

DRAFT FOR DISCUSSION ONLY
CAPTIVE INSURANCE ISSUES

With the exception of the financial test, all financial assurance mechanisms rely on a third party to ensure that funds will be available for liability claims or closure. The purpose of this structure is to ensure that, in the event of a financial failure of the facility, the third party will be able to provide the necessary funding. This purpose is only achieved if the financial stability of the third party is independent of the facility. Where this independence is lacking, the failure of both parties can occur simultaneously, leaving the required financial assurance unfunded. Captive insurance creates such a situation.

A "captive insurance company" is a corporation organized for the purpose of insuring the liabilities of its owner. At one extreme is the case presented here, where the insured is both the sole shareholder and only customer of the captive.

There may be other permutations involving less than 100% ownership or more than a single customer, although at some point the term "captive" is no longer appropriate.

Clougherty Packing Co. v. Commissioner, 811 F.2d 1297 (9th Cir.1987).

In the case of a "pure" or "single parent" captive insurer, the financial stability of the third party is completely dependent on the financial health of the parent. Commonly, the assets of such captive insurance companies consist only of the unsecured obligations of the parent facility. Thus, a failure of the parent facility will necessarily cause a failure of the captive insurer. The potential liabilities of such an insurer may easily reach several millions of dollars (not less than \$2,000,000 in liability and commonly in excess of \$3,000,000 for closure.) The State of Vermont, home to many captive insurance companies, requires a paid in capital and surplus of only \$250,000. (Vermont Insurance Code, section 6004.)

Captive insurance companies have the ultimate effect of providing the same form of financial assurance as does the financial test, that is first party assurance. Captive insurance however does not provide the same safeguards as does the financial test. There is no annual review of the financial health of the facility or the captive, no independent assessment by a third party accountant, and no minimum net worth or financial ratios required.

In its discussion of captive insurance, *Amerco, Inc. v. Commissioner of Internal Revenue*, 979 F.2d 162 (9th Cir. 1992) determined that, since the true risk remains with the insured party, captive insurance lacks the essential characteristics of true insurance, risk-shifting and risk-distribution:

... it is fair to say that " '[r]isk-shifting' means one party shifts his risk of loss to another, and 'risk-distributing' means that the party assuming the risk distributes his potential liability, in part, among others. An arrangement without the elements of risk-shifting and risk-distributing lacks the fundamentals inherent in a true contract of insurance."

Pure captive insurance does not shift or distribute the parent's risk and is therefore not insurance at all. In addition, captive insurance commonly fails to meet an important regulatory requirement, that the policy be assignable to a new owner. (Cal. Code Regs., title 22, § 66264.143(e)(7).) The purpose of this requirement is that, upon the transfer of a facility, there shall be no lapse in financial assurance.

Originally, captive policies were silent on, or actually prohibited, assignment. More recent policies facially comply with the requirement by providing that assignment may be made with the consent of the insurer, which shall not be unreasonably withheld. However, the Vermont Insurance Code states:

'Pure captive insurance company' means any company that insures risks of its parent and affiliated companies or controlled unaffiliated business. (Section 6001(14).)

... no pure captive insurance company may insure any risks other than those of its parent and affiliated companies or controlled unaffiliated business." (Section 6002(1).)

(a) The license of a captive insurance company may be suspended or revoked by the commissioner for any of the following reasons:

...

(7) failure otherwise to comply with the laws of this state. (Section 6009.)

Since assignment could not lawfully be made under the laws of the state incorporating and licensing the captive insurance company, refusal to consent to the assignment would not be "unreasonable." The assignment provision is therefore a sham and the policy fails to comply with the requirements of California law.

Financial assurance is most important when the facility is unable to provide for liability or closure from its own resources. It is exactly at this time that captive insurance fails.

There are at least seven states whose regulations directly address the use of captive insurance as RCRA financial assurance.

State	Closure	Post-Closure	Liability
Alabama	Prohibited unless qualification for the financial test is also demonstrated.		Permitted.
Arkansas	Prohibited	No express provision.	Prohibited
New Hampshire	Prohibited.		
Tennessee	A.M. best rating at least A or A- or have special approval from the Commissioner. An insurer that is a "captive insurance company", as that term is used in T.C.A. Sections 56-13-106 through 56-13-133 ¹ , may not be utilized unless the Commissioner determines that such captive insurance company offers coverage that is equivalent in protection to other insurance companies or other allowable financial assurance mechanisms.		may not be utilized unless the Commissioner determines that such captive insurance company offers coverage that is equivalent in protection to other insurance companies or other allowable financial assurance mechanisms.
Washington	(ii) Insurance companies providing . . . coverage must have a current rating of financial strength of: (A) AAA, AA+, AA, AA-, A+, A as rated by Standard and Poor's; (B) Aaa, Aa1, Aa2, Aa3, A1, A2 as rated by Moody's; or (C) A++, A+, A, A-, B++, B+ as rated by A.M. Best;		
Wisconsin	Except for captive insurance companies, the insurer shall be licensed to transact the business of insurance or eligible to provide insurance as an excess or surplus lines insurer in one or more states. The department, after conferring with the Wisconsin insurance commissioner, shall determine the acceptability of a surplus lines or captive insurance company to provide coverage for proof of financial responsibility. The department shall ask the insurance commissioner to provide a financial analysis of the insurer including a recommendation as to the insurer's ability to provide the required coverage. The department shall be the beneficiary of the insurance policy. The department may require a periodic review of the acceptability of a surplus lines or captive insurance company.		

Delaware prohibits captive insurance for solid waste but allows it for hazardous waste. Washington expressly prohibits captive insurance for solid waste.

¹ § 56-13-102. Definitions:
 (5) "Captive insurance company" means any pure captive insurance company, any mutual captive insurance company, any industrial insured captive insurance company and any association captive insurance company, as defined in this section;

(14) "Pure captive insurance company" means any domestic insurance company licensed under the provisions of this chapter for the purpose of making insurance and reinsurance as provided in §§ 56-13-103 and 56-13-104, which has a parent.