

# Montana State Legislature

2011 Session

**Exhibit 7**

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Montana Captive  
Insurance Association, Inc.

# MONTANA CAPTIVE DOMICILE REPORT

EXHIBIT 7  
DATE 2/16/2011  
HB 419

Montana Captive Insurance Association, Inc.

[www.mtcaptives.org](http://www.mtcaptives.org)

2010



Dear Colleagues:

On behalf of the MCIA board of directors and professional staff, I am pleased to present the association's report of Montana's growing captive insurance industry and business-friendly regulatory environment. This report provides a variety of information that we hope you find useful in understanding why Montana is a great captive domicile and how our association is helping to make the domicile even better.

MCIA is committed to supporting the continued growth of the state's captive insurance industry and thanks its member companies for providing us the resources to do so. A listing of our service provider members is included as part of this report.

Finally, I encourage you to join us for MCIA's annual conferences held in the spring and summer, attracting more than 100 industry professionals each year. Complete event details can be accessed on-line at [www.mtcaptives.org](http://www.mtcaptives.org).

We hope to see you in Big Sky Country so that you can experience first-hand why Montana is the best place in the west for captive insurance companies to hang their hat.

Sincerely,

Brenda M. Olson  
Chairperson  
Montana Captive Insurance Association, Inc.

# COMMISSIONER OF SECURITIES & INSURANCE

MONICA J. LINDEEN  
COMMISSIONER



OFFICE OF THE MONTANA  
STATE AUDITOR



Dear Friends-

Thank for your interest in captive insurance opportunities in the state of Montana.

Over the past two years since being elected as state auditor and insurance commissioner, I have been very impressed with the vibrancy of our state's captive insurance industry, which has strengthened my commitment to building on this success. This domicile report tells our story.

Fortunately, I have a great captive regulatory team behind me who shares my vision for growth and success. So, my central message is that Montana wants your captive business and we will do our best to earn it. You will not be disappointed should you decide to do business in the Big Sky state.

Let me also take this opportunity to encourage your active participation in the Montana Captive Insurance Association, Inc. (MCIA). This organization has played a key role in helping to build the state's captive insurance industry and my office continues to work closely with MCIA representatives on a variety of projects of interest to captive owners and industry service providers.

I look forward to seeing you in Montana some time soon.

Sincerely,

Monica J. Lindeen  
Commissioner of Securities & Insurance  
Office of the State Auditor

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# The Basics

## about Captive Insurance Opportunities in Montana

The cost and availability of corporate insurance continues to be a major concern of Montana's business community. Interestingly, many business leaders do not know that Montana has recently taken action to help businesses find a solution to their risk management challenges by allowing them to form and operate captive insurance companies that can insure business risks anywhere in the world.

In this regard, a formal introduction to captive insurance is clearly overdue.

The simplified explanation of captive insurance is that it is a specialized form of self-insurance where a corporate entity or a group of corporate entities form their own insurance company to insure the risks of its parent(s) and affiliated entities.

Only certain states allow the formation of captive insurance companies, and Montana took action to become a captive "domicile" in 2001. Since then the state has licensed more than 60 captive insurance companies, which were formed to cover a variety of corporate risks.

In years past, most captive insurance companies were formed in offshore locations, such as Bermuda or the Cayman Islands, but the current trend is for captives to be formed in domestic domiciles. Montana is part of this domestic domicile club, which is a tremendous advantage to the state's business community.

## Why Form a Captive

There are many good reasons for business owners to form a captive insurance company – not the least of which is creation of teamwork among the risk management, treasury and tax-accounting functions for overall improved financial health. Several more specific reasons are as follows:

### ■ The Alternative to Commercial Insurance

The first apparent benefit of forming a captive is to take control of the risk management budget – for now and into the future. Underwriting cycles for first dollar coverage become nonevents for the owner of a captive, and exposures that are difficult to cover on the commercial market are secure in a captive. Captives commonly provide policies covering property, liability, Excess Workers' Compensation, and medical stop loss insurance. Life, health, surety, marine and disability insurance can also be written by a captive insurance company.

### ■ Coverage Tailored to an Organization's Specific Needs

Many organizations – to their dismay – experience shifting or evolving risks as their businesses grow or take new directions. Exposures such as environmental risk, employment practices liability, flooding and many other risks can be actuarially quantified and protected in a captive program while others wait for the development of "off the shelf" programs from commercial insurers.

### ■ Accumulation of Investment Income to Reduce Net Costs

The captive has control over its investment income. As with any insurance company, the captive invests the assets that support loss reserves and capital surplus. Prudent investing can return profits greater than those that would be provided by a commercial insurer and will help immunize the loss portfolio against unexpected inflation.

### ■ Improved Cash Flow

A captive provides a place to store funds for future liabilities without paying for risk transfer. The reserve funds don't have to be identified for a particular exposure, but exist in a pool. This pool of funds can be used to insure any difficult-to-insure exposures without further cost to the insured businesses.

### ■ Incentive for Loss Control

It's amazing how careful people can become if they have to pay for their mistakes. The same holds true among owners of captive insurance companies. They quickly understand the value of things like operational safety programs, careful maintenance, staff training and peer review, depending on the exposures being covered. It's no coincidence that captive owners usually see decreased loss experience in the years following captive formation. This results in healthier, more productive and profitable organizations.

### ■ Greater Control Over Claims

Claims handling is performed at the direction of the captive owner rather than an insurance company whose best interests are often served by delaying claims (see Hurricane Katrina). Claims review includes all the necessary parameters and standards that the captive owner requires for efficient risk management.

### ■ Underwriting and Retention Funding Flexibility

Underwriting and Retention Funding Flexibility Many large organizations with decentralized operations may experience different appetites for risk and at different levels. For example, a parent organization may be able to maintain higher risk retention than its local operation units can. A captive can be extremely effective in its ability to spread risk according to the needs of the organization.

### ■ Reduced Cost of Operation

In short, there is no point in forming a captive that will not reduce overall operating costs. A captive may offer the early recognition of losses for federal income tax purposes. Premiums may be tax deductible if the captive is found by the IRS to be an insurance company by insuring the exposures of those other than its parent. Whether premiums will be deductible when paid needs to be addressed by any corporation that considers forming a captive.

### ■ Direct Access to the Reinsurance Markets

As an insurance company, a captive may purchase a selected level of loss protection from reinsurance companies. Unlike the "primary" insurance market, the reinsurance market is largely unregulated concerning forms, rules and rates. Unique exposures can be handled with customized policy language.

## Forms of Captive

All captive insurance companies are owned and controlled by their insureds. But they may take various forms:

### Single Parent Captives

Single parent captives are owned and controlled by one company and insure the risk of those companies, their subsidiaries, and their affiliated entities.

### Group Captives

Association captives are insurance companies that are owned and controlled by two or more non-affiliated organizations that the captive insures. The association captive can either insure businesses within a common industry, and insure similar types of risks or it can insure non-homogeneous businesses and insure different risks.

### Risk Retention Groups

Risk Retention Groups (RRGs) are enabled and protected by the federal Liability Risk Retention Act and are a form of a group captive that may be licensed in one state to operate in all states. At present, risk retention groups are limited to insuring liability exposures.

### Agency Captives

Reinsurance captives and protected cell captives are formed and controlled by insurance brokers/agents who have chosen to participate, together with insurance companies, in the risks of their own clients.



*Montana is the best captive insurance domicile in the west. It has all the key elements needed for successful captive and RRG programs: direct access to knowledgeable and fair regulators, a legacy of strong legislative support, business-friendly flexible laws, a lack of bureaucratic red-tape, a wide array of cost-effective service providers, and the collective voice of the MCJA in promotion and education. Montana captives and RRGs get business done at the speed of light in comparison to other captive domiciles while maintaining high quality standards.*

Brenda M. Olson  
President  
ORG Risk Management

# Montana Premium Tax

As Montana's captive insurance industry has grown over the past several years, so does its positive economic impact in the form of premium taxes paid to the state. The information provided below illustrates the growth in premium tax revenue since 2001. MCIA expects this positive trend line will continue for many years to come.

Year	# Captives Licensed	Premium Tax	Premiums Written
2001	1	-0-	-0-
2002	3-1	\$ 20,037	\$ 8,750,200
2003	5-2	\$ 51,713	\$ 6,419,100
2004	5-1	\$ 72,569	\$ 7,690,736
2005	3	\$ 86,696	\$ 14,759,504
2006	8	\$ 161,994	\$ 31,580,902
2007	10-1	\$ 226,168	\$ 37,877,161
2008	8-3	\$ 339,585	\$ 65,123,909
2009	16-4	\$ 420,070	\$ 74,863,332

\* Final 2010 data will be available in March of 2011.

## Type of Coverage Currently Being Written by Montana Captives

Captive insurance companies licensed in Montana are currently being used for many different types of corporate risks, including:

- Agency Professional Liability
- Trucking Liability
- Attorney's Liability Reinsurance
- Warranty
- Bail Bond Liability
- Work-Comp Deductible Buy-Down
- Worldwide Cargo & Transit
- Cable Repair, Communications Company
- Contractors Liability
- Contractual Liability
- Defense Costs
- Employment Practices Liability
- Environmental Liability
- Excess Property
- Excess Stop Loss
- Excess Workers' Compensation
- Medical Malpractice
- On-Site Cleanup
- Patent Defense
- Reinsurance
- Third-Party Liability
- Computer & Privacy Liability
- Aviation Liability
- Administrative Action
- Directors & Officers Liability
- Litigation Expense
- Livestock Liability
- Primary & Excess Liability
- Punitive Damages Liability
- Tax Audit Expenses
- Unfair Competition Liability
- Wage and Hour Liability

# Montana's Captive Insurance Law

In 2001, Montana became the 16<sup>th</sup> state to pass legislation opening existing insurance regulations to the captive insurance industry. Under Mont. Code Ann. § 33-28-101 *et. al*, a company or association of companies may form a wholly owned subsidiary to insure the parent entity. The parent company retains part of the insurance risk within the company and the captive company collects the premiums and handles the claims.

There are many different legal issues involved in forming and operating a captive insurance company including:

- What type of captives are allowed under Montana law
- What capital and surplus requirements exist
- What are the investment limitations under Montana law
- What are the regulatory requirements
- What kinds of fees and taxes are applicable

## Capital and Surplus:

One of the primary legal aspects is the capital and surplus requirements that are imposed by every domicile that permits captives, including Montana. Montana's capital requirements are as follows: 1) in the case of a pure captive insurance company -- \$250,000, 2) in the case of a captive risk retention group -- \$500,000, 3) in the case of an association -- \$750,000. Vermont, for example, the largest on-shore captive domicile, requires a statutory minimum for a single-parent captive of \$250,000, \$500,000 for an industrial insurer, \$750,000 for an association, and \$500,000 for a sponsored captive. An important key about Montana's legal requirements is that capital and surplus may be in the form of either cash or an irrevocable letter of credit issued by a Montana chartered bank or a member bank of the federal reserved system and approved by the Commissioner.

More recent legislation reduced the minimum capital surplus requirements for captive reinsurance companies by fifty percent.

Now the requirements for pure captives that reinsure an admitted carrier are \$125,000 and the requirements for association captives that reinsure an admitted carrier are \$375,000. In addition, the minimum capital for protected cell captive insurance companies with ten or fewer homogeneous cells to \$250,000. Protected cell captives with more than ten cells have a minimum capital surplus requirement of \$500,000.

## Investment Limitations:

For pure captives, Montana law does not have any restrictions on allowable investments, except that the Commissioner may prohibit or limit investments that threaten the solvency or liquidity of the Company.

## Regulatory Requirements:

Montana's regulatory requirements are similar to those in many domiciles. A captive must file an annual GAAP financial statement, NAIC convention statement for RRG's and association captives, and financial statements audited by an independent CPA six months after fiscal year end. The 2007 legislation clarified that GAAP reporting is acceptable for captives and Risk Retention Groups, and that approved letters of credit are recognized as assets.

## Fees and Taxes:

The fees and taxes are one of the most significant legal issues involved in domiciling a captive. Montana's fees and taxes are often much less than other domiciles. The following chart details some of the issues specific to Montana and its statutory requirements.



*As a captive formation and management firm, The Taft Companies rely heavily on our strong relationship with Montana's captive regulators. They are readily available to help us with any problems and are willing to work with each of our client's specific needs. Over the years I have seen remarkable growth and opportunities arise from Montana based captives. There is great value to be had in choosing Montana as a domicile.*

*Dick Goff*  
Managing Member  
W.A. Taft & Co (MT) L.L.C.

## Capitalization

(1) A captive insurance company may not be issued a license unless it possesses and maintains unimpaired paid-in capital and surplus of: (a) in the case of a captive risk retention group, not less than \$250,000; (b) in the case of an industrial insured captive insurance company, not less than \$500,000; and (c) in the case of an association captive insurance company, not less than \$750,000.

(2) The Commissioner may require additional capital and surplus based upon the type, volume, and nature of insurance business transacted.

(3) Capital and surplus may be in the form of cash or an irrevocable letter of credit issued by a bank chartered by the state of Montana or a member bank of the federal reserve system and approved by the Commissioner.

## Application & Fees

The application form must be filled out in its entirety. When submitted, it should include all the material requested, together with the \$200 application fee and the \$300 license fee.

## Investment Restrictions

(1) A captive risk retention group and an association captive insurance company shall comply with the investment requirements contained in Title 33, chapter 12, and the rules promulgated in accordance with these provisions.

(2) A pure captive insurance company is not subject to any restrictions on allowable investments, except that the commissioner may prohibit or limit any investment that threatens the solvency or liquidity of the company.

(3) Only a pure captive insurance company may make loans to its parent company or affiliates, although prior approval of the Commissioner is required.

## Tax Issues

(minimum of \$5,000 in premium taxes)

Premium Level	Direct Tax Rate	Reinsured Tax Rate
\$ 1 – 20m	0.4%	0.225%
\$ 20 – 40m	0.3%	0.15%
Over \$40m	n/a	0.05%

## Reserve & Underwriting Reruitments

Montana administrative rules require that loss reserves and loss expense reserves be certified by a Fellow of the Casualty Actuarial Society, a member in good standing of the American Academy of Actuaries, or an individual who has demonstrated his competence in loss reserve evaluation to the Commissioner. The Commissioner must approve the actuary. The applicant must select an actuary that meets the requirements of the administrative rule.

## Reporting Requirements

(1) A captive insurance company is not required to make an annual report except as provided in this section.

(2)

a) On or before March 1 of each year, each captive insurance company shall submit to the Commissioner a report of its financial condition in a form and manner as required by the Commissioner, verified by oath of two of its executive officers.

b) Each captive insurance company shall report using generally accepted accounting principles, unless the commissioner requires the use of statutory accounting principles, with any necessary or useful modifications or additions required by the Commissioner. The commissioner may also require the report to be supplemented by additional information.

## Local Office Requirements

All books, records, and other information necessary for a statutory examination should be located in Montana.

# MCIA Fifth Annual Conference

Draws Nearly 100 Attendees

July 21, 2010



Nearly 100 attendees participated in the Montana Captive Insurance Association, Inc. (MCIA) Annual Conference this week at the Grouse Mountain Lodge in Whitefish, Montana. The event marked the fifth anniversary of the association, which was formed about two years after the passage of captive legislation in Montana.

Conference attendees included owners of licensed captive insurance companies, representatives from leading industry service providers and key captive regulators. Many of the registrants came from out of state, with one coming from as far as London.

The educational program featured 12 separate sessions focused on topics of direct interest to those interested in doing captive business in Montana. Key highlights included:

- Proposed improvements to Montana captive insurance law
- How to set up a protected cell captive in Montana
- New accounting standards affecting captive insurance companies
- Federal legislative/regulatory developments
- The role of independent captive insurance company directors
- New risk based capital requirements

Perhaps of most interest, Montana's chief captive regulator, Steve Matthews, provided an update on captive formations in the domicile and the how the State Auditor's office is preparing for future growth

In addition to the great educational sessions, attendees were able to take advantage of numerous networking opportunities. And from an economic developments perspective, the MCIA conference generated significant revenue for local Whitefish businesses.

The date and location for the 2011 Annual Conference will be announced soon.