

Your Domicile Defines Your Captive (What to Look for in a Captive Domicile)

by Thomas P. Stokes

Domicile is arguably the most important factor in the creation or relocation of your captive insurance company. It would not even be going too far to say that the domicile you choose could spell its ultimate success or failure. While so many other considerations are critical to your captive program and its contribution to your risk management efforts, none is as strategic as finding the right domicile partner.

The proliferation of domiciles in the United States and around the world can make the evaluation process a daunting one. Growing competition among new and existing domiciles opens up lots of possibilities for captive programs, but can also cause headaches down the road. With a systematic approach, a little leg work and some input from knowledgeable industry veterans, you can make your choice with confidence. Consider these fundamental factors when searching for the perfect domicile for your captive.

Healthy Competition

Competition is a wonderful thing because it leads to cost reduction, more efficient utilization of available resources, and new and better ideas. Of course, there are winners and losers in any competition. With more than 5,200 captive programs throughout the world, competition for your business has resulted in many new domiciles seemingly springing up overnight. Not all domiciles are created equal, and a close look at the regulatory structure of your potential domicile choices is critical.

Regulatory Balance

Domiciles strive to strike a balance between allowing captive owners the freedom to operate as needed and imposing appropriate regulatory oversight. The very nature of captives requires them to be flexible enough to provide for the needs of their owners when conventional means are unavailable or too expensive. Proper oversight must be imposed to allow the necessary freedoms without permitting structural breakdowns that could tarnish the domicile's reputation.

Many domiciles have, over time, developed reputations for achieving this balance. However, balance means different things in different situations and industries. Just because a domicile has a great reputation does not necessarily make it appropriate for every captive. For example, it may not make sense for a U.S.-based company to locate its captive in a domicile halfway around the world unless there are specific reasons for doing so.

Operating Flexibility

With the proliferation of captives, there comes an increasing degree of complexity. To meet these evolving needs, some domiciles highlight their flexibility. One example of a domicile's flexibility is in its available choices for legal structure. A wide variety of options can move a domicile to the top of the list. Many limited liability companies (LLC's) and Sub-Chapter S Corporations need the flexibility to mirror the structure of their captives with their own. This is especially critical for the evolving middle market company sector that often operates in a variety of legal formats.

Captives may also require flexibility in other areas. Domiciles vary in the accounting methods they allow. Some offer captives a choice of calendar or fiscal year-ends to facilitate consolidation with affiliates or comply with local or international accounting and reporting standards. These choices can help your captive minimize frictional costs.

Legislative Environment

It is vitally important to research potential domicile choices to learn whether they exist in an atmosphere of constant refinement. Look at legislative agendas to determine whether captive issues are not only raised, but acted upon. Domiciles that continually update their captive statutes to keep them current with developing insurance and other related issues illustrate commitment to their captive base. A domicile's years of experience can help you decide where to locate your captive, but just because a domicile has been around for a while does not mean it necessarily has a captive-friendly environment. Look for dedication and responsiveness, as evidenced by positive legislative activity.

Regulatory Environment

While legislative dedication and responsiveness are important, a domicile's regulators and how they interact with captives give clues to a domicile's true value. Knowledge, experience and dedication to the captive industry are key factors to look for when evaluating a domicile. Meet with prospective regulators to best learn how they and their domiciles may accommodate your needs, now and in the future.

Look for full-time domicile regulators whose total responsibility is the health, vitality and growth of captives. Some domiciles allocate staff with other duties to tend to captive issues on an as-needed basis. Developing key long lasting relationships may be difficult. Suitable domiciles should have legislators who fund a robust annual budget that allocates sufficient resources to pay captive-only regulators, meet the needs of the domicile's captives and provide balanced oversight.

Committed captive regulators should participate in outreach opportunities to prospective and existing captive owners through participation in industry events and educational opportunities that demonstrate the domicile's dedication and commitment.

Costs

In order to strike the right balance of operating costs with other competitive factors, you should compare differing capital requirements, surplus standards and other variable costs such as taxes, fees and assessments.

Choosing a domicile solely on the basis of lowest cost of operation can backfire quickly. When presenting arguments to decision-makers about your choice of domicile, it is far better to argue for the non-cost issues up front to avoid problems in the future. Make sure you stress the importance of meeting your captive's long term needs, versus pocketing a few dollars in the short term.

Other practical cost factors to consider include:

- Distance of the domicile from parent company management. Travel costs and lost productivity can mount quickly.
- Annual meeting requirements, especially where a domicile requires a representative from the captive to physically appear at least annually.
- Applicability of certain taxes, such as the federal excise tax imposed on offshore captives.

So Add it All Up

When searching for the right captive domicile fit, keep these key factors in mind:

Regulatory balance. Weigh the freedoms of operation with solid regulatory framework and balanced oversight.

Operating flexibility. Talk with captive owners, attend captive conferences and contact experienced captive professionals for feedback to ensure that your prospective domicile can meet your demands for flexibility.

Legislative environment. Look at the domicile's history of statutory changes and improvements, which are important indicators of legislative support.

Regulatory environment. Meet with regulators to measure their enthusiasm for their domicile. Ask for examples demonstrating how they have worked with owners in various situations. An economical way to accomplish this is to attend captive venues where many domiciles actively participate in events.

Cost. While operating cost considerations are certainly important, make sure to weigh all other factors before coming to a conclusion.

Make the Right Choice

Competition among new and developing domiciles gives you a wide variety of choices when creating or redomiciling your captive. When you fully understand all that prospective domiciles have to offer, you can make a better informed decision about where to locate and maintain your captive. Carefully examine prospective domiciles and weigh their advantages and disadvantages to find one that best meshes with your goals and puts your captive firmly on the road to success.

There is a lot of information out there. Consider partnering with an experienced, independent captive insurance consultant to help you choose the best-fit captive domicile and maintain an operating strategy that ensures both initial and continued success.

Tom Stokes is Managing Principal of The Towner Management Group (NY) LLC and Consulting Practice Leader for TMG. A veteran of more than two decades in the captive and insurance industries, Tom previously held thought leadership positions with the world's largest public accounting firms and captive consultants and managers, including KPMG, PwC, Aon and Willis.

To learn more, contact Tom at (718) 618-4439 or tom.stokes@townermanagement.com. Towner Management is an independent, full-service captive insurance and international business entity management company with a multi-domicile reach, dedicated to providing its clients with alternative risk solutions to meet their diverse needs.