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Onshore attractions help keep some owners at home

By MICHAEL BRADFORD
March 07, 2005

The rise of domiciles in the United States has given captive owners a lot of reasons to stay home.

As the number of states allowing captives has increased, owners no longer reflexively look to Bermuda, Cayman or other offshore locales. Some U.S. domiciles, Vermont and South Carolina among the most notable, have experienced steady growth in the number of captives by offering the same quality of regulatory and infrastructure services as the old hands offshore, but with the added convenience of easier accessibility for many owners.

Offshore managers, particularly those in Bermuda, are taking notice.

Captive activity in Bermuda has slowed in recent years, and managers there say that is largely because of competition from the profusion of U.S. domiciles. New insurer incorporations, most of them captives, fell in Bermuda last year to 77 from 89 the previous year.

"We have a lot more competition nowadays," said Rory Gorman, managing director with Marsh Management Services (Bermuda) Ltd., referring to Bermuda as a captive domicile. "The marketplace is a lot more fragmented," he added, with approximately 20 U.S. domiciles vying for captive business.

"We're fighting for every client we can," Mr. Gorman said.

Captive clients considering onshore domiciles usually find that the "incidental costs" such as fees for management, administration, audits and other such services are "pretty much a wash" when compared to the costs in Bermuda, said Mr. Gorman. But many have "a desire to be in a U.S. state, to begin with," he noted. "And with more and more states having captive legislation, often the solution is right on their doorstep."

Bermuda has fought some image problems in recent years, which may have scared some captive sponsors away.

Comments by Democratic presidential candidate Sen. John Kerry, D-Mass., in last year's campaign gave the word "offshore" a negative connotation and linked it with Bermuda, creating "some unwanted, adverse publicity," noted Mr. Gorman. "But I think we're over that now," he said.

Some U.S.-based managers contend, though, that such bad publicity does influence some captive owners.

"The offshore stigma is a real issue," said Gary Osborne, the Montpelier, Vt.-based president of USA Risk Group, the holding company for several captive management companies, including some in offshore domiciles. Sen. Kerry's comments and other negative publicity have made some people reluctant to be seen doing business offshore, Mr. Osborne said.

Robert L. Johnson, senior vp with Marsh Management Services Inc. in Charleston, S.C., agreed that the stigma associated with offshore business centers makes some people "uncomfortable" because locating there is not seen as "politically correct."

Mr. Johnson said, though, that offshore markets "are not struggling," and some U.S. companies still favor them.

Convenience, in many cases, wins out when it's time to select a domicile.

"It used to be advantageous to go offshore for tax purposes, but not now," said Elizabeth Steinman, New York-based first vp of HSBC Insurance Management.

Clients now choose domiciles based more on the type of captive they are forming, the regulatory environment of the domicile and how comfortable they feel operating there, she said. All things being equal, geography wins out, Ms. Steinman remarked. "These are pretty senior executives, and their time is very valuable," she said.

Bill West, chief financial officer for builder Dunmore Homes L.L.C. in Roseville, Calif., said he chose to go to Hawaii rather than Bermuda to set up a general liability captive because it is much easier to reach the U.S. domicile. "Nothing we saw told us that we wanted to go completely across the country to set this up, as opposed to going to Hawaii."

Taxes, fees and regulatory issues do not determine where clients will go, said Jason Palmer, managing director for Willis Management (Hawaii) Ltd. in Honolulu.

"The cost of doing business is almost the same, so it really isn't an issue. It's what fits best for the client or prospect in the location that we would recommend," Mr. Palmer said.

The travel issue is not as simple as which domicile is closest, though. Going to Bermuda can accomplish more than just dealing with captive operations, Mr. Gorman pointed out.

"When all things are equal or close to equal," Bermuda has an advantage in many cases over its onshore competitors, Mr. Gorman said. "We are sitting in the middle of one of the biggest insurance and reinsurance markets in the world," he said.

Many clients are in Bermuda "renewing their policies, anyway, with the markets here," he said, so "it makes travel sense" to situate the captive in Bermuda rather than in a U.S. domicile in which the parent does not operate and has no other reason to visit. "So I think we benefit from that," he said.

Mr. Palmer agreed that a captive sponsor often chooses an offshore domicile because it has an established relationship there, whether it is, for example, to buy reinsurance in Bermuda or even to vacation in Cayman.

David Hennes, director of risk management at The Toro Co. in Minneapolis, said that the ability to conduct other insurance business in Bermuda, as well as the domicile's experience with captives, helped sway the manufacturer of outdoor products toward the island rather than to Vermont.

"But it was close," Mr. Hennes acknowledged.

Toro established Red Iron Insurance Ltd. in 2001 to write warranty coverages and deductible buybacks for some of the company's self-insurance programs, Mr. Hennes said. Toro chose Bermuda because "we had been comfortable with the environment in Bermuda," having dealt with XL Capital Ltd. and having held meetings annually with the insurer, he noted.

"We've been happy with the business environment in Bermuda," said Mr. Hennes. "They've been doing captives for a long time, and their longevity won us over vs. Vermont."

Fairview Health Systems in Minneapolis has owned a Bermuda captive since 1975 to cover its medical malpractice, general liability and corporate automobile risks for seven hospitals, 300 physicians and 30 clinics, according to Michael Seitz, vp for risk management services.

Moving the captive onshore, or to Cayman, a domicile with a reputation for hosting health care captives, would not be worth the expense or the loss of relationships, Mr. Seitz said. "We have an established team in

Bermuda. We feel that we have a good local relationship, and if we were going to move it, we would just have to re-establish everything," he said.

"I don't think there's any financial incentive" to move the captive, Mr. Seitz said, because uprooting it would be too expensive.

Mr. Osborne of USA Risk Group said offshore companies moving to the United States could incur more expenses. It may be easier to form a new company onshore than to redomesticate an offshore operation, he said.

Some captives, though, are considering making the move from offshore domiciles.

John O'Brien, Charleston, S.C.-based chief executive officer of Charleston Captive Management Co., said he has seen "a great deal of interest" among offshore companies that want to relocate in the states. The captives, one of which writes hospital-related risks for large universities, want to move partly because of the perceived negativity of being offshore.

Setting up in the United States is not the solution for every captive, experts acknowledge.

Mr. Osborne said that locating offshore could be best for companies "when there's still a problematic structure to do onshore." That problem could be a captive structure not suited to an onshore domicile or one that would find the capital and collateral requirements of an offshore location more suitable, he explained.

But, he added, "our company tends to tell people, `We'll start you onshore unless you tell us what you're doing is going to be problematic here."'

Guy F. Ragosta, regional executive officer with Willis Management (Vermont) Ltd. in Burlington, Vt., said that, with "the whole corporate governance issue, I don't think we see as much business going offshore as we used to, unless there's international risk."

Non-U.S.-owned companies that have U.S. interests will continue to view Bermuda as an attractive domicile, Mr. Ragosta predicted. "But if you're the CFO of a U.S. company and you have to sit in front of your board, it's hard to go down there if you have options like Vermont, South Carolina, Arizona," Mr. Ragosta said.

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