

25 years after law, a top domicile rules

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More than a quarter of a century later, Reg Beane remembers a phone call he received from Burt Carbino, a prominent New York risk manager.

At the time of that phone call, Mr. Beane, then director of governmental affairs at the Risk & Insurance Management Society Inc., had "tucked in my top left desk drawer" draft captive domicile legislation.

The intent of the legislation, crafted at RIMS' request by a young New York attorney named John Sarchio, was simple: give U.S. corporations interested in setting up captive insurance companies a domestic alternative to offshore domiciles, such as Bermuda and the Cayman Islands.

Mr. Beane, now the president of First Commercial Insurance Co., a small workers compensation insurer in Miami Lakes, Fla., had floated the proposal by several risk managers in Colorado, which, nearly a decade earlier, had become the first U.S. state to pass captive legislation.

But Colorado had found few takers and licensed only a handful of captives. The reason: Its captive statute was too restrictive to make the domicile attractive.

The proposal in Mr. Beane's desk drawer took a different approach, eliminating such restrictions as a requirement that captive sponsors prove that insurance was not available in the traditional market before they could establish a captive, which had crippled Colorado's appeal as a domicile.

Indeed, H. Lincoln Miller Jr., a New York insurance broker, who had strong ties to Vermont, where he maintained a summer home, later described the law that emerged from Mr. Sarchio's draft this way: "There's nothing else like this in the U.S."

But the Colorado risk managers with whom Mr. Beane discussed the proposal were not encouraging. The political climate in Colorado, they told him, would not be receptive to such a proposal.

It was at that point that Mr. Beane received Mr. Carbino's call. Mr. Carbino explained that Mr. Miller, who was his broker, had good political connections in Vermont. Mr. Miller had, in fact, been interested for some time in expanding Vermont's insurance base, such as through a new electronic insurance exchange.

Mr. Miller, now the group chairman of USA Risk Group Inc. in Montpelier, Vt., brought the insurance captive idea to Al Moulton, Vermont's commissioner of economic development. Later, Mr. Moulton discussed it with Stewart Ledbetter, the commissioner of the Vermont Department of Banking and Insurance, and later George Chaffee, who in 1980 succeeded Mr. Ledbetter.

Mr. Chaffee, now retired, was quickly taken with the idea of Vermont as a captive domicile. "I understood the concept and the nature of the problem," he said.

Mr. Chaffee brought the proposal to Vermont Gov. Richard Snelling, who did not immediately embrace the idea. In fact, Gov. Snelling, at a later meeting with Mr. Chaffee and other backers of the proposal, peppered the group with tough questions.

“Some people came away from that meeting discouraged,” said Mr. Chaffee, who was more optimistic, aware that Gov. Snelling's tough questioning was his operating style and was not an indicator of opposition or support for a proposal.

In fact, a few weeks later, Gov. Snelling signed on.

“Go for it,” Mr. Chaffee recalled Gov. Snelling telling him. “We had his blessing,” Mr. Chaffee said.

That was the start of a campaign-whose leaders included Messrs. Moulton and Chaffee-to win the support of the Vermont Legislature, a campaign that at its core involved educating state legislators about what an insurance captive was and what the potential impact of becoming a captive domicile could have on the Vermont economy.

That campaign was wildly successful: When the Legislature passed the captive bill in 1981, it did so with just one dissenting vote.

Unstoppable movement

Now as Vermont celebrates the 25th anniversary of its captive law, its success and impact-not just in Vermont, but on the entire captive movement-goes far beyond what its early backers envisioned.

“Not in my wildest dreams did I think this would happen,” Mr. Beane said.

“I never thought Vermont would become as big as it did,” said Tom Duffield, a retired risk manager who was Archer Daniels Midland Co.'s vp of risk management and insurance at the time the Decatur, Ill.-based agribusiness giant set up a Vermont captive in 1983.

Today, Vermont, which currently has 552 captives, is the world's third-largest captive domicile and the largest captive center in the United States. Vermont, in fact, has more than three times as many captives as Hawaii, the second-largest U.S. domicile.

The state's top three captive regulators-Len Crouse, deputy commissioner-captive insurance division; Derick White, director of captive insurance; and Peter Raymond, director of financial examinations-together have 43 years of captive regulatory experience, which Vermont captive executives say is a longer tenure than senior regulators in any other domicile.

“The size and reputation of its professional regulatory staff does not exist anywhere else,” said Pamela Davis, president and chief executive officer in Santa Cruz, Calif., for the Alliance of Nonprofits for Insurance Risk Retention Group, which has been operating in Vermont since 2001.

The state's reputation is such that for risk managers, the name Vermont is synonymous with captives, said Terri Wilfong, senior manager-risk and insurance services in Wilmington, Del., for pharmaceutical giant AstraZeneca, which established a Vermont captive 12 years ago.

Indeed, well over 40% of Fortune 100 companies-including well-known corporate names such as Alcoa Inc., Exxon Mobil Corp., Microsoft Corp., The Walt Disney Co. and Wal-Mart Stores Inc.-now have captives in Vermont, while the annual conference of the Vermont Captive Insurance Assn., which will be held this week in Burlington, has become the largest meeting of captive sponsors and service providers in the world, attracting more than 1,200 people.

The economic impact of having so many captives has been huge on Vermont, a state with a population of just over 620,000. A study by the Vermont Department of Economic Development found that in 2003 captives supported about 1,400 jobs, a figure likely considerably higher today as the state has licensed more than 100 captives since that study was conducted.

A model for others

But the impact of Vermont's captive law extends beyond the Green Mountain State. Vermont's success as a captive domicile has been a catalyst for a score of other states enacting similar measures, giving risk managers domicile choices that didn't exist 25 years ago.

“Other states have taken note of what Vermont has accomplished,” said Jon Harkavy, vp and general counsel in the Arlington, Va., office of captive manager Risk Services L.L.C.

Luck-or as Mr. Sarchio, now a partner at Chadbourne & Parke L.L.P. in New York, puts it-“serendipity,” is at least partly responsible for Vermont's success.

Certainly, Vermont benefited from the failure of states-Colorado and Tennessee-that beat Vermont to the punch in enacting captive statutes to update their laws to make them more competitive with Vermont.

Other states, most notably Delaware, did pass attractive statutes, but then set up procedures that essentially closed themselves off to most captive sponsors. Delaware, for example, which passed captive legislation in 1984, for years was interested only in captives that agreed to employ a large number of staff in the state, captive managers said.

Vermont also was a beneficiary, as were other domestic domiciles, from several changes in federal law during the 1980s. Congress, for example, passed measures in 1984 and 1986 that largely eliminated the tax advantages associated with setting up captives offshore.

"After 1986, the tax advantages of being offshore diminished dramatically," said Gary Osborne, president of USA Risk Group Inc. in Montpelier.

Also in 1986, Congress expanded a 1981 law to allow special multiple-owner captives, known as risk retention groups, to fund members' casualty coverages, except workers compensation. A key condition set by Congress is that risk retention groups had to be licensed in the United States, giving Vermont and other states a market closed to offshore domiciles. Today, more than 230 RRGs operate in the United States, with 77 of them licensed in Vermont, far more than any other state.

Being the first domestic state with an attractive captive statute gave Vermont the lead in winning captives sponsored by employers that already had captive programs offshore but were eager to bring those programs ashore once they had the ability to do so.

"Vermont was much more convenient than Bermuda," recalled retired Alcoa financial executive Harold Meeks, who was Alcoa's assistant treasurer when the aluminum producer set up its Vermont captive in 1983 and became the first Fortune 100 company to do so.

"As our program was growing, it was becoming just too cumbersome to operate offshore," said Jaxon White, chairman, president and CEO of Medmarc Insurance Group in Chantilly, Va. Medmarc, then known as Medmarc Ltd., a provider of product liability coverage to medical equipment manufacturers, in 1986 became the first captive to come ashore under the newly expanded U.S. Risk Retention Act. Medmarc later was reorganized as an admitted insurer in Vermont.

While an attractive law and timing were key in Vermont's success, those factors are overshadowed by what captive sponsors and risk managers say is the No. 1 reason Vermont boomed as a captive domicile: its regulatory approach.

Pro-business regulation

Captive sponsors and managers, without exception, describe that approach as tough, fair and flexible, and exactly what they are looking for from a captive domicile.

"We welcome tough regulation. We do not shy away from it. But they are not in the business of creating bureaucratic roadblocks," said Ms. Davis of the Alliance of Nonprofits for Insurance Risk Retention Group.

"It is a unique combination. Vermont regulators are pro-business, which they combine with strong and fair regulation," said Ray Oberg, who for many years ran M&M Insurance Management Services Inc.'s Vermont office-the state's biggest captive manager-and now is the controller for hedge fund Aladdin Capital Holdings L.L.C., in Stamford, Conn.

Indeed, as Richard Heydinger, retired director of risk management services for Hallmark Cards Inc., which set up a captive in Vermont in 1984, recalled, "If you had a solid business plan, Vermont regulators were great supporters. If there was, however, any sleight of hand, you'd be out of there in a hurry."

The accessibility of regulators, say captive sponsors, also has been a key factor in Vermont's success.

"It starts with availability and accessibility. You call Len Crouse and say, 'Can we meet the day after tomorrow?' It will happen. They are very approachable," said Gary Baxter, who retired several years ago as assistant treasurer/director of insurance for Weyerhaeuser Co., the big Federal Way, Wash.-based forest products maker that set up a Vermont captive in 1983.

At the same time, from the very beginning, there has been a consistency and continuity of support for the captive industry from state lawmakers and regulators.

That support has not wavered, regardless of whether a Republican or a Democrat was governor, which party controlled the Legislature or who was the top captive regulator.

“The interest has come and gone elsewhere. In Vermont, the interest in captives is stable and companies love stability,” said Roger Phelps, the retired president of Alcoa's captive, Three Rivers Insurance Co.

That support continues today at the highest level.

“The past 25 years have provided the blueprint for the next 25 years—regulation that is knowledgeable, consistent and forward-thinking. We'll continue to keep customer service foremost in mind and make sure that our legislation keeps pace with the changing needs of the industry,” said Vermont Gov. Jim Douglas.

Captive executives say state support comes from officials' understanding of the importance of the captive industry to Vermont.

“The revenues generated by captives mean something to a small state. As a result, legislators and regulators are very receptive to new ideas to make the captive law better,” said Brian Donovan, Arlington Heights, Ill.-based president of Vermont-domiciled STICO Mutual Insurance Co., a Risk Retention Group, that provides pollution liability coverage to storage tank manufacturers and installers.

For example, Mr. Donovan noted, state legislators on several occasions have passed bills lowering premium taxes on captives, heeding warnings that such reductions were necessary to keep Vermont competitive with other domiciles. Even so, Vermont still collects nearly \$23 million annually in captive premium taxes.

“They listen here,” Mr. Donovan said.

And Vermont officials say they will continue to listen to keep the state's leading position in the captive insurance market.

“Our door is always open. We promise to continue to lead,” Gov. Douglas said.

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