



# OPEN FOR BUSINESS

Connecticut's revised law expressly recognises different types of captives and provides a \$7,500 first-year tax credit

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**O**n 27 October 2011, Connecticut Governor Dannel Malloy signed into law An Act Promoting Economic Growth and Job Creation in the State<sup>1</sup> (the "Act"), which is intended to spur the creation of new jobs, encourage innovation and entrepreneurship, and strengthen the state's overall competitiveness. This article highlights the provisions of the Act, which revise Connecticut's existing captive insurance law and make Connecticut a more attractive domicile for captive insurance companies. They include a first-year tax credit for newly established captives in the amount of \$7,500, more fully developed provisions on what constitutes "common ownership and control" for

the purpose of aggregating tax liability among multiple insurers, and the express recognition of different types of captive entities. Moreover, the more comprehensive law should simplify for Connecticut-domiciled captives the task of satisfying IRS consideration of the rigor of captive insurance regulation as part of the test of whether the captive conforms with commonly accepted notions of an insurance company.

Captive insurance companies are most often established with the specific objective of financing the risks of their parent group or groups and sometimes also insuring the risks of the group's customers. To date, more than 5,000 captives have been formed worldwide; however, since the passage of Connecticut's original captive insurance statute<sup>2</sup>, enacted in 2008, no company has as yet chosen Connecticut for its captive domicile.

Connecticut's original statute<sup>3</sup> and its revision were modelled in large part after its counterpart in Vermont, which is the most popular US domicile with more than 900 captives formed under its laws. Connecticut insurance commissioner Thomas Leonardi said: "This updated captive law reinforces the State of Connecticut's position as the insurance capital of the United States. To be attractive to captive insurance companies, the state and its insurance department must have flexibility to set the reserve requirements of the captives based upon their performance. We look forward to welcoming those captives that are well-managed and well-capitalised."

The revisions to Connecticut's insurance statute should increase certainty with respect to what is covered under the statute. The Act also codifies the commissioner's discretion in certain instances. For example, the revised statute broadens the types of insurable losses eligible for recovery by the captive insurer to "any kind of loss, damage or liability properly a subject of insurance, if such insurance is not prohibited by law or is not disapproved by the commissioner as being contrary to public policy". Previously, it was unclear whether certain types of losses would be eligible for coverage by a Connecticut-domiciled captive insurance company.

The Act initially provided for the creation and operation of, and regulatory matters with respect to, "pure" captive arrangements. The revisions now re-



flect the evolving captive insurance industry, which include statutory recognition of different types of companies and structures, such as “protected cells”, “incorporated protected cells”, “alien captive insurance companies”, “special purpose financial captive insurance companies”, “sponsored captive insurance companies” and “branch captive insurance companies”. Additionally, it codifies the procedures by which a company may gain regulatory approval and be subjected to regulatory review, and provides certain assurances, such as statutory affirmation that certain items disclosed to the commissioner are confidential and not subject to subpoena. It also makes it easier for a captive to establish Connecticut as its domicile by allowing the commissioner to permit the formation of a Connecticut captive that is established for the sole purpose of merging with a captive organised in another jurisdiction.

#### Sponsored captive insurance companies

Sometimes called a “cell captive”, “rent a captive” or “segregated portfolio company”, a sponsored captive is a popular choice for businesses with smaller operations, in that they are able to enjoy the benefits of owning a captive insurance company without the costs of forming and operating their own stand-alone entity. The statute provides a definition of a sponsored captive as a company (i) in which the minimum paid-in capital and surplus are provided by one or more sponsors, (ii) that insures the risks of its participants through separate participant contracts, and (iii) that funds each participant’s liability through a protected cell and segregates the assets of each cell from the assets of other cells and from the assets of the sponsored captive’s general account.

A sponsored captive insurance company may establish one or more “protected cells” under certain conditions, which ensure the autonomy of its cells as follows:

1. the stockholders of the sponsored captive shall be limited to its participants and sponsors (except for nonvoting shares approved by the commissioner)
2. each cell shall be accounted for separately on the books and records of the sponsored captive;
3. no liabilities of the sponsored cap-

tive’s other insurance businesses may be chargeable against the assets of a protected cell

4. no sponsored captive may sell any assets of the protected cells without the consent of such cells.

#### Special purpose financial captive insurance companies

The Act provides that a captive insurance company that is engaged in, or will be engaged in, an insurance securitisation shall be deemed to be a “special purpose financial captive insurance company”. “Insurance securitisation” is defined as a transaction or group of related transactions, that are effected through related risk transfer instruments and facilitating administrative agreements, followed by an approach to the capital markets, such as by issuance of securities or by obtaining a letter of credit or other capital from a third party, the proceeds of which are used to

with a principal place of business located in Connecticut. Before the branch may become licensed, the alien captive insurance company must petition the insurance commissioner to issue a certificate setting forth the commissioner’s finding that, after considering the character, reputation, financial responsibility, insurance experience, and business qualifications of the officers and directors of the alien captive, the licensing of the branch will promote the general good of Connecticut. Annually, the branch must submit to the commissioner a copy of all reports and statements required by its domicile, verified under oath of two executive officers of the alien captive.

In order to do business in Connecticut, branch captives must have and maintain, as security for the payment of liabilities attributable to the branch operations, at least \$250,000 in capital and reserves on its insurance policies

**“ CONNECTICUT WILL NO DOUBT IN THE FUTURE BE AT THE FOREFRONT OF CAPTIVE JURISDICTIONS ”**

fund the special purpose financial captive insurance company’s obligations under a reinsurance contract with a ceding primary insurer.

An officer of the special purpose financial captive insurance company must also submit an affidavit that (i) the proposed company and its reinsurance and securitisation contracts comply with Connecticut’s insurance laws, and (ii) the company’s investment policy reflects and takes into account the liquidity and preservation of its assets. Finally, the special purpose financial captive insurance company must provide a legal opinion that its offer and sale of any securities complies with all applicable securities laws.

#### Branch captive insurance companies

“Branch captive insurance companies” are defined as any alien captive insurance company<sup>4</sup> licensed by the insurance commissioner to transact business in Connecticut through a business unit

or reinsurance contracts, including reserves for losses, allocated loss adjustment expenses, incurred but not reported losses and unearned premiums. Such amounts may be held, with the prior approval of the insurance commissioner, under a trust or in the form of an irrevocable letter of credit, and the \$250,000 may be held in cash on deposit with the commissioner. Branch captives may write insurance or reinsurance for its parent’s (and affiliates’) employee benefit business, but only if such business is subject to the Employee Retirement Income Security Act of 1974, as amended.

#### Paid-in capital and surplus requirements

The Act specifies the minimum paid-in capital and surplus requirements, which may be increased by regulations adopted by the Insurance Commissioner as set forth in the table, below. Such amounts may be in the form of cash or an irrevocable letter of credit approved

by the Commissioner. The minimum requirements remain the same for all captives as initially under the Act, except for association captive insurance companies, for which such requirement has been reduced from \$750,000 to \$500,000.

**Premium tax and financial incentive**

The tax levied on premiums collected by captive insurance companies, payable by March 1 annually, remains unchanged, but the Act now provides for tax rates on reinsurance premiums. The premium tax rates are as follows:

Connecticut provides the incentive of a first-year tax credit in the amount of \$7,500, which is the amount of the minimum tax set by the statute.

The new law provides that one or more captives under common ownership and control shall be taxed as though they were a single captive insurance company. By providing a definition for “common ownership and control”, the statute enables more certainty with respect to a captive’s tax planning. In the case of sponsored captive insurance companies, the statute clarifies that each protected cell is treated as a separate captive insurance company owned and controlled by such protected cell’s participants.

**Insurance department funding and resources**

Under Connecticut’s new legislation, which goes into effect on 1 July 2012, a “Captive Insurance Regulatory and Supervision Account” will fund staff positions and other expenses related to the regulation of captives. This account is funded by eleven percent (11%) of the premium taxes paid by captives, and by fees and assessments collected by the Commissioner. Two percent (2%) of the account may be transferred to the Department of Economic and Community Development for the purpose of promoting the captive insurance industry in Connecticut. With the new law, the Department of Insurance (DOI) is expected to add four to five positions to its staff.

**Excess workers’ compensation insurance**

The Act enables any captive to provide excess workers’ compensation insurance to its parent and affiliated companies, unless prohibited by the laws of the state having jurisdiction over the trans-

CAPTIVE TYPE	CAPITAL AND SURPLUS REQUIREMENT
Pure captive	Not less than \$250,000
Association captive	Not less than \$500,000
Industrial insured captive	Not less than \$500,000
Risk retention group	Not less than \$1,000,000
Sponsored captive	Not less than \$500,000
Special purpose financial captive	Not less than \$250,000
Sponsored captive licensed as a special purpose financial captive	Not less than \$500,000

PREMIUM AMOUNT	TAX RATE ON DIRECT PREMIUMS	TAX RATE ON REINSURANCE PREMIUMS
First \$20m	0.38%	0.214%
Next \$20m	0.285%	0.143%
Next \$20m	0.19%	0.48%
Over \$60m	0.72%	0.24%

action, or by federal law. Furthermore, any captive may reinsure a workers’ compensation qualified self-insured plan of its parent and affiliated companies, unless prohibited by federal law.

**Conclusion**

With the amendments to Connecticut’s captive insurance laws in place, it is now the objective of Connecticut’s Department of Economic and Community Development to promote the benefits of a Connecticut domicile, which include being a member of the business community in the nation’s insurance capital with its 150-year history of insurance expertise, well-developed regulation and a Governor who stresses the im-

portance of insurance to his state. Connecticut will no doubt in the future be at the forefront of captive jurisdictions, which serve captives of all sizes and types and offer any category of insurance product. ☺

<sup>1</sup> Public Act No. 11-1

<sup>2</sup> Public Act No. 08-127, An Act Concerning Captive Insurance Companies

<sup>3</sup> The revisions are based, in part, upon recommendations of the authors and their colleagues within the Captive Insurance Group at Anderson, Kill & Olick, P.C., which opened an office in Stamford, Conn. in January 2011.

<sup>4</sup> An “alien captive insurance company” is defined by the new statute as any insurance company formed to write insurance business for its parent and affiliated companies and licensed pursuant to the laws of another jurisdiction that imposes statutory or regulatory standards on companies transacting the business of insurance in such jurisdiction that the commissioner deems to be acceptable. Public Act No. 11-1, Sec. 55(2).



Connecticut’s new legislation goes into effect on 1 July 2012