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Client Alert: New Risk Management Tool – Ohio Captive Insurance Law

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If you answer “yes” to any of the following questions, you should consider the benefits of Ohio’s new captive insurance company legislation.

1. Is your company currently self-insuring its own risks or considering self-insuring its own risks (such as, business interruption or cyber security insurance)?
2. Is your company having difficulty placing its insurance needs at an affordable price?
3. Is your company interested in potential federal and state tax savings?
4. Have your company’s risk managers evaluated the use of captive insurance companies, but decided that a captive domiciled offshore or in a foreign jurisdiction was not attractive to your company or that your company was too small to create a captive insurance company?

Substitute House Bill Number 117 (Ohio’s Captive Legislation) will become effective mid-September 2014. Ohio’s Captive Legislation creates a regulatory scheme that permits the formation in Ohio of pure captives (a captive that insures only the risks of its parent and affiliates), protected cell captives (a captive that is made up of separate segregated cells that each contain their own assets and liabilities) and a special purpose financial captive. This alert will focus only on pure captives, but we are available to answer any questions you may have regarding protected cell captives and special purpose financial captives.

Ohio’s Captive Legislation provides large and small (public and private) companies with the ability to create a captive insurance company subsidiary and to utilize that captive in its risk management program. A captive insurance company provides an alternative (or supplement) to traditional insurance or the establishment of a traditional self-insurance program. Some of the benefits of forming a captive include:

- Greater control of risks covered and the claims paid by the captive (i.e., no longer reliant on unrelated party to determine if insurance coverage exists)
- Ability to insure risks that otherwise were cost-prohibitive or uninsurable
- Potential savings on, and stability of, insurance costs
- Possible tax deductibility of the insurance premium paid to the captive
- Asset protection

The captive becomes your company's insurance company and provides your risk manager with greater control over the insurance coverage provided to your company and the claims that will be paid. While the creation and operation of a captive insurance company is not without expense and, as of the date of this alert, the Ohio Department of Insurance has not yet promulgated regulations governing captives, it appears that Ohio will not create an onerous regulatory scheme and will require minimal filings as well as a modest capital and surplus requirement.

To become licensed under Ohio's Captive Legislation, the captive will be required to maintain a minimum capital and surplus of \$250,000. The capital and surplus may be in the form of cash, approved marketable securities and certain letters of credit. The captive's board of directors are given broad discretion regarding the investment of the captive's assets, but must exercise the judgment and care that a person of reasonable prudence, discretion and intelligence might exercise in the management of a like enterprise. Investments are required to be of sufficient value, liquidity and diversity so as to assure the captive's ability to meet its outstanding obligations, based on reasonable estimations of new business production for its current lines of business. No captive may loan money to its parent or affiliates without the prior written approval of the superintendent of the Ohio Department of Insurance.

Ohio's Captive Legislation requires that a captive pay the superintendent a fee equal to 0.35% of its net direct premiums. The annual minimum aggregate fee to be paid by the captive is \$7,500, with an annual maximum aggregate fee of \$250,000.

Ohio's Captive Legislation permits captives to issue various types of insurance coverage to its parent and affiliates, including, but not limited to:

- Commercial multiple peril
- Medical malpractice
- Workers compensation (to the extent permitted by law, but only for the purpose of indemnification of a self-insuring employer pursuant to Ohio Revised Code Section 4123.82(B)(1))
- Commercial auto liability
- Commercial auto physical damage

The determination of whether your company could benefit from the formation of a captive insurance company is dependent on your specific facts and circumstances. This is especially true with respect to the tax treatment related to the captive, including whether the premiums paid to the captive can be deducted as an insurance expense for income tax purposes. Generally speaking, premiums would be deductible for a valid licensed captive insurance company if the arrangement satisfies the tax definition of "insurance."

That definition requires risk transfer and risk distribution to be present in the captive arrangement.

If you have any questions regarding Ohio's Captive Legislation, wish to discuss the possibility of forming your own captive insurance company or are approached by insurance professionals or risk managers about captives and would like an informed perspective, please contact Tom Szykowny (teszykowny@vorys.com or 614.464.4671), Anthony Spina (aspina@vorys.com or 614.464.4958) or Gregg Zelasko (gjzelasko@vorys.com or 614.464.6416).