



**Department of Insurance**

**State of Arizona**

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REGULATORY BULLETIN 2005-7<sup>1</sup>

TO: Captive Insurers, Captive Insurance Trade Associations and Other Interested Parties

FROM: Christina Urias  
Director of Insurance

DATE: October 26, 2005

RE: **Arizona Captive Insurance Program**

The purpose of this Regulatory Bulletin is to describe key elements of A.R.S. § 20-1098, et seq., Arizona's captive insurance laws (including recent revisions enacted by HB 2600, effective August 12, 2005), to discuss the applicability of other insurance laws to captive insurers, and to describe the administrative components of the captive insurance program. This Arizona Department of Insurance (ADOI) Regulatory Bulletin supersedes Regulatory Bulletin 2002-06.

A.R.S. §20-1098, et seq. permits the formation of four (4) forms of captive insurers. An "agency captive insurer" must be owned by one or more business entities that are licensed in any state as insurance producers or managing general agents and may only insure risks on policies placed through their owners. A.R.S. § 20-1098(2). A "group captive insurer" (including risk retention groups formed pursuant to the federal Liability Risk Retention Act of 1986, industry groups and associations) may insure only the risks of the group members and their affiliates. A.R.S. § 20-1098(8). A "protected cell captive insurer" may insure the risks of separate participants through a contract and may segregate each participant's liability through one or more "protected cells." A.R.S. § 20-1098(14). Finally, a "pure captive insurer" may insure the risks of its affiliates or "controlled unaffiliated business." A.R.S. § 20-1098(15).

A captive insurer must maintain a principal place of business and hold at least one board of directors' (or, for reciprocal insurers, subscribers' advisory committee) meeting in Arizona each year. A.R.S. § 20-1098.01 (D). A captive insurer must also engage an Arizona resident

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<sup>1</sup> This Substantive Policy Statement is advisory only. A Substantive Policy Statement does not include internal procedural documents that only affect the internal procedures of the Agency, and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona Administrative Procedure Act. If you believe that this Substantive Policy Statement does impose additional requirements or penalties on regulated parties, you may petition the agency under Arizona Revised Statutes Section 41-1033 for a review of the Statement.

captive manager. A.R.S. §§ 20-1098(10), 20-1098.01(F)(5), and 20-1098.16. The statutes set forth additional requirements related to the formation, licensing and regulation of captive insurers. The Captive Insurance Overview, available on the ADOL's website or from ADOL's Captive Insurance Administrator, provides a more comprehensive description of the captive insurer requirements.

Certain elements of the law merit further amplification, as follows:

**Fees:** A.R.S. § 20-167(H) requires captive insurers to pay certain fees prescribed by the Director. Accordingly, ADOL promulgated A.A.C. R20-6-2002 requiring captive insurers to pay a \$1,000 nonrefundable fee for issuance of the license, and a nonrefundable annual renewal fee of \$5,500. These fees are payment in full and in lieu of all other taxes and fees (notably premium and income taxes) except for the tax on real and tangible personal property in Arizona, the state transaction privilege tax and use tax, and the transaction privilege and use tax imposed by a county, city or town. A.R.S. § 20-1098.17(B).

**Form of Minimum Capital and Surplus:** The minimum capital and surplus required by A.R.S. § 20-1098.03(B) may be in the form of cash or an irrevocable and unconditional letter of credit that satisfies the conditions set forth in the statute. The amount and character of capital and surplus is subject to the Director's discretionary authority. A.R.S. §20-1098.03(C). For group captive insurers (including risk retention groups), the group captive owners **must** contribute the minimum capital and surplus.

**Applicability of Title 20:** Pursuant to A.R.S. § 20-1098.15(A), Chapter 2, Article 6 of Title 20, relating to unfair practices and frauds, applies to captive insurers, except to the extent the Director determines the nature of captive insurance renders particular provisions of Chapter 2, Article 6 inappropriate. The Director has determined that it is inappropriate to apply the following provisions of Chapter 2, Article 6 to captive insurers:

- § 20-448(C) (unfair discrimination, other than life and disability)
- § 20-451 (rebates, other than life and disability)
- § 20-452 (prohibited inducements)
- § 20-460 (free choice of insurance producer)
- § 20-465 (fees charged by producers and insurers)
- § 20-466(G) and (J) (fraud referrals, assessments)
- § 20-466.03 (fraud statement on claim form)

Pursuant to A.R.S. § 20-1098.15(B), all other provisions of Title 20 that are not inconsistent with the captive insurer article are applicable to captive insurers, except to the extent the Director determines the nature of captive insurance renders particular provisions of Title 20 inappropriate. The Director has determined that it is inappropriate to apply the following provisions of Title 20 to captive insurers:

- **Chapter 1**
  - A.R.S. § 20-156(G) (financial surveillance assessment)
- **Chapter 2**
  - A.R.S. § 20-213 (deposit requirements)
  - A.R.S. § 20-229 (countersignature requirement)
  - A.R.S. § 20-260 (limit of risk)<sup>2</sup>
  - Article 4 (rates and rating organizations, A.R.S. §§ 20-341 through 20-379)
  - Article 4.1 (open competition rates and rating organizations, A.R.S. §§ 20-381 through 20-399)
  - Article 4.2 (compliance with filed rates, A.R.S. §§ 20-400 through 20-400.10)
  - A.R.S. §§ 20-407 through 20-420 and 20-422 (surplus lines insurance)
  - Article 8 (insurance holding company systems, A.R.S. §§ 20-481 through 20-481.30)

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<sup>2</sup> This section uses the mandatory language “no insurer shall . . .”. The Director will exercise discretion on whether to apply risk retention limits to captive insurers. Unless the Director considers A.R.S. §20-260 inappropriate to apply to captive insurers within the meaning of A.R.S. §20-1098.15(B), the Director would not have that discretion. ADOI will continue to evaluate the limit of risk when reviewing captive insurer applications and applicants should ensure that the actuarial feasibility study addresses this issue.

- **Chapter 5**
  - A.R.S. §§ 20-1110 through 20-1117 (policy forms)
  - A.R.S. §§ 20-1129 through 20-1122 (binders; renewal of policy by certificate or endorsement; assignment of policies)
- **Chapter 6**
  - Article 7 (property insurance, A.R.S. §§ 20-1501 through 20-1509)
  - Articles 11 and 12 (cancellation or non-renewal of personal automobile and personal homeowners' insurance, A.R.S §§ 20-1631 through 1634 and §§ 20-1651 through 1663)
  - Article 14 (cancellation or non-renewal of commercial insurance, §§ 20-1671 through 20-1679)
- **Chapter 7**
  - Article 2 (health care insurers, §§ 1721 through 20-1724)
- **Chapter 12** (joint underwriting associations, A.R.S §§ 20-2201 through 20-2221)

Pursuant to A.R.S. §20-1098.15(B), all other provisions of Title 20 that are not inconsistent with express provisions of the captive insurer article are applicable to captive insurers. ADOI may, in the future, make further determinations as to the applicability of other insurance laws to captive insurers.

**Legal Investments:** Group captive insurers, agency captive insurers and protected cell captive insurers must comply with the investment requirements for traditional insurers (specified in A.R.S. §§ 20-531 through 20-562). A.R.S. § 20-1098.10(A). Pure captive insurers are not subject to restrictions on allowable investments, except that the Director may prohibit or limit any investment that threatens solvency or liquidity. A.R.S. § 20-1098.10(B).

**Annual Report and Audited Financial Statements:** ADOI has developed a recommended form of annual report for captive insurers to satisfy the requirements of A.R.S. § 20-1098.07. The form and instructions are available through the Captive Insurance Administrator, as described below. Captive insurers must submit audited financial statements required by A.R.S. § 20-1098.07(B) no later than sixty (60) days after submission of the annual report **and must also submit** an Accountant's Letter of Qualifications as specified in the N.A.I.C. Annual Statement Instructions.

**“Captive” No Longer Required in Captive Insurer’s Name:** The passage of HB 2600 eliminated the previous requirement that each captive insurer include the term “Captive” in its name. Previously licensed captive insurers may submit a form to remove the term from the insurer’s name, if they so choose. The form and instructions are available from the Captive Insurance Administrator.

**Updated Biographical Affidavits:** ADOI now requires a captive insurer’s officers and directors to submit updated Biographical Affidavits every three (3) years commencing on the third anniversary of the license issuance date. A.R.S. § 20-1098.01(D)(1).

**“Protected Cell Captive Insurers”:** A “protected cell captive insurer” is one of the four (4) existing forms of Arizona captive insurer. A.R.S. §§ 20-1098(14); 20-1098.05. Other forms of captive insurer (e.g., group captive insurers including risk retention groups) may not establish “protected cells” to insure risks.

**Commercial Automobile Liability Coverage:** A.R.S. §20-1098.01(A)(5)(g) prohibits captive insurers from direct writing commercial motor vehicle insurance (except as a qualified self insurer); however, this prohibition does not apply to risk retention groups due to the broad definition of “liability insurance” in the federal Liability Risk Retention Act of 1986, 15 U.S.C. §3901(a)(1) and (2).

**Use of “Fronting Companies”:** ADOI has determined that the federal Liability Risk Retention Act of 1986, 15 U.S.C. §3901(a)(4)(G)(i) permits fronting arrangements and risk retention groups may engage “fronting companies” to directly write insurance business and then, in turn, provide reinsurance to the fronting company.

Please visit ADOI’s web site ([www.state.az.us/id](http://www.state.az.us/id)) for additional information on captive insurers. You should direct requests for additional information or questions on forming a captive insurer in Arizona to the ADOI Captive Insurance Administrator, at (602)-912-8420 or [rmorris@id.state.az.us](mailto:rmorris@id.state.az.us).