus on licensing

Captive insurance company law in some jurisdictions can create uncertainty insofar as it overlaps with the entity statute (e.g, the corporation statute) that governs the formation and internal affairs of the organization seeking a captive insurance company license. (For example, some captive insurance company laws require a certain number of incorporators or otherwise impose requirements that are typically addressed in the governing entity statute.) The potential for this sort of confusion is minimized under Delaware's new captive insurance company law. It is designed clearly to serve as a licensing statute only.

CONCLUSION

The enactment of the Delaware Revised Captive Insurance Company Act provides captive insurance opportunities unavailable in any other jurisdiction. The new captive insurance company statute promises to offer flexibility in an environment of responsible, sensible regulation, all within the context of existing “Delaware advantages.” As a result, existing captive insurers and parties interested in the benefits offered by captive insurance should seriously consider Delaware as the place to locate their captive insurance company.

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