Are Onshore Captive Domiciles Gaining an Edge?

With additional captive domiciles entering the picture, more U.S.-based captives are starting to choose onshore domiciles more often.

When a captive insurance company is in the formation process there are many domicile options it can choose from. In the early history of captives, domiciles were few in number and were primarily offshore, but in the last fifteen years more and more U.S. states have passed captive legislation giving captives the opportunity to choose domiciles closer to home. As the captive insurance sector continues to grow, the expansion of captive domiciles gives new and established captives more choices in which to license their company.

Brief Background

An onshore captive domicile is a U.S. state has passed laws allowing for captive formation. Similarly in Europe, onshore domiciles are those that fall under the jurisdiction of the European Union. Offshore domiciles are usually territorial islands or small countries. Beginning with Bermuda in the 1960s as the original offshore domicile, many islands in the Atlantic also became domiciles including The Cayman Islands, The Bahamas, Barbados, Anguilla, and the British Virgin Islands. Other island domiciles include Gibraltar, Guernsey, Malta, and Singapore. There are also nations that operate as captive insurers such as the Qatar Financial Centre.

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In the United States, Vermont is the primary onshore domicile. The state was an early adopter of captive laws and is ranked along with Bermuda and The Cayman Islands as the top domiciles in the world. Other states that adopted captive law early, beginning in the late 1980s, were Colorado, Hawaii and Kentucky, but the total number of captive domicile states remained low. Since 2000, more than twenty states have adopted captive law or revised existing captive law, bringing the number of onshore captive domiciles to around 35, in order to get a piece of the expanding captive pie.

**Onshore vs. Offshore**

The original captive companies were domiciled in Bermuda. Following their successful operations, other territories began welcoming captive insurance companies. Originally offshore domiciles offered flexible regulation for the nascent captive insurance industry. Flexible regulations were important thirty to forty years ago when managers were still working out the logistics of running captives, as it gave them the wiggle room to discover the best ways to run their businesses.

One of the primary reasons offshore domiciles are still attractive is that they often are still more flexible with their regulations and still have lower capital requirements and still have lower or no taxes on premium. There are also some specific third-party risks that are more sensibly insured offshore. Another added benefit is that offshore captives have been regulating captives far longer than most U.S.-based state domiciles and have the infrastructure to support their needs.

Yet, now that the captive industry is well-established, many of the original benefits that offshore domiciles offered have been reduced. In recent years, as both captives and onshore domiciles have become more reputable and sophisticated in their operations, the reasons for captives domiciling offshore have greatly diminished. With the advent of more states adopting captive law, regulators have had to become more educated, knowledgeable, and savvy in the regulation of captives. The states that are dedicated to bringing captive business to their region are keeping their captive laws up-to-date to meet the conditions required by new captives while continuing to regulate them responsibly.

When considering an onshore domicile versus offshore, there is generally more transparency in U.S.-based domiciles regulation and oversight. More transparency in captive transactions enhances the perception of the legitimacy of captives in the financial sector. While captive industry detractors may not be satisfied, the transparency required by onshore domiciles goes a long way to improve the industry’s reputation.

The expanded onshore domicile market has improved market competitiveness which has helped to make U.S. domiciles more economical than offshore domiciles. In addition to costs, domiciling onshore can also be more convenient. Domiciling closer to a company’s main offices is more expedient and cost-effective than dealing with overseas regulators. According to Thomas P. Stokes, practice leader for JLT Insurance Management US – a captive management company that operates in both the United States and in several offshore domiciles, “Most new captives, with U.S. parents, choose the U.S. domiciles for simplicity and economy of operating costs.”

Michael Corbett, the captive director for the Tennessee Department of Commerce and Insurance, agrees, “It would be a guess, but given the activity in various onshore domicile of the past three years, I would say there is definite choice to house captives onshore.”

Offshore domiciles are still attractive to captives, but the advantages they had are reduced as domiciling onshore is usually less expensive. With more states introducing captive law, captives now have better access to more localized regulation and oversight.

According to Corbett, “Choice is not a factor if the product does not suit the need. From my vantage point, the regulation onshore meets the need of the owner.”

**Redomiciling from Offshore to Onshore**

Many states that have adopted captive law in recent years have done so with the intention of luring offshore domiciles to redomicile onshore. As captives become established they will sometimes reorganize to a different domicile that is more favorable to their current state of business. States such as Texas, which has a number of Fortune 500 companies, passed captive law purposely to try to bring the captive insurance companies of large corporation into the state.

However, there has been little movement towards redomiciling from offshore to onshore. According Marsh Risk Management Research division’s annual report on captive from May 2014, “The Evolution of Captives: 50 Years Later,” only eleven out of the 1,148 captives analyzed for the study chose to redomicile in 2013. The study stated that the results did not indicate that redomiciling would become a trend soon.

Yet, many onshore captive managers are seeing more interest in redomiciling from offshore captives. Stokes said that it isn’t “officially a trend yet, but we have seen [some] captives redomiciled to the U.S., and we have performed analyses for offshore entities considering redomiciling.”

“We’ve seen our share,” said Corbett. “Bermuda and Cayman have both seen movement to Tennessee. We are also seeing many captives that were formerly offshore in Turks and Caicos, Anguilla and others that are... redomicesticating back to Tennessee.”
The outlook for U.S.-based domiciles is becoming brighter. New domiciles entering the market have to be competitive in what they can offer captives – both new and established. This in turn encourages established captive domiciles to tweak and improve their own laws in order to stay ahead of the competition. Captive insurance companies now have a much broader selection to choose from and the ability to pick the domicile that can best serve their individual needs.

According to Corbett, “The decision to domicile onshore seems simple to me. Twenty years ago, there were few viable onshore choices and the expertise was dominated by offshore locations. Today, that is no longer true. Onshore locations like Tennessee with a business friendly environment and an active effort to “regulate to yes,” make the desire to house a captive offshore less attractive. While the offshore locations still offer a great place to have a board meeting once a year, the cost of being away from the office can no longer be ignored.”

While some captive critics say that all these new captive domiciles mean that there is a “race to the bottom” in regulation, captive regulators understand better than anybody how important it is that captives be perceived as legitimate insurance alternatives. Captive oversight will remain robust, and perhaps become even more transparent as state and the National Association of Insurance Commissioners work to develop national guidelines for captive regulation.

In addition, Solvency II will be fully implemented at the beginning of 2016. Solvency II is a directive by the European Union that will standardize insurance regulation among its members, primarily in the form of capital requirements related to solvency issues. The requirements that go into effect next year will likely see Europe-based captives redomicile onshore in Europe. Bermuda, the leading captive domicile in terms of numbers, is looking to align its captive capital and solvency rules with those of the European Union in order to remain an attractive domicile for its European captives. “[This] could, if fully implemented, provide an edge to U.S. domiciles at some point in the future,” said Stokes.

U.S captive domiciles will continue to be separate entities with a wider variation of regulatory requirements and oversight that will allow onshore companies more flexibility in choosing the right domicile for their captives.

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