Increasing Number of Captives Opt to Domicile on U.S. Soil

Favorable establishment conditions, interstate competition, federal legislation spur an uptick in domestic captives

By Anya Khalamayzer, PropertyCasualty360.com May 3, 2012

The recent growth spurt among captives opting to domicile domestically can be attributed to lower establishment costs, more streamlined capitalization requirements and state governments offering increasingly creative incentives.

Another factor: more location options. The Captive Insurance Companies Association (CICA) reports that Florida and New Jersey will be the newest states open for business, effective this July.

The Captive Insurance Companies Association reports in its annual Captive Market Study that 79.1% of companies participating in the survey are currently domiciled within the U.S.

The Vermont insurance market—one of the oldest in the U.S.—is still the No. 1 domicile in the country with 30-40 percent of *Fortune* 500 companies owning a captive in the Green Mountain State. But other states are taking steps to make themselves more attractive and to catch up.

These efforts are beginning to pay off. Utah, Kentucky, Montana and Delaware, for example, have each experienced double-digit growth in business between 2010 and 2011, according to CICA's last domestic industry report.

Oregon is allotting a portion of its budget to hire 18 captive regulators; South Carolina's Insurance Funding Program is helping the state's Jobs-Economic Development Authority finance special-purpose captives through state-controlled surplus bonds; and Nevada is reducing compliance expenses by simplifying insurers' applications and reporting processes.

Newcomer Florida is promoting a simplified and low-cost application process to encourage captive formation and woo those seeking re-domestication. Gov. Rick Scott recently signed a law allowing single-parent, special-purpose, industrial and captive reinsurance companies to exist within the state. Licensees must pay a $1,500 application and $1,000 annual renewal fee. Oregon, another domestic newbie, requires a $5,000 annual fee in place of premium taxes.

Other states are trying to stand out by offering niches for such risk-retention groups as those dealing in Cyber Liability or Health Care.

In 2011, Maine revived its captives market and became a haven for Workers' Compensation when it became the first state to allow captives to offer health insurance—an increasingly popular position as the health-care bill pushes companies to offer specialized wellness programs.

ECONOMIC ADVANTAGES SWEETEN THE POT

In the last decade, this shift by states to a more captive-friendly environment has spurred 52 percent of new captives to choose a U.S. jurisdiction as their domicile, whereas between 1991 and 2000, only 35 percent of captives were domestic, according to Marsh's 2012 Captive Benchmarking Report.

"States view captives as a way to keep their fingers on the pulse of business formation," says Arthur Koritzinsky, Marsh's North American captive advisory leader.

Updates about state efforts to fertilize captive formation are cropping up in real time on Web sites such as CICA's, and agencies such as Marsh annually monitor the captives industry in surveys which are readily available online. The State of Vermont even has an interactive questionnaire available online offering direct help for businesspeople seeking a tailored consultation for a potential captives business.

> **With Internet** visibility, industry pressure and sales pressure coming from state regulators, it's no shock that I'm predicting 10,000 captives to exist within the next three years."
>
> *Andrew Barile, President and CEO of Andrew Barile Consulting Corp. Inc.*

"With Internet visibility, industry pressure and sales pressure coming from state regulators, it's no shock that I'm predicting 10,000 captives to exist within the next three years," says Andrew Barile, an insurance consultant and author of two publications on the worldwide captives market (see p. 34).

"One of the issues driving the captives market right now is that you don't have to be a salesman to sell the concept [to companies]," he continues. "And all the states now recognize that it's a great source of revenue, and they can make money off of captives through fees and premium taxes."

For his part, Koritzinsky identifies a couple of reasons why the practice of domiciling in the U.S. is gaining popularity. "Firstly, income-tax rules for captives owned by U.S. companies are largely the same now whether onshore or offshore.

"And when a new captive market opens up," Koritzinsky continues, "there are businesses within that state willing to keep their captives close."

Another factor helping to encourage domestic captives is the Nonadmitted and Reinsurance Reform Act of 2010, which helps in-state companies reduce their procurement taxes. Small captives must elect to be U.S. taxpayers in order to take advantage of the wealth-accumulation options and tax benefits allotted them by the Internal Revenue Service Code, says Koritzinsky.

And with the global risk of terrorism ever present, the federal backstop of the Terrorism Risk Insurance Act provides coverage from terrorism-caused biological, nuclear, chemical and radiological perils and is not available internationally.

Additionally, Sanford Elsass, chairman of the National Risk Retention Association, points out that the Patriot Act puts stringent due diligence on banking and cash flows in and out of the country. "If you're a little captive, those changes and expenses could cause you to stay onshore," he says. "The [biggest] factors aren't only the costs of doing business offshore but also the cost of travel, because if you're an offshore captive you can't have board meetings onshore."

Although onshore captives have expanded greatly since Colorado became the first American state to allow captives in the 1970s, followed by Vermont and Tennessee, the day may never come when captives are welcomed in each jurisdiction.

"I doubt we will ever get to a position where all 50 states have captives laws," says Koritzinsky. "For example, California and Texas have a bias against captives.

"It's a question of control," he explains. "Regulators often have a hard time keeping their hands off of business."