

AN ACT

ENTITLED, An Act to revise certain provisions related to the regulation of captive insurance companies.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF SOUTH DAKOTA:

Section 1. That § 58-46-1 be amended to read as follows:

58-46-1. Terms used in this chapter mean:

- (1) "Affiliated entity," any entity, in the same corporate system as the captive insurance company, owned or controlled, directly or indirectly, by a parent or subsidiary, or a member organization by virtue of control, operation, or management. In the case of a trust captive insurance company, an affiliated entity of the trust which holds ownership interest in the trust captive insurance company also includes any other trust created by the settlor, the settlor's grandparents or their descendants, the settlor's spouse, or any trust created by any one of the aforementioned persons;
- (2) "Association," any legal association of entities, the members of the organization of which:
 - (a) Own, control, or hold with power to vote all of the outstanding voting securities of a group captive insurance company incorporated as a stock insurer or nonprofit corporation; or
 - (b) Have complete voting control over group captive insurance company formed as a limited liability company;
- (3) "Captive insurance company," any insurance company licensed under chapter 58-46;
- (4) "Controlled unaffiliated business," any person or entity that is not in the corporate system of a parent and its affiliated entities and has an existing contractual relationship for its control, operation, or management with the parent or one of its affiliated entities;
- (5) "Director," the director of the Division of Insurance;

- (5A) "Entity," a corporation, business trust, cooperative corporation, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency, or instrumentality, or any other legal or commercial entity;
- (5B) "Governing board," in the case of a corporation, its board of directors; in the case of a member managed limited liability company, its board of members; in the case of a manager managed limited liability company, its board of managers; in the case of a partnership, its general partner; in the case of a business trust or trust, its trustee; and in the case of any other entity not defined, the person in charge of managing its business affairs;
- (6) "Group," any association of entities with substantially similar or related risks, the members of which collectively own, control, or hold with power to vote all of the outstanding voting securities or other ownership interest of a group captive insurance company;
- (7) "Group captive insurance company," any entity licensed under this chapter that insures the risks of the member organizations of the group, the risks of the affiliated entities of the member organizations, or the risks of the association;
- (8) "Member organization," any entity that belongs to an association;
- (9) "Parent," an entity that directly or indirectly owns, controls, or holds with power to vote fifty percent or more of the outstanding voting securities of a pure captive insurance company;
- (10) "Pure captive insurance company," any entity licensed under this chapter that insures risks of its parent and affiliated entities or a controlled unaffiliated business;
- (11) "Participant contract," with respect to a sponsored captive insurance company, a contract by which a sponsored captive insurance company insures the risks of one or more

participants, and limits the losses of each participant to its pro rata share of the assets of one or more protected cells identified in the participant contract;

(12) "Special purpose captive insurance company," a captive insurance company that is licensed under this chapter that does not meet the definition of any other type of captive insurance company defined in this section and it may insure the risks of its parent, unless otherwise approved by the director;

(13A) "Participant," any person or entity that is insured by a sponsored captive insurance company, where the losses of the participant are limited through a participant contract to the participant's pro rata share of the assets of one or more protected cells identified in the participant contract;

(13B) "Protected cell," a separate and distinct account established and maintained by or on behalf of a sponsored captive insurance company in which assets, including assets invested pursuant to section 26 of this Act, are accounted for and recorded for one or more participants in accordance with the terms of one or more participant contracts to fund the liability of the sponsored captive insurance company assumed on behalf of the participants as set forth in the participant contracts;

(14) "Sponsor," a person or entity qualifying as a sponsor under section 24 of this Act;

(15) "Sponsored captive insurance company," a captive insurance company that is licensed under this chapter:

(a) Of which the minimum capital and surplus required by this chapter is provided by one or more sponsors;

(b) That insures the risks of its participants only, through separate participant contracts; and

(c) That funds its liability to each participant through one or more protected cells and

segregates the assets of each protected cell from the assets of other protected cells

and from the assets of the sponsored captive insurance company's general account;

(16) "Trust captive insurance company," a captive insurance company whose ownership interest is held in a trust or trusts;

(17) "Trust," any trust with a South Dakota jurisdiction provision as set forth in §§ 55-3-40 to 55-3-42, inclusive, and which complies with § 55-3-39.

Section 2. That § 58-46-3 be amended to read as follows:

58-46-3. No captive insurance company may do any insurance business in this state unless:

(1) It first obtains from the director a certificate of authority authorizing it to do insurance business in this state;

(2) Its governing board holds at least one meeting each year in this state in which a quorum is physically present;

(3) It maintains its principal place of business in this state and keeps at this place complete records of its assets, transactions, and affairs, in accordance with the methods and systems which are customary or suitable as to the kinds of insurance transacted. In lieu thereof or if required by the director, in the director's discretion, the captive insurance company shall appoint a captive manager approved by the director. The captive manager shall maintain the complete records required in this section. The captive manager shall make available all information to the director upon request; and

(4) It, and if applicable its captive manager, appoints a resident agent to accept service of process and to otherwise act on its behalf in this state. If the registered agent cannot, with reasonable diligence, be found at the registered office of the captive insurance company or captive manager, the director shall be an agent of the captive insurance company upon whom any process, notice, or demand may be served.

Section 3. That chapter 58-46 be amended by adding thereto a NEW SECTION to read as follows:

A group, sponsored, or special purpose captive insurance company shall limit its exposure to loss on any one risk or hazard to an amount deemed acceptable by the director. The amount shall be determined based on whether the risk or hazard is reinsured through an insurance company that is licensed or accredited in this state, or other safeguards to the group, sponsored, or special purpose captive insurance company's financial solvency and stability are adequate.

Section 4. That § 58-46-5 be amended to read as follows:

58-46-5. In addition to the information required by § 58-46-4, each applicant captive insurance company shall file with the director evidence of the following:

- (1) The amount and liquidity of its assets relative to the risks to be assumed;
- (2) The adequacy of the expertise, experience, and character of the management;
- (3) The overall soundness of its plan of operation;
- (4) The adequacy of the loss prevention programs of its parent and affiliated entities; and
- (5) Such other factors deemed relevant by the director in ascertaining whether the proposed captive insurance company will be able to meet its policy obligations.

Section 5. That § 58-46-6 be amended to read as follows:

58-46-6. Each captive insurance company shall pay to the director a nonrefundable fee of two thousand dollars for examining, investigating, and processing its application for certificate of authority. Two or more captive insurance companies under common ownership or control shall pay this fee for each application submitted to the director for a certificate of authority. A sponsored captive insurance company shall pay an additional one thousand dollars for every additional cell. The director may retain legal, financial, and examination services from outside the department. The reasonable cost of the services may be charged against the applicant with notice to the applicant. The

provisions of chapter 58-3 apply to examinations, investigations, and processing conducted under the authority of this chapter.

Section 6. That § 58-46-7 be amended to read as follows:

58-46-7. If the director is satisfied that the documents and statements that the captive insurance company has filed comply with the provisions of this chapter, the director shall issue a certificate of authority authorizing it to do insurance business in this state.

Section 7. That § 58-46-8 be amended to read as follows:

58-46-8. No captive insurance company, other than a trust captive insurance company, may be issued a certificate of authority unless it possesses and maintains unimpaired paid-in capital and surplus of two hundred fifty thousand dollars. A sponsored captive may include the capital and surplus of its protected cells in calculating its capital and surplus. No trust captive insurance company may be issued a certificate of authority unless it possesses and maintains unimpaired paid-in capital and surplus of one hundred thousand dollars or a greater amount of which shall be determined at the discretion of the director.

The initial capital and surplus may be in the form of cash or an irrevocable letter of credit issued by a bank chartered by the State of South Dakota or a member bank of the Federal Reserve System and approved by the director. The director may prescribe additional capital and surplus for any captive insurance company based upon the type, volume, and nature of insurance business transacted.

Section 8. That § 58-46-9 be amended to read as follows:

58-46-9. No captive insurance company may pay a dividend out of, or other distribution with respect to, capital or surplus, in excess of the limitations set forth in § 58-5A-35, without the prior approval of the director.

Section 9. That § 58-46-10 be amended to read as follows:

58-46-10. A pure captive insurance company may be incorporated as a stock corporation, a

nonstock corporation, a nonprofit corporation, or may be formed as a limited liability company, business trust under chapter 47-14A, or other form of legal entity as approved by the director.

A group captive insurance company may be incorporated as a stock corporation or as a nonstock corporation, may be formed as a limited liability company, a business trust, or may be organized as a reciprocal insurer, or other form of legal entity as approved by the director.

A special purpose captive insurance company may be incorporated as a stock corporation or as a nonstock corporation, may be formed as a limited liability company, business trust or trust, or may be such other form of legal entity as approved by the director.

A trust captive insurance company may be incorporated as a stock corporation or as a nonstock corporation, or may be formed as a limited liability company, or business trust, or other form of legal entity as approved by the director.

A sponsored captive insurance company may be incorporated as a stock corporation or as a nonstock corporation, or may be formed as a limited liability company, or business trust, or other form of legal entity as approved by the director.

Section 10. That § 58-46-11 be amended to read as follows:

58-46-11. A captive insurance company shall have at least three organizers of whom at least one shall be a resident of this state.

Section 11. That § 58-46-12 be amended to read as follows:

58-46-12. At least one of the members of the governing board of a captive insurance company incorporated in this state shall be a resident of this state.

Section 12. That § 58-46-13 be amended to read as follows:

58-46-13. Any captive insurance company formed under the provisions of this chapter shall have the privileges and be subject to the provisions of the general corporation or trust law, as other relevant state law proscribes, as well as the applicable provisions contained in this chapter. In the

event of conflict between the provisions of this chapter and those of the general corporation law and trust law, the provisions of this chapter shall control.

Section 13. That § 58-46-15 be amended to read as follows:

58-46-15. Each group or sponsored captive insurance company shall submit annually to the director a report of its financial condition pursuant to § 58-6-75, no later than six months after the close of its financial year. The report shall be audited by an independent certified public accountant pursuant to chapter 58-43. Each group or sponsored captive insurance company shall file with its annual report of financial condition an actuarial opinion pursuant to § 58-26-13.1. If requested by the director, the group or sponsored captive insurance company shall submit quarterly reports of its financial condition pursuant to § 58-6-75.

A pure or trust captive insurance company shall submit annually no later than six months after the close of its financial year to the director a report of its financial condition using statutory accounting principles certified under oath by two of its officers. A pure or trust captive insurance company shall provide a report of its financial condition audited by an independent certified public accountant every five years pursuant to chapter 58-43 if it has annual direct premiums written of less than two million five hundred thousand dollars. If a pure or trust captive insurance company has two million five hundred thousand dollars or more of annual direct premiums written, it shall provide a report of its financial condition audited by an independent certified public accountant every three years pursuant to chapter 58-43. Following its first year of operation, and in connection with its audited statement of financial condition (or more often if requested by the director), each pure or trust captive insurance company shall file an actuarial opinion pursuant to § 58-26-13.1.

No later than six months after the close of its financial year, a special purpose captive insurance company shall submit to the director a report of its financial condition pursuant to § 58-6-75. The report shall be audited by an independent certified public accountant pursuant to chapter 58-43.

Following its first year of operation, and every three years thereafter, a special purpose captive insurance company shall file with its annual report of financial condition an actuarial opinion pursuant to § 58-26-13.1. If requested by the director, the special purpose captive insurance company shall submit quarterly reports of its financial condition pursuant to § 58-6-75.

Upon request to and approval by the director, a captive insurance company may use generally accepted accounting principles in lieu of statutory accounting principles in its certification of its financial condition.

Section 14. That § 58-46-16 be amended to read as follows:

58-46-16. A pure or trust captive insurance company may make written application for filing the report required by § 58-46-15 on a fiscal year-end that is consistent with the parent company's fiscal year. If an alternative reporting date is granted, the annual report is due six months after its fiscal year-end.

Section 15. That § 58-46-18 be amended to read as follows:

58-46-18. The certificate of authority of a captive insurance company to do insurance business in this state may be suspended or revoked by the director for any of the following reasons:

- (1) Insolvency or impairment of capital or surplus;
- (2) Failure to meet the requirements of § 58-46-8;
- (3) Refusal or failure to submit an annual report, as required by § 58-46-15, or any other report or statement required by law or by lawful order of the director;
- (4) Failure to comply with the provisions of its own organizational documents or bylaws;
- (5) Failure to submit to examination or any legal obligation relative thereto, as required by § 58-46-17;
- (6) Use of methods that, although not otherwise specifically prohibited by law, nevertheless render its operation detrimental or its condition unsound with respect to the public or to

its policyholders;

- (7) Failure otherwise to comply with the laws of this state.

If the director finds, upon examination, hearing, or other evidence, that any captive insurance company has violated any of these provisions, its certificate of authority may be suspended or revoked if it is deemed to be in the best interest of the public and the policyholders of such captive insurance company, notwithstanding any other provisions of this chapter.

Section 16. That § 58-46-19 be amended to read as follows:

58-46-19. No pure or trust captive insurance company is subject to any restrictions on allowable investments. However, the director may prohibit or limit any investment that threatens the solvency or liquidity of any such company.

Unless the director has provided written approval of a different requirement or limitation, group, sponsored and special purpose captive insurance companies shall comply with the investment requirements and limitations applicable to other insurance companies pursuant to chapter 58-27.

Section 17. That § 58-46-20 be amended to read as follows:

58-46-20. A pure or trust captive insurance company may make a loan to its parent or affiliated entities. No loan to its parent or affiliated entities may be made without prior written approval of the director. A group, sponsored, or special purpose captive insurance company may make a loan to its group or members of its group if prior written approval by the director has been provided. The approval shall be evidenced by a note in a form approved by the director.

Section 18. That § 58-46-21 be amended to read as follows:

58-46-21. Any captive insurance company may take credit for reserves on risks or portions of risks ceded to reinsurers complying with provisions of chapter 58-14 or 58-46. Prior approval of the director shall be required for ceding or taking credit for reserves on risks or portions of risks ceded to reinsurers not complying with chapter 58-14 or 58-46.

Section 19. That § 58-46-23 be amended to read as follows:

58-46-23. No captive insurance company may join or contribute financially to any plan, pool, association, or guaranty or insolvency fund in this state. No captive insurance company or its parent or affiliated entities may receive any benefit from any such plan, pool, association, or guaranty or insolvency fund for claims arising out of the operations of the captive insurance company.

Section 20. That § 58-46-23.1 be amended to read as follows:

58-46-23.1. A pure captive insurance company may enter into any arrangement to provide risk management services to a controlled unaffiliated business or an unaffiliated business but may not accept any insurance risk from an unaffiliated business. A trust captive insurance company may enter into any arrangement to provide risk management services to an affiliated entity and may accept insurance risk from an affiliated entity.

Section 21. That chapter 58-46 be amended by adding thereto a NEW SECTION to read as follows:

A captive insurance company may not insure:

- (1) Any life or health risk; or
- (2) Any personal lines property casualty risk.

Section 22. That § 58-46-24 be amended to read as follows:

58-46-24. Each captive insurance company shall pay to the Division of Insurance an annual supervision fee of the greater of five thousand dollars or eight one-hundredths of one percent on gross premiums, less return premiums, for insurance written on all risks or property resident, situated, or located within this state, and on risks and property situated elsewhere upon which no premium tax or fee is otherwise paid during the year ending on the preceding December thirty-first. A sponsored captive company shall pay for each protected cell an additional annual supervision fee of the greater of five hundred dollars or eight hundredths of one percent on gross premiums, less

return premiums, for insurance written on all risks or property resident, situated, or located within this state, and on risks and property situated elsewhere upon which no premium tax or fee is otherwise paid during the year ending on the preceding December thirty-first. The annual supervision fee shall be due and payable on or before March first of each year. If the aggregate annual supervision fees to be paid by a captive insurance company calculated under this section amount to less than five thousand dollars in any year, such captive insurance company shall pay an annual supervision fee of five thousand dollars for the year. The aggregate annual supervision fees calculated under this section may not equal more than fifty thousand dollars.

Section 23. That chapter 58-46 be amended by adding thereto a NEW SECTION to read as follows:

A sponsored captive insurance company may establish and maintain one or more protected cells to insure risks of one or more participants, subject to the following conditions:

- (1) The owner of a sponsored captive insurance company is limited to its participants and sponsors;
- (2) The assets of each protected cell shall be held in a separate account or fund and accounted for separately on the books and records of the sponsored captive insurance company to reflect the financial condition and results of operations of such protected cell, net income or loss of such protected cell, dividends or other distributions to participants of such protected cell, and such other factors regarding such protected cell as may be provided in the applicable participant contract or required by the director;
- (3) The assets of a protected cell are not chargeable or accessible for the liabilities of any other protected cell, unless that cell is specifically reinsuring the risk or a portion of the risk in another cell or, unless otherwise agreed in the applicable participant contract, of the sponsored captive insurance company generally;

- (4) No sale, exchange, transfer of assets, dividend or other distribution, may be made with respect to a protected cell by such sponsored captive insurance company without the consent of the participants of each affected protected cell;
- (5) No sale, exchange, or transfer of assets, or other distribution (other than a payment or dividend to a participant or sponsor in accordance with the applicable participant contract, resulting in no less than one hundred five percent of capital to expected losses in any particular plan year), may be made with respect to a protected cell to a sponsor or a participant without the director's approval;
- (6) Each sponsored captive insurance company shall annually file with the director such financial reports as the director may require, which shall include accounting statements detailing the financial experience of each protected cell;
- (7) Each sponsored captive insurance company shall notify the director in writing promptly and in any event within ten business days of any protected cell that is insolvent or otherwise unable to meet its claim or expense obligations. The director may suspend or revoke the certificate of authority of the sponsored captive insurance company for failure to comply with this subdivision, and may suspend or revoke the sponsored captive insurance company's ability to maintain the protected cell if the cell is insolvent or otherwise unable to meet its claim or expense obligations;
- (8) No participant contract may take effect without the director's prior written approval, and the addition of each new protected cell and withdrawal of any participant or termination of any existing protected cell shall constitute a change in the plan of operation of the sponsored captive insurance company requiring the director's prior written approval; and
- (9) The business written by a sponsored captive insurance company, with respect to each protected cell, shall be:

- (a) Fronted by an insurance company licensed under the laws of this state or any other state;
- (b) Reinsured by a reinsurer authorized or approved by this state or any other state;
- (c) Secured by a trust fund in this state for the benefit of policyholders and claimants or funded by an irrevocable letter of credit or other arrangement that is acceptable to the director. The amount of security provided may be no less than the reserves associated with those liabilities which are neither fronted nor reinsured, including reserves for losses, allocated loss adjustment expenses, incurred but not reported losses and unearned premiums for business written through such protected cell. The director may require the sponsored captive insurance company to increase the funding of any security arrangement established under this subdivision. If the form of security is a letter of credit, the letter of credit shall be established, issued, or confirmed by a financial institution chartered by or licensed or otherwise authorized to do banking business in this state, or by any other financial institution approved by the director. A trust fund maintained pursuant to this subdivision shall be established in a form and upon such terms approved by the director; or
- (d) Any combination of these.

Section 24. That chapter 58-46 be amended by adding thereto a NEW SECTION to read as follows:

A sponsor of a sponsored captive insurance company shall be any entity approved by the director. A risk retention group may not be a sponsor of a sponsored captive insurance company, and a risk retention group may be a participant of a sponsored captive insurance company only to the extent that it is the sole participant of one or more protected cells.

Section 25. That chapter 58-46 be amended by adding thereto a NEW SECTION to read as

follows:

Any entity may be a participant in any sponsored captive insurance company. A sponsor may be a participant in a sponsored captive insurance company. A participant need not be an owner of the sponsored captive insurance company or any affiliate thereof.

Except as otherwise approved by the director, a participant may insure through a sponsored captive insurance company only its own risks and the risks of its affiliates who are participants.

Section 26. That chapter 58-46 be amended by adding thereto a NEW SECTION to read as follows:

Notwithstanding the provisions of section 23 of this Act, a sponsored captive insurance company may combine the assets of two or more protected cells for purposes of investing those assets. Such a combination of assets may not be construed as defeating the segregation of assets for purposes of section 23 of this Act, or for accounting or other purposes. A sponsored captive insurance company shall comply with investment requirements as may be approved by the director upon application by a sponsored captive insurance company.

Section 27. That chapter 58-46 be amended by adding thereto a NEW SECTION to read as follows:

The director shall prescribe the form for making an application and any application submitted shall contain such information as required. The applicant may, with approval of the director, designate confidential information.

All information the director generates in making an investigation or examination of a captive insurance company is confidential. All confidential information is the property of the division but shall be furnished to the captive insurance company for its confidential use. Under no circumstances may a captive insurance company disclose a report or any supporting documentation to anyone, other than directors and officers of the captive insurance company or anyone acting in a fiduciary capacity

for the captive insurance company, without written permission from the director.

The director shall give ten days' prior written notice of intent to disclose confidential information to the affected captive insurance company. Any captive insurance company which receives a notice may object to the disclosure of the confidential information and shall be afforded the right to a hearing in accordance with the provisions of chapter 1-26. If a captive insurance company requests a hearing, the director may not reveal confidential information prior to the conclusion of the hearing and a ruling. Disclosure of confidential information shall be made only to formal regulatory bodies which clearly have a need for the confidential information. Prior to dissemination of any confidential information, the director shall require a written agreement not to reveal the confidential information by the party receiving the confidential information. In no event may the director disclose confidential information to the general public, any competitor, or any potential competitor of a captive insurance company, or its parents or affiliates.

The submission of any information to the division in the course of any application, investigation, or examination shall not be construed as waiving, destroying, or otherwise affecting any privilege any person may claim with respect to the information under South Dakota law or federal law.

For the purposes of this chapter, confidential information includes the names of stockholders, membership interest holders, or owners, ownership information, capital contributions, addresses, business affiliations, state and director findings through any examination or inquiry of any kind, and any information required to be reported or filed with the director.

The provisions of this section do not apply to the disclosure of information by the director in connection with the institution and prosecution of an action against a captive insurance company under this chapter. Disclosure of confidential information may be made only to formal governmental regulatory bodies which have a need for the confidential information.

Section 28. That chapter 58-46 be amended by adding thereto a NEW SECTION to read as

follows:

The director may promulgate rules pursuant to chapter 1-26 to further the provisions of this chapter. The rules may include:

- (1) Definition of terms;
- (2) Requirements for doing business;
- (3) Application requirements and procedures;
- (4) Conditions for receiving a certificate of authority;
- (5) Criteria for suspending or revoking a certificate of authority;
- (6) Organizational structure;
- (7) Financial condition;
- (8) Pooling and sharing risks; and
- (9) Notice requirements.

Section 29. That § 58-3-3.4 be amended to read as follows:

58-3-3.4. The provisions of §§ 58-3-3.1 to 58-3-3.3, inclusive, 58-3-7.4, and 58-3-11 do not apply to farm mutual insurers subject to chapter 58-35 and captive insurance companies subject to chapter 58-46 unless the farm mutual or captive insurance company wrote premiums in excess of one million dollars in the prior calendar year.

An Act to revise certain provisions related to the regulation of captive insurance companies.

=====

I certify that the attached Act
originated in the

HOUSE as Bill No. 1061

Chief Clerk

=====

Speaker of the House

Attest:

Chief Clerk

President of the Senate

Attest:

Secretary of the Senate

House Bill No. 1061

File No. _____

Chapter No. _____

=====

Received at this Executive Office
this _____ day of _____ ,

20____ at _____ M.

By _____
for the Governor

=====

The attached Act is hereby
approved this _____ day of
_____, A.D., 20____

Governor

=====

STATE OF SOUTH DAKOTA,
ss.

Office of the Secretary of State

Filed _____, 20____
at _____ o'clock __ M.

Secretary of State

By _____
Asst. Secretary of State