

CORPORATE AND SECURITIES LAW

ALERT

NEWS FOR THE CLIENTS AND FRIENDS OF BASS, BERRY & SIMS PLC

Enactment of Legislative Overhaul Makes Tennessee Attractive Domicile for Captives

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Over the weekend, the Tennessee General Assembly approved sweeping legislation that completely overhauls Tennessee's captive insurance company law, creating new opportunities for holding companies and corporations to self-insure their own risks or to join with others in forming insurance companies to insure similar risks. The legislation also creates the prospect, in some cases, for companies to significantly reduce their premium tax burdens and potentially their workers' compensation expenses. Enactment of the legislation, the Revised Tennessee Captive Insurance Act ("Act"), places Tennessee on the short list of states senior management should consider when looking to establish a self-insurance vehicle. Also, Tennessee has now become an ideal domicile for special purpose financial captives ("SPFCs"), established by life insurers and other entities to securitize their risk, and for branch captives to insure or reinsure the employee benefits business risk of affiliates.

Passage of the Act (H.B.2007) has been among the top legislative priorities of Governor Bill Haslam, as part of his Administration's broad initiative to encourage establishment of new companies – and jobs – in Tennessee. He is expected to sign the legislation¹ into law as early as the end of this week. A detailed bill summary is available [here](#).

When Tennessee originally enacted its captive law (Tenn. Code Ann. Sections 56-13-101 et seq.) in 1978, it was one of the first states in the U.S. to permit formation of captives. Other states soon followed suit and adapted their laws to the evolving needs of self-insurance and financial markets. Commissioner of Commerce and Insurance Julie McPeak said her goal in drafting the Act was to use a "one shot" approach to bring Tennessee's captive law up-to-date and also make it as flexible and broad as possible. The Department of Commerce and Insurance ("Department") relied on statutes in a number of leading captive states, including Vermont, South Carolina, Delaware, Montana, Kentucky and Hawaii, in crafting the Act. The Department also actively sought and considered comments from Tennessee corporations and domestic insurers as part of its efforts to ensure the Act was best in class.

¹ A copy of House Amendment No. 1, which rewrites the bill (H.B.2007) as originally introduced in its entirety, is available at this link <http://www.capitol.tn.gov/Bills/107/Amend/HA0364.pdf>.

A modest technical amendment adopted by the House (Amendment No. 2) is available at this link: <http://www.capitol.tn.gov/Bills/107/Amend/HA0522.pdf>.

Seven Types of Captives Authorized

The Act provides for the formation of seven types of captives: (1) pure captive insurance companies; (2) association captive insurance companies; (3) industrial insured captive insurance companies; (4) risk retention groups ("RRGs"); (5) protected cell captive insurance companies; (6) branch captive insurance companies; and (7) SPFCs. The Act provides for captives to be established as corporations, limited liability companies and partnerships. The Act sets minimum capital and surplus requirements for these entities at prudent levels that are comparable to other states: \$250,000 for pure captives, branch captives and SPFCs; \$500,000 for association captives, industrial insured captives and protected cell captives; and \$1,000,000 for RRGs. The Commissioner will determine the amount of any additional surplus required based upon review of the applicant's plan of operation and associated insurance risk.

Under the Act, captives are authorized to underwrite the following coverages: professional liability, property, casualty, errors and omissions, comprehensive general liability, life, excess coverage for accident and health, employee benefits for parent companies pursuant to federal law requirements (i.e., ERISA), and workers' compensation. Captives also are authorized to reinsure risks ceded by any other insurer. Such reinsurance could include, for example, insurance provided by the captive to a qualified self-insured plan of a parent or affiliate for workers' compensation or accident and health coverage.

Once licensed, captives are required to file statements of financial condition with the Department on an annual basis. Unlike regular insurance companies however, captives are permitted to file statements in accordance with GAAP, rather than utilizing statutory accounting principles. The Act specifies the types of investments that captives are permitted to hold and the types of risks they can insure/reinsure. Captives will be subject to examination by the Department at least once every three years; the exam cycle may be extended to every five years at the Commissioner's discretion.

Favorable Tax Treatment

Significantly, the Act establishes premium tax rates that are competitive with other favored captive domiciles and that are, in most cases, substantially lower for risks maintained in captive insurance companies than in other self-insured entities. The direct premium tax rates are as follows:

- (1) for the first \$20 million in direct net premium collected or contracted – four tenths of one percent (.04%); and
- (2) for each dollar of direct net premium above \$20 million – three tenths of one percent (.03%).

Assumed reinsurance premium tax rates (applicable only to where the risks are not already subject to direct premium tax above) are as follows:

- (1) for the first \$20 million of assumed reinsurance premium – 225 thousandths of one percent (.225%); and

(2) for each dollar of assumed reinsurance premium above \$20 million – 150 thousandths of one percent (.150%).

The aggregate annual minimum tax due by a captive based on the above direct premium and reinsurance premium rates is \$5,000, and the aggregate maximum tax is \$100,000. Certain other tax rules apply to cell captives and SPFCs that are a part of a consolidated group.

Effective Date and Licensure Process

The bill provides an effective date of September 1 for issuance of licenses, but is effective upon Governor Haslam's signature for purposes of developing and publishing applications, promulgating rules and accepting applications for new captives. The new form of application is expected to be prepared and released within the next couple of months.

The licensure and supervision of captives is anticipated to be conducted in a new Captives Section of the Department's Insurance Division, which will be overseen by a new director position. Now that the legislation has been passed by the General Assembly, Commissioner McPeak is expected to soon announce the individual who will serve as the new director. She has indicated the individual will have significant experience in the area, probably including having served in a senior position with another state insurance department. The new Captives Section is expected to quickly add analysts and other staff positions, with personnel sourced from both within and outside the Department.

We are in regular and active communication and consultation with the Insurance Division and are monitoring developments closely as the Department gears up to accept new applications during the summer. We welcome comments or questions about technical aspects of the Act, the rationale and process for establishing a captive and the process for seeking and securing a license in Tennessee.

If you have any questions regarding the issues addressed in this *Corporate and Securities Law Alert* or if you would like to set up a meeting with us and your management team or board of directors regarding these developments, please feel free to communicate with your regular contacts in our Corporate and Securities Group or either of the Corporate Insurance Partners listed below.

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