

**AN INTRODUCTION TO CAPTIVES, MUTUAL  
INSURANCE COMPANIES, RISK RETENTION  
GROUPS, AND SELF-INSURED WORKERS'  
COMPENSATION TRUSTS**

**by**

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# **An Introduction to Captives, Mutual Insurance Companies, Risk Retention Groups, and Self-Insured Workers' Compensation Trusts**

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The main purpose of this article is to provide the reader with a primer on some of the forms of insurance companies permitted in this state which are known as captive insurance companies and mutual insurance companies. It also discusses organizations known as risk retention groups and self-insured workers' compensation trusts.

There are more than 5,000 captive insurance companies worldwide today.<sup>2</sup> Over 40% of major U.S. corporations have one or more captives.<sup>3</sup> Once the sole domain of large companies, captives are being used more and more by medium and even small businesses. Captives are gaining in popularity as they can address certain needs that a traditional insurance company cannot.

Mutual insurance companies date back to 17<sup>th</sup> Century England.<sup>4</sup> The first successful mutual insurance company in America was founded in 1752 by Benjamin Franklin.<sup>5</sup> It remains in business today and is called the Philadelphia Contributionship for the Insurance of Houses from Loss by Fire.<sup>6</sup>

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<sup>1</sup> The author would like to acknowledge the generous contributions of Eric Portuguese, Esq. with respect to the discussion of risk retention groups and self-insured workers' compensation trusts.

<sup>2</sup> <http://www.riskmgmtadvisors.com/captiveinsurance/captive-faq.php>

<sup>3</sup> *Id.*

<sup>4</sup> <http://www.namic.org/about/mutuals.asp>

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

In essence, a captive insurance company is a closely held insurance company formed to insure the risks of its parent and affiliates.<sup>7</sup> A mutual insurance company shares some of the same characteristics as a stock insurance company and operates much like any other corporation. In New York, captives and mutual insurance companies are governed by Articles 70 and 12 of the Insurance Law, respectively.

Risk retention groups, which are similar to captives, were created under the Product Liability Risk Retention Act of 1981 as amended by the Liability Risk Retention Act of 1986 in which Congress enabled insureds to self-insure through what is known as insurance cooperatives called risk retention groups.<sup>8</sup> While a risk retention group is similar to a captive, retention groups include multiple unaffiliated policyholders which are equity owners of the group. Generally, these groups create a “shell” insurance company, retain liability for small claims, reinsure against large losses, and hire third-party organizations to provide management services, underwriting services, and claims management services.<sup>9</sup> Under the Federal Act, the provisions of Insurance Law § 3420<sup>10</sup> are preempted.<sup>11</sup>

Authority for the creation of self-insured workers’ compensation trusts can be found at section 50(3-a) of the Workers’ Compensation Law. It requires that its group members all be within the same industry. Each member of the trust is

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<sup>7</sup> [http://www.riskmgmtadvisors.com/captive insurance/index.php](http://www.riskmgmtadvisors.com/captive%20insurance/index.php)

<sup>8</sup> See *Insurance Co. of State of Pa. v. Corcoran*, 850 F.2d 88 (2d Cir. 1988).

<sup>9</sup> See *Oneida Savings Bank v. Uni-Ter Underwriting Management Corp.*, 2014 WL 4678046 (N.D.N.Y. 2014).

<sup>10</sup> Among other things, this comprehensive statute obligates insurers to take certain steps when denying coverage for certain kinds of claims and sets minimal standards for certain kinds of insurance policies.

<sup>11</sup> See *Insurance Co. of State of Pa. v Corcoran*, *supra*.

required to periodically contribute funds to the trust in amounts based on an actuarial review of the member's anticipated workers' compensation claim liabilities. The trust participants must agree to be responsible for the workers' compensation obligations of not only its business, but also of each and every other business that participates in the trust. In recent years, a number of New York self-insured trusts were found to have been underfunded and unable to pay claims.

There are two kinds of captive insurance companies in New York, namely, a "pure captive insurance company" and a "group captive insurance company." A pure captive insurance company is any company that is a subsidiary of an "industrial insured" which is one hundred percent owned by or is a statutory subsidiary of the "industrial insured" and is licensed under the provisions of Article 70 and which has the primary purpose of providing insurance or reinsurance for the risks of its parent or affiliated companies.<sup>12</sup> An industrial insured is an insured: whose net worth exceeds one hundred million dollars; who is a member of a holding company system whose net worth exceeds one hundred million dollars; who is the metropolitan transportation authority and its statutory subsidiaries; or, who is a city with a population of one million or more.<sup>13</sup>

The second kind of captive, a group captive insurance company, is any domestic insurance company licensed under Article 70 for the primary purpose of providing insurance or reinsurance covering the risks of the industrial insureds

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<sup>12</sup> Ins. Law § 7002(h).

<sup>13</sup> Ins. Law § 7002(e).

that comprise an “industrial insured group.”<sup>14</sup> With limited exceptions, an industrial insured group is any group of unaffiliated industrial insureds that are engaged in similar or related business activities.<sup>15</sup>

A captive operates like other forms of insurance companies. It must be licensed.<sup>16</sup> It sets premiums and underwrites policies and pays claims. It may be sued in court for declaratory relief. In addition, a captive must maintain its principle office and records in New York.<sup>17</sup> The biggest difference between it and other kinds of insurance companies is that it may not provide insurance to the public generally.

A mutual insurance company shares many characteristics with other forms of corporations. The management and affairs of a domestic mutual insurance company rest with the board of directors.<sup>18</sup> It must have at least seven directors.<sup>19</sup> The board elects the company’s officers as provided in the company’s by-laws.<sup>20</sup>

Every policyholder is a member of a domestic mutual insurance company and as such, has voting rights and shares in dividends declared by the board.<sup>21</sup> A policyholder has the right to inspect the mutual insurance company’s books.<sup>22</sup> A mutual insurance company sets premiums and pays claims.

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<sup>14</sup> Ins. Law § 7002(f).

<sup>15</sup> Ins. Law § 7002(g).

<sup>16</sup> Ins. Law § 7003(b)(1).

<sup>17</sup> Ins. Law § 7003(b)(3).

<sup>18</sup> Ins. Law § 1209(a).

<sup>19</sup> Ins. Law § 1209(b).

<sup>20</sup> Ins. Law § 1209(c).

<sup>21</sup> Ins. Law § 1211(a); *see also* Ins. Law § 4114.

<sup>22</sup> *Klonick v. Equitable Life Assurance Society of the United States*, 77 Misc.2d 246 (Sup. Ct. Monroe Co. 1974).

There are many benefits to a captive. Such benefits include: (1) flexibility in policy design, coverage, and claims handling; (2) the ability to provide coverage which is not otherwise available; and (3) the ability to provide customized coverage.<sup>23</sup> Mutual insurance companies enjoy the benefit of servicing the insurance needs of its policyholders without the additional obligation of meeting the investment needs of stockholders.<sup>24</sup>

Captives may underwrite, on a primary basis, most of the kinds of insurance set forth in Insurance Law § 1113. This includes, but is not limited to, the following kinds of insurance:

1. fire;
2. property;
3. glass;
4. boiler and machinery;
5. elevator;
6. animal;
7. collision;
8. personal injury liability;
9. property damage liability;
10. credit;
11. marine and inland marine;
12. gap;
13. legal services; and
14. involuntary unemployment.

Captives may also write these kinds of insurance on a reinsurance basis.<sup>25</sup>

With this stated, captive carriers can only underwrite risks associated with activities engaged in by the captive's parent or affiliated company. In the case of a pure captive insurance company, it may only insure, on a primary basis, the

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<sup>23</sup> [http://www.riskmgmtadvisors.com/captive insurance/index.php](http://www.riskmgmtadvisors.com/captive%20insurance/index.php)

<sup>24</sup> <http://www.namic.org/about/mutuals.asp>

<sup>25</sup> Ins. Law § 1114.

risks of its parent and affiliated companies.<sup>26</sup> A group captive insurance company may only insure, on a primary basis, the risks of the industrial insureds that comprise the industrial insured group.<sup>27</sup>

There is an intricate web of statutory exceptions and exceptions to exceptions with respect to the kinds of insurance captives may write. For example, captives may not provide primary insurance or reinsurance of any of the following kinds of insurance:

1. life insurance;
2. annuities;
3. accident and health insurance;
4. title insurance;
5. mortgage guaranty insurance; or
6. financial guaranty insurance.<sup>28</sup>

Captives may not provide, on a primary basis, workers' compensation or employer's liability insurance, nor any other kind of insurance required as proof of financial responsibility for obtaining a license or permit, such as, for example, motor vehicle liability coverage.<sup>29</sup> However, a pure captive insurance company is not prohibited from providing, on a primary basis to its parent or affiliated company, an insurance or self - insurance program of the kinds of insurance listed directly above, provided the insurance or self - insurance program has qualified under applicable state or federal law with respect to the program.<sup>30</sup>

Captives are further restricted with respect to reinsurance. Captives may

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<sup>26</sup> Ins. Law § 7003(a)(1).

<sup>27</sup> Ins. Law § 7003(a)(2).

<sup>28</sup> Ins. Law § 7003(a)(3).

<sup>29</sup> Ins. Law § 7003(a)(4).

<sup>30</sup> Ins. Law § 7003(a)(4)(c).



only reinsure the risks set forth in Insurance Law § 7010, which provides:

- a. Any captive insurance company may assume reinsurance on risks ceded by any other insurer when the risks ceded under the reinsurance agreement are solely those of the industrial insured or members of industrial insured group owning the captive insurance company.
- b. With the approval of the superintendent, any captive insurance company may assume risks of any other insurer, provided the reinsurance premiums assumed do not exceed fifty percent of the assuming captive insurance company's gross premiums written in any calendar year.
- c. Any captive insurance company may take credit for reserves on risks or portions of risks ceded to reinsurers complying with the provisions of paragraph nine of subsection (a) of section one thousand three hundred one and section one thousand three hundred eight of this chapter. Prior approval of the superintendent shall be required for ceding or taking credit for reserves on risks or portions of risks ceded to reinsurers not complying with these sections.

In addition, a pure captive insurance company which is formed by a city with a population of 1,000,000 or more may insure for its parent, statutory subsidiary or affiliated company, only for liability stemming from the response to the World Trade Center attacks of September 11, 2001.<sup>31</sup> This also applies to reinsurance.<sup>32</sup>

Generally speaking, mutual insurance companies may write the same kinds of insurance that stock insurance companies can write. This includes casualty and property-related policies such as the commonly known homeowners, businessowners, general liability and automobile liability insurance policies.

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<sup>31</sup> Ins. Law § 7003.

<sup>32</sup> *Id.*