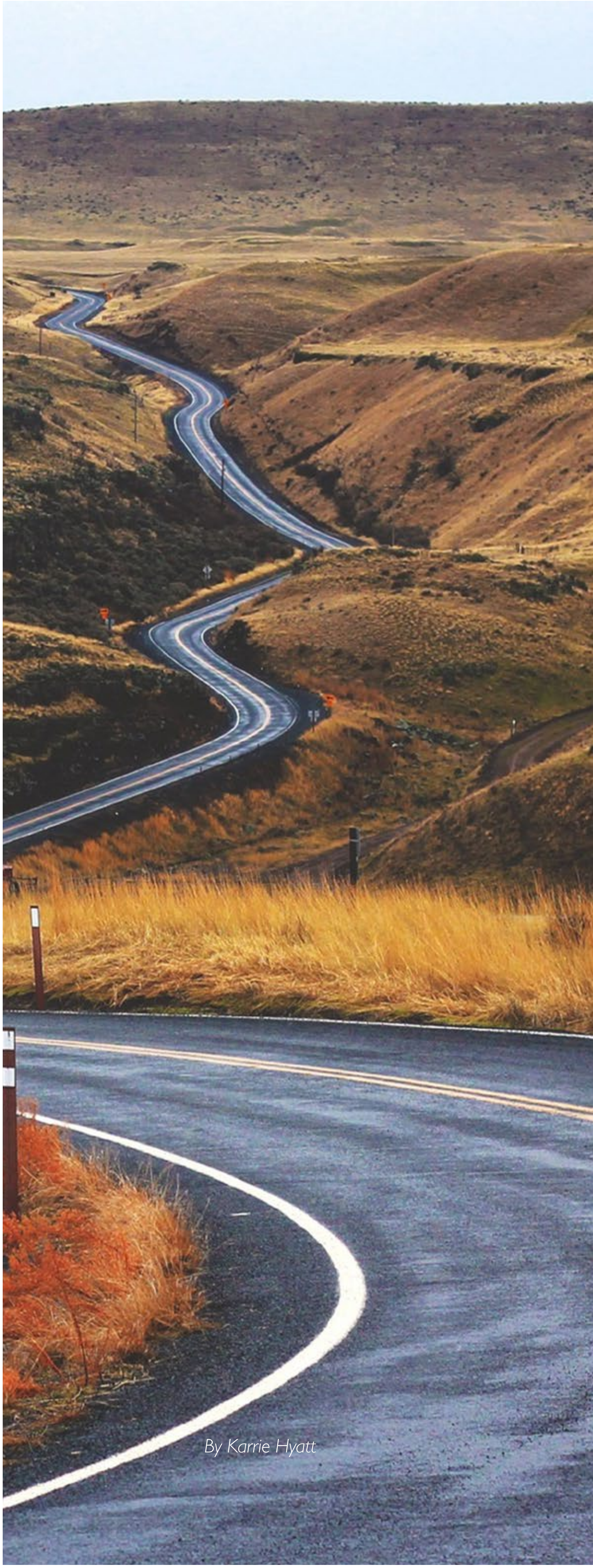

UPS and DOWNS for the Captive Sector in 2016

By Karrie Hyatt

2016 did not see many changes in the United States captive sector. Other than the IRS's continued offensive against captives using the 831(b) tax designation, there was very little federal involvement with the captive sector. More dynamic were developments in captive domiciles, with five states updating their captive laws and several newer domiciles staking a strong claim for themselves. Captive numbers were varied across the board with some established domiciles seeing a decline and other domiciles seeing exponential growth. Now several months into 2017, several domiciles have already instigated updates to their captive laws while several domiciles are forecasting a good year for captive formations.

Captive Law Updates

Five captive domiciles updated their captive laws in 2016. In Vermont, updating the captive law has become an annual event. In April 2016, Governor Pete Shumlin signed new legislation that amended Vermont's 20-year-old captive law. Changes included refining governance standards, expanding dormancy, and allowing for cells to be transferred, sold, assigned or converted to stand alone captives without affecting the rights or obligations of the cell.

Tennessee also updated its captive law in 2016. Tennessee is one of the oldest U.S. captive domiciles with captive law originally signed in 1978. However, after the 1980s the state was not promoted as a captive domicile until the law was amended in 2011 and the Tennessee Captive Insurance Association was formed to support the domicile. Since 2011, Tennessee has updated the law regularly. The 2016 update allows for a more efficient transition for redomesticating captives and offers an incentive, in the form of tax relief, for offshore captives choosing to redomicile to the state. Other changes include strengthening protections for cell company assets, self-procurement tax forgiveness, and the setting of March 15 as the due date for annual reports and premium tax payments.

Georgia was an early player in the captive arena, signing its original law in 1989, but after the insurance market fell in the late 1990s, did not pursue captives until they updated their law in 2015. Last year, the state once again updated the law to reflect current trends in the captive arena. Changes in 2016 included clarifying the coverage pure captives are authorized to write, removing the requirement that captive management companies be home-based in Georgia, clarifying that letters of credit can be used to capitalize pure captives, with the addition of several minor tweaks to make the law more user-friendly.

One of the newest domiciles, North Carolina, came into the market with a strong captive law and has updated it twice since it was originally passed in 2013. 2016's update was included in a broader insurance bill for the North Carolina insurance department that included 44 items, five of which apply to captive insurance companies.

The changes made to the captive law removes the requirement that captives hold an annual board meeting if it uses at least two North Carolina service providers; updates rules for redomestication; allows for provisional approval for up to 90 days; allows the insurance commissioner to grant extensions to captives to file annual reports; and allows the commissioner the discretion to deviate from capital and surplus requirements for protected cells.

Last year, Alabama updated its captive law for the first time since it was enacted in 2006. Alabama has proven to be a quiet but resilient captive domicile with 61 captives domiciled at the end of 2016. The amendments to the law offer two premium tax incentives to domiciling captives in the state.

The first change allows for a $100,000 cap on annual premium tax. The second offers newly formed captives a one-year exemption from premium taxes. As the number of captives in the state rose from 42 at the end of 2015, the changes seemed to have spurred some growth for the domicile.

More legislative changes are on the horizon for 2017. The Vermont, Tennessee, and Texas legislatures all introduced new captive legislation in January.

Utah and Oklahoma are also looking to update their law this year.

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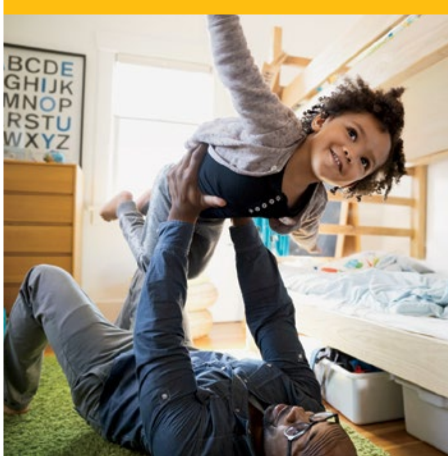

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Captive Domiciles By the Numbers

Most domiciles saw fewer captive formations in 2016 as compared to 2015, but there were a few notable exceptions from some of the newest domiciles.

North Carolina doubled the number of captives, and cell captives, domiciled in the state to reach 550 risk-bearing entities—190 captives and 363 cell or series captives. In August, the domicile celebrated the licensing of its 100th pure captive and by the end of the year had reach 150 pure captives domiciled. The domicile has only been licensing domiciles since 2014 and is on a trajectory to match the numbers of some of the most well-established captive domiciles.

Texas and Ohio both saw an increase in formations. Texas's captive law was enacted in 2013 and has grown by about ten captives each year, until 2016, when the domicile saw 14 captives licensed in the state. Three captives also withdrew their license which left the domicile with 32 active captives at year-end. Ohio, which enacted captive law in the middle of 2014, saw an increase of ten captives last year, bringing the total number of captives to 14. The domicile is optimistic about 2017, foreseeing continued growth.

"Ohio's reputation for common sense regulation continues to draw interest from businesses working to fulfill insurance needs," said Lt. Governor Mary Taylor, also Ohio Department of Insurance director. *"The number of captives more than doubled in 2016 and we expect to maintain that growth trajectory this year."*

Another one of the newer domiciles, Oklahoma—which originally passed captive law in 2004 but didn't begin recruiting captives until after the legislation was amended in 2013—gained seventeen captives in 2016, but 15 withdrew, leaving the total number of captives for the domicile at 75. According to James A. Mills, director of Captive Insurance with the Oklahoma Insurance Department. "The past year was very uncertain across the board, and we hope that [2017] brings stability to the financial markets and clarity to IRS treatments of captives that lends to a successful year for all."

Nevada had a similar experience to Oklahoma, with 30 captives formed and 23 withdrawing. The number was down from 2015. Robert Gallegos, with the Captive Program of the Nevada Division of Insurance, said, "I can tell you that the Division closed the year with a small-captive formation level equal to that of 2013-2014 (2015 was an exceptional year) and that closures were 60% or more higher than 2013-2015." The domicile had 205 captives at the end of 2016 and it's not optimistic about captive growth for the upcoming year.

According Gallegos, *"Given the impact of IRS changes to the 831(b) tax code, and in consideration of certain internal adjustments, we have forecast fewer formations for 2017. We are in 'renewal season' now, and serving the fiscal and reporting needs of our base is of primary concern."*

Utah continues to see strong growth, with 68 captives and 13 cell captives formed last year for a total of 81 new risk-bearing entities. South Carolina saw 17 new captives which was down by 13 from the previous year.

Tennessee continues to see solid growth with the addition of 37 new captives and an additional 67 cell captives for a total of 104 for the year. In total the state has 159 captives and 379 protected cells for a total 538 risk-bearing entities. The domicile's amended captive legislation, which makes redomestication to the state attractive, seems to be working. In a statement from the Tennessee Department of Captive Insurance, Director Michael Corbett said, "The redomestication of nine captive insurance companies to our state shows that more and more leaders in this industry are comfortable setting up their captives here. We especially appreciate the efforts of the Tennessee Captive Insurance Association (TCIA) in helping to make this growth happen."

Continuing its strong growth, Delaware added 164 captives, series, and cells. The domicile has created a niche for itself in developing series captives with 80 formed in 2016. However, the domicile also licensed 77 pure captives, two special purpose captives, three special purpose financial captives, and two cell captives.

Captive juggernaut Vermont, saw 26 new captives in 2016. Steady has always been Vermont's approach to growing their captive industry. According to a statement from David Provost, Vermont's Deputy Commissioner of Captive Insurance, "The quality of Vermont's 2016 licensees was outstanding. Vermont's focus will always be licensing quality companies and regulating them in an appropriate manner commensurate with their risk." Of the 26 new captives there were 15 pure captives, five risk retention groups, three special purpose financial insurers, one sponsore d captive, one industrial insured captive, and one association captive. Vermont had 584 active captives at the end of 2016. ■

Karrie Hyatt is a freelance writer who has been involved in the captive industry for more than ten years. More information about her work can be found at: www.karriehyatt.com.