

State Of the Domicile

Experts discuss issues concerning captives.



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Gray has been involved with the captive insurance industry for about 20 years, 13 with Aon Insurance Managers. Currently she is the regional managing director of the Americas.



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White has been in the industry for about 30 years, primarily as an insurance and reinsurance underwriter. He is the former head of captive-insurance development in Washington, D.C., and Delaware, and currently is the managing principal with Prism Strategies LLC.



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Mills is the director of Deloitte's U.S. insurance group. Prior to coming to Deloitte, he was the superintendent of the New York State Insurance Department. Mills is also a former New York State Assemblyman.



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Last November a panel of experts met at A.M. Best headquarters to discuss the issues surrounding setting up an insurance domicile. This edited transcript of the "State of the Domicile" webcast covers the issues involved with changing domiciles, the benefits of forming one and whether it's more beneficial to create a captive onshore or offshore.

Webcast moderators: Lee McDonald, group vice president, A.M. Best Co. and Meg Green, *BestWeek/BestWire* senior associate editor.

Changing Domiciles

MCDONALD: We're seeing a pickup in competition among the domiciles. What are we seeing at this point as far as activity and what seems to be driving it?

GREEN: States really like to get into the captive domicile business. It's a good source of revenue for a lot of them and it brings in good employment and it's good, clean employment, there's no pollution risk or anything like that. A number of states enjoy the revenue, the premium tax that comes in. If you look back in 2007, the then-governor of Vermont, Jim Douglas, said the captive premium tax brought in just about as much revenue as the state lottery system. So, I think that got a lot of people's attention as far as starting a regulatory structure.

MCDONALD: One recent headline was Willis announcing it's moving from Bermuda to Dublin. In general, is that playing out on a worldwide stage?

GREEN: It is. A number of companies are redomiciling around the world as they're looking for...perhaps a better tax structure, but also they're looking at regulation and Ireland itself is very popular right now because it's part of the European Union and setting up shop there gives you access to all of Europe.

MCDONALD: What are the domiciles looking for and what's driving the activity here that you can see?

MILLS: It's bragging rights. It's something to be able to say, look, we created jobs, we recruited jobs, we brought jobs into our state and when a company decides to redomesticate and leave, of course that becomes a major black mark upon an administration or a governor.

You don't want to see jobs leaving your domicile, your state, your jurisdiction and going somewhere else. I think especially in this environment—in the last year and a half what we've seen, especially in the financial services industry, the ability to become competitive to bring more financial services industry jobs into your state because they are good jobs. They're good-paying jobs. They're "clean" jobs. They're no impact other than a positive one.

MCDONALD: Nancy, is this a new environment?

GRAY: It's absolutely a new environment, I would say, in the last 10 years. We really have seen an expansion in the number of captive domiciles, especially in the U.S. It's not just in the U.S.; we're seeing it on a global basis as well but certainly in the U.S. We have close to 30 states now looking to compete for this captive insurance company business. Over 10 years ago if you were a U.S. corporation you had basically three captive domiciles to select from: Bermuda, Cayman or Vermont. With 30 states now trying to compete for that business it's a different marketplace.

MCDONALD: In addition to the Willis move, we did see some large carriers move internationally—a bunch out of the U.K., some across continents, things like that. Are we seeing any trends emerging there? What are they citing as their reasons?

GRAY: A couple of years ago you saw a number of companies going to Bermuda. And now it seems that some are seeking other locations. A number of U.K. companies are moving out of that region.

MCDONALD: Is taxation a major issue here?

MILLS: I don't think there's any real mystery. These companies have a fiduciary responsibility to shareholders if they're a public company to do what's right for the company and I think it's purely a matter of competition, of looking for competitive, favorable tax structures, for a regulatory regime that's beneficial...And let me clarify that. I don't necessarily mean a lesser of a regulatory regime.

Most Popular U.S. Domiciles

(by number of affiliated and unaffiliated single companies)

State of Domicile	Number of Companies
Texas	470
New York	351
Illinois	328
Pennsylvania	302
California	289
Florida	239
Ohio	231
Wisconsin	193
Arizona	175
Michigan	160

Source:  BestLink

You know in a lot of these instances these companies are not necessarily looking for the softer regulatory regime. I think that they're looking for a better regulatory regime. And I think that the level of professionalism and the complexity that the regulatory regime is able to deal with, with regard to their company, is an attractive thing. Obviously they don't want the toughest regulation in that it constricts their ability to operate, but they're looking for a regulatory environment that's favorable. I do think at the end of the day it all comes down to dollars and cents and the tax structure and their ability to be competitive with their competitors is the major driver.

WHITE: I think there are a couple of things going on here. First of all there are some concerns about the fallout from what has been a very terrible situation with credit capital within the financial markets. And I think most businesses are seeing a situation where they're getting a feel from various regulatory authorities about what their concerns might be. And

there's a tendency when something this dramatic happens to err too far on one side or the other. My opinion of regulation has always been that it is clarity and consistency that businesses are looking for. And when you get a situation where it becomes apparent that the regulatory domicile that you're in is not as clear about what they're going to do or they're not consistent in their treatment of businesses or you have some reason to believe they may not be, then that's going to create the situation where you move.

Growth Factors

MCDONALD: Which is the most portable and active of the new domicile locations? A couple of years ago we only had a handful, or less than a handful, of viable captive destinations. What is the impact of that and is that a trend that is going to go even further?

CHANSKY: The impact has been a dispersion of captives really throughout the country. We've seen over the last five to seven years there were only two or three U.S. domiciles of any consequence and now we can count close to 10 that are viable and I believe there are over 30 that actually have laws. So the consequences are there are a tremendous amount of choices. It puts people like Nancy in an interesting position, trying to navigate through all those choices for their clients and customers, trying to decide what is the best match.

Do I see that continuing? I'd actually be surprised if states continue to try to come in. I feel like we're almost at a saturation point. Not to say that another state won't put a captive on the books tomorrow, but I think there are plenty of choices and if we look at the number of captives in some of these domiciles that have passed laws, there are several that have none or one or two. There really isn't any lifeblood to those states to grow that situation or change it at all.

Regulatory/Law

MCDONALD: Bill, you're sort of the Johnny Appleseed of the captive world. You've helped two domiciles get going—Washington, D.C. and Delaware. How far is this going and do you see more captive activity on the way from states and non-U.S. domiciles that don't host captives? Is there still an opportunity to get established and make it worth their while?

WHITE: I think the point was made by someone earlier that we may have reached a saturation point in terms of availability. Choice is always good in terms of having as much of a selection as possible. But what's even more important is the point that you just brought up, about how the regulation really looks and how in sync it is with business needs. That is a key element in terms of developing any kind of regulatory domicile. And I think that for most of the domestic domiciles, they've done exactly what you've said and that is, originally, (they) just took Vermont's captive law, copied it or maybe tweaked here or there to fit their particular situation or their particular needs, depending on which element of their state actually pushed to get something done in terms of a captive domicile.

MCDONALD: The way states entered the captive arena was by sort of cloning Vermont's law. How much diversity is there in captive law these days?

CHANSKY: Some of the diversity we're seeing is actually in the tax rates. One way for a domicile to differentiate themselves from a Vermont or any other domicile is to establish a different premium tax structure or to have no premium tax at all. There are actually a couple of states that just charge a fairly nominal fee.

One of the domiciles—I believe there's a name, something like a wildcard provision—that's basically saying that, subject to the approval of the commissioner, we will match any law in any domicile. So, it's sort of the ultimate flexibility. The domicile's been praised and criticized. Praised for having that flexibility and criticized for a 'we'll match the lowest offer' kind of a thing. And it's not a secret, that domicile is Washington, D.C., and they've done fairly well in bringing in captives.

The Benefits of Captives

MCDONALD: Nancy, would you just lay out for us very quickly the benefits of forming a captive?

GRAY: Certainly. When looking at the formation of a captive insurance company, it's a risk management tool to manage your total cost of risk. You look at what's available. You have to determine as to whether or not you're going to self-insure a program or pass on your risk to the traditional insurance markets. What we've seen with past market cycles is that during hard market cycles it was very difficult for many companies to get the type of covers that they needed. Either the pricing was very high or capacity wasn't there. So they turned to self-insurance and alternative vehicles, such as

Most Popular Global Domiciles

(by number of affiliated and unaffiliated single companies)

Country of Domicile	Number of Companies
United States	3,876
United Kingdom	783
Germany	659
Spain	431
Netherlands	342
France	331
Argentina	280
Ireland	277
Canada	267
Italy	220

Source:  BestLink[®]
Global

captive insurance companies, which allowed them to manage their risk better.

MCDONALD: So if you tie that in to where you're going to domicile that captive, does your choice there affect how you form a captive? How much risk you put into that captive, what you do with that captive? Or are they pretty much interchangeable at this point?

GRAY: They're pretty much interchangeable, as you look to what are the more popular uses of the captive vehicle. Certainly the deductible casualty programs—you know, writing workers' comp, GL, auto liability are the traditional coverages that run through a captive. The captives are also used to access the reinsurance marketplace more on the property side, so it provides additional capacity accessing.

In terms of captive domicile and location, it really doesn't make that much of a difference. So, among the U.S. captive domiciles, if you have a global risk then you might need to have a local insurer in some of the European

Union countries. So you would form a captive maybe in Dublin or in Guernsey, where you can access coverage or be considered a local insurance company for those locations. But again, taxation is another factor in terms. To say that taxation doesn't play a role in the formation of captives I would say is incorrect. It does enter into the equation and I'm talking about income tax more than premium tax here.

Onshore or Offshore?

MCDONALD: Nancy, as you work with clients and you lay out options for them is there a question of onshore or particular locations that they are just reluctant to do?

GRAY: Yes. The onshore and offshore question comes up quite frequently. Not with just new captive formations but with our existing captive client base, trying to determine as to whether they're domiciled in the right location currently. The growth of Bermuda, really looking back from a historical standpoint, there were really good tax reasons to form in Bermuda pre-1986.

Back then there really weren't any choices in the U.S. in terms of new domiciles other than maybe Vermont, at that point, had their captive law on the books. There were a scattering of other captive domiciles in the U.S., but primarily Vermont was, from that standpoint, able to grow. The tax law changes that were instituted in '86 changed the tax benefits associated with domiciling in Bermuda. So it made it more of a level playing field in terms of whether you were in the U.S. or an offshore captive domicile. Since then, of course, we've seen a lot of growth. BR

The entire transcript can be accessed at www.ambest.com/domiciles09/webcast-transcript.pdf.
A video replay is available at www.ambest.com/domiciles09.