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Do you think 831(b) captives make business sense for lawful placement of risks from Washington State?

Steven Beeghly **Partner at Kreger Beeghly, PLLC, & Insurance Company Investor & Founder**

First, don't shoot the messenger. I want to start a dialogue and not comment on reasonableness of Washington State statutes. Here goes. Do you think proposing/using an 831(b) captive for risks where the insurable interest in whole/part is from Washington State makes sense based upon requirement for lawful placement of insurance restricted to admitted or surplus line insurers (with narrow exception)? WA has no self-procurement law, and all captives covering insurable interests whole/part need fronting to not break the law. For 831(b) captives in particular, would need for fronting to be compliant make economic sense based on availability and affordability of fronting for WA risks?

What about prudent planning - would you ignore the fronting requirement and "just risk it" for an 831(b) (or any captive not using fronting), subjecting captive owners, insureds, promoters, service providers and producers to possible ramifications? Welcoming comments in my desire to start a dialogue about lawfully using an 831(b) captive for risks with insurable interests in the Evergreen State. Thanks, Steve.

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John

John Weitzel

Owner at Palmetto Consulting

Sure, I think it makes sense for a captive domiciled outside Washington State to write business that includes risks in states that include Washington State. An 831(b) is simply an IRS election that is made, but like any other single parent or group captive, the captive is regulated by its state of domicile. Given the volume of premium within a small insurance company, it would rarely make any economic or other sense to introduce the cost of a front into the equation.

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Steven

Steven Beeghly

Partner at Kreger Beeghly, PLLC, & Insurance Company Investor & Founder

Thanks for the comment. Problem is in Washington State, the law of the captive domicile is not relevant to the issue of legal insurance placement for insurable interests (risks) from WA. We have seen that argument fail many times. In your example, of risks that include insurable interests in Washington State, you must use fronting to not break the law, and appreciate your note that it would rarely make economic sense.

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Patrick

Patrick Theriault

Managing Director at Strategic Risk Solutions

I am not familiar with WA laws and regulations, but I expect that organizations in WA could have commercial coverage with a SIR or purchase a large deductible policy right? If yes, what would then prevent the entity from setting up a captive to issue a deductible reimbursement policy for the self insured risk?

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Steven

Steven Beeghly

Partner at Kreger Beeghly, PLLC, & Insurance Company Investor & Founder

Sorry, no. That is the point of the discussion - any risk (regardless of characterization such as deductible funding/1st party versus 3rd party, etc.) with insurable interest in Washington State requires fronting to not be illegal. Absent placement with either admitted or surplus line eligibile insurer, I'm afraid it will likely be characterized as an unlawful placement, with potential criminal and civil penalties for all involved. Hope that helps. This is for any insurance, but the question I have is if people think an 831(b) would be economically feasible for Washington State risks in light of the fronting need to not break the law. Thanks for the comment, Steve.

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Patrick

Patrick Theriault

Managing Director at Strategic Risk Solutions

I guess I find it interesting how the law could put requirements around how someone can finance its retention, but then again laws sometimes dont make sense and that could be one fo them. Anyway, I have a client that has a fronted captive and made the 831(b) election. So, nothing prevents it and it can still definitely make sense. Fronting costs can reduce the benefits of forming a captive, but that analysis is no different than with captives that do not elect to be taxed under section 831(b). You would need to do the financial analysis and determine on a case by case basis whether the benefits after the additional frontings costs still make the project viable. You would also of course have the question as to whether you can find someone willing to front the risk in the first place.

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Chris

Chris Conder

VP at FD&S Insurance Agency, Inc.

I am not sure that I have any clients that would not want a fronting arrangement due to many business relationships (lenders, vendors, etc.) that would not be comfortable unless their insurance was placed with an A-VII or stronger company. I have never placed captive business without a front, and usually the front is providing reinsurance. The cost of a front is well worth the ease of doing business and it does provide some security.

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Patrick

Patrick Theriault

Managing Director at Strategic Risk Solutions

Agree with your comment Chris. The one difference is that many small captives are structured to insure deductibles, SIR, exclusions, etc.... so there is already commercial coevrage in place to meet the needs of the stakeholders you described.

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Jay

Jay Adkisson

Partner at Riser Adkisson LLP

@Steven - Isn't direct procurement a felony in Washington State? It is always interesting to see disclaimers from certain insurance companies that specifically exclude Washington State, and only Washington State, from many coverages because of the strict laws there. Merely domiciling the captive outside of Washington State isn't enough -- the problem is the Washington State business that buys the insurance is subject to penalties (if I've understood Steven's previous posts correctly).

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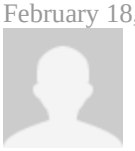

Steven

Steven Beeghly

Partner at Kreger Beeghly, PLLC, & Insurance Company Investor & Founder

Yes, it is a class B felony to unlawfully place insurance with an unlicensed insurer that is not surplus line eligible in Washington State. These are in addition to civil and personal liabiliy remedies under the statute. I believe there are about a dozen other states that have no self-procurement statutory framework. But I do not know what the sanctionable remedies are in the other states off top of my head. Does anyone else?

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Randy

Randy Beckie

Managing Director of Frontrunner Captive Management LLC

Three Felonies a Day, the book by Harvey Silverglate (2009), offers a perspective on the difference between the existence of laws and the selectivity of enforcement. Widely acclaimed; interesting read.

In a state that has a self-procurement tax (consider California), strictly speaking isn't the lawfulness of selling captive insurance coverage within that state dependent on paying the self-procurement tax?

Steve's question isn't confined to relevance in the state of Washington and a dozen others; for insureds that are too small to qualify for an industrial insured exception, the question could be asked nearly everywhere and nearly all the time, with the notable exception of doing captive insurance business where the insured is located within the captive's domicile. A question of a second order would be: How much does it matter if a legal question that could be asked goes routinely unasked by anyone? I suppose this is the sort of question that if posed to 10 lawyers would generate 20 different opinions.

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John Weitzel likes this

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Jay

Jay Adkisson

Partner at Riser Adkisson LLP

Actually, Washington law is much more restrictive than that of any other state, and their regulators are notoriously aggressive in going after even innocent offenders. BTW, tax law does not control civil or penal law, of course, so whether or not the independently-procured tax may be assessed under Todd Shipyards and its progeny will not prevent other unpleasantries. Even large corporate captives routinely struggle with Washington law, as Steven has noted on other occasions.

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Steven

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Partner at Kreger Beeghly, PLLC, & Insurance Company Investor & Founder

Thanks Randy - I like how you articulated your posting. Ascertaining how to legally sell/place insurance where the insurable interest lies I would think to be a foundational question prior to submitting an application for a captive and well before issuing a policy by all involved. I'm no plaintiff's lawyer, but it doesn't stretch my imagination to estimate if a regulatory action commences, in addition to all the potential criminal and civil ramifications for all involved, that once the initial dust settles, suit(s) by captive owners could commence against all service providers under the theory of 'knew, or should have known' about legality or lack thereof in the jurisdiction where the insurance covers the insurable interest. Especially so against the promoter(s) targeting prospective captive owners. With more than 20% of the US states having no self-procurement laws, it seems to me that this sub-issue of my posting could be an entirely new topic of discussion. Thanks for the posting - you are right, you get differing opinions from different lawyers, but I would at least expect consensus to try and find out from a local lawyer what is lawful and what could be a substantial area of exposure.

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