

Ariz. Close To Strengthening Captive Insurer Regs

By Jonathan Randles

Law360, New York (April 18, 2014, 5:20 PM ET) -- A bill sent Thursday to Arizona Gov. Jan Brewer would strengthen state standards for captive insurers by requiring insurance subsidiaries to disclose more information regarding their financial relationships to their affiliated companies and provide regulators with additional tools to oversee potentially problematic tax structures.

SB1089 was sent to the governor's office for final approval after clearing both the Arizona House and Senate this week. The legislation would bring Arizona's accreditation standards for captive insurers in line with the [National Association of Insurance Commissioners](#).

The bill would require a controlling entity that seeks to cede its control in a domestic insurer to file a confidential notice with the Arizona Department of Insurance. Similar notification would also be required for a company seeking to acquire a domestic insurer.

The proposed legislation would also increase the state's oversight of certain transactions involving domestic insurers that have in the past been a source of concern for the [Internal Revenue Service](#). A company may not enter into a tax allocation agreement or guarantee with its captive insurer before notifying the state's DOI.

In general, the use of a guarantee in a deal involving a captive insurer is considered aggressive and may trigger scrutiny from the IRS because of the potential that such a structure could create a circular cash flow.

Similarly, in SB1089 a company would need to notify Arizona's DOI if its captive enters into any reinsurance pooling agreement with an insurance subsidiary.

SB 1089 has been the top legislative priority for the DOI this year - it is the only bill the state regulator has introduced this session. Bringing the state's rules regarding insurance subsidiaries in line with the NAIC are necessary if Arizona's insurance regulator wants to maintain its national accreditation beyond January 2016.

These updates will allow the department to better understand an insurer's financial

relationship with its affiliates while permitting the department to participate in collaborative and cooperative forums with other insurance regulators,+Arizona DOI lobbyist Andrew Carlson said at a hearing on the bill earlier this year.

SB1089 was introduced into the Arizona legislature in January, days before the U.S. Tax Court said **in a important ruling for captive insurers** that [Rent-A-Center Inc.](#) is allowed to deduct payments made to its Bermuda-based insurance subsidiary.

In a split decision, the Tax Court found that the deductions were permitted because RAC's insurance unit Legacy shifted risk from the company's numerous subsidiaries. The ruling was the latest in a series of decisions in the last several years that have been favorable toward captive insurers which, at times, have irked the IRS because of their potential for abuse.

Rent-A-Center is like many other national companies that have begun turning to captive insurance as a means of covering unique risks that are a part of certain types of business.

According to the ruling, RAC's decision to create a wholly owned insurance subsidiary was born out of concern for its growing risk management costs during a rapid expansion in the 1990s and early 2000s. During that time, the number of RAC's company-owned stores increased from 27 to 2,623, the ruling said.

In 2002, [Aon Risk Consultants Inc.](#) advised RAC in the creation of its wholly owned insurance subsidiary. After researching the potential pros and cons, RAC decided to incorporate Legacy to provide coverage for its various business entities.

During the tax years at issue in the case, RAC also obtained unbundled workers' compensation, automobile and general liability policies from Discover Re, according to the ruling. The arrangement allowed RAC to seek coverage from Discover Re, Liability or both, depending on the amount of the covered loss.

--Editing by Emily Kokoll.