Act 370 Improves Captive Insurance Law in Arkansas

Zachary Steadman
zsteadman@mwlaw.com
(501) 688.8892

Jeffrey Thomas
jthomas@mwlaw.com
(501) 688.8879

07/11/2017

On March 7, Governor Hutchinson signed Act 370 which revised certain provisions of Arkansas law related to formation and operation of captive insurance companies. Act 370 does a number of things to update the captive framework in Arkansas.

Here, we have highlighted how the changes to the law are beneficial for a business that is either thinking about setting up an Arkansas captive or thinking about redomesticating an existing captive to Arkansas:

1. Protected Cells – A sponsored captive insurance company is a structure created by a sponsor to house individual insurance arrangements called "cells." Each cell is created to insure its own risk. For instance, a parent corporation may set up a sponsored captive insurance company and form cells for subsidiary companies. Similarly, a financial institution may form a sponsored captive insurance company and offer small companies the benefits of a captive insurance company without the burden of starting their own company. Prior to Act 370, the only option to set up a cell was through a "protected cell" which was a separate account set up by the sponsored captive for one of the participants. Act 370 allows for "incorporated protected cells" which are protected cells established as corporations (or other legal entities) separate from the sponsored captive insurance company. In other words, the incorporated protected cell of a sponsored captive is created under Arkansas's business law as its own true corporation, as opposed to a cell that is created by contract. As a separate legal entity, an incorporated protected cell would enjoy the same corporate benefits as a standalone corporation.
2. Flexibility in Organizational Structure – Act 370 allows a captive insurance company to form and operate in any form of business organization authorized under Arkansas law with approval of the Insurance Commissioner. The Arkansas captive code was originally established in 2001. Since then, Arkansas has passed legislation that allows for limited liability companies. This organizational flexibility allows Arkansas captive law to parallel Arkansas business law as it changes, which provides greater flexibility for the captive owner.
3. Mergers/Conversion – Act 370 allows for a captive insurance company to be converted or merged with and into another captive insurance company. For instance, it would allow a captive insurance company set up as a traditional corporation to convert to a limited liability company. This provides additional flexibility to allow an organization to change its captive insurer as its business needs change.
4. Fronting Requirements – "Fronting" is the use of a licensed, admitted insurer to issue an insurance policy on behalf of a captive insurer. However, none of the risk is transferred from the captive to the fronting insurer. Prior to Act 370, use of a fronting carrier was mandatory for protected cells within a sponsored captive insurance company. Act 370 changes Arkansas captive law to provide an option that a fronting carrier may not be required if approved by the

Arkansas Insurance Department. As a result, there are possible cost savings involved with removal of a fronting company.

5. Dormant Captive Insurance Company –The dormant status establishes a solution for a captive insurance company that has ceased insurance operations but does not want to relinquish its license should it determine that it wants to resume operations in the future. Forming and licensing a captive insurance company is an arduous task and this allows a captive insurance company the option to pause operation without the burden of going back through the licensing process. Changing the captive insurance law to allow for dormant status makes it easier for a company that is not transacting business to retain its license without many of the burdens and fees associated with yearly renewals.

Captive insurance companies can offer a number of benefits to their owners. Most of the benefits are correlated with risk management or financial savings. Below are examples of some specific benefits:

- Creates a central focus on a company's risk management program;
- Allows the captive to tailor coverage to the needs of the parent;
- May provide coverage that is otherwise unavailable or prohibitively expensive;
- Provides access to reinsurance;
- Direct control over claims handling;
- Offers the ability to offer structure a risk management program around a self-funded insurance company;
- The captive may charge consistent premiums unrelated to commercial market swings;
- Potential tax advantage over self-insurance; and
- Ability to lower administrative costs.

In sum, passage of Act 370 strengthens the existing benefits of owning and operating a captive insurance company. This is a positive move forward to support and grow the captive insurance industry in the state of Arkansas. Act 370 helps Arkansas compete with other captive domiciles in an effort to create new captives or redomesticate captives to Arkansas that may have previously chosen a different state to form their captive insurance company.