Hello. I’m Lee McDonald with the A.M. Best Company and welcome to our webcast, State of the Insurance Domiciles. We have an interesting topic and some fascinating guests, so we’ll get to it shortly. This webcast is sponsored by the New Hampshire division of economic development. For more information about them here’s a website which is: www.nheconomy.com and I’ll give you a contact, Michael Bergeron. He’s with the New Hampshire division of economic development and his e-mail is mbergeron@dred.state.nh. So what we’re going to talk about now is domiciles, including nations and U.S. states. They’re positioning themselves to host insurance activity. We’ll also talk about why some insurers including brokers, carriers and captives have either moved among or set up operations in particular domiciles. We have four guests on the program today, three in the studio and one on the phone. We have Nancy Gray of Aon Insurance Services, William White of Prism Strategies, Howard Mills of Deloitte and Joel Chansky of Milliman. We also have Meg Green from A.M. Best joining us.

I’m going to ask the participants to talk for a second...
about who they are and a little bit about their organization. Nancy, why don't we start with you?

GRAY: Thank you, Lee. I'm been involved with the captive insurance industry for about 20 years now, 13 with Aon Insurance Managers. Currently I'm regional managing director of the Americas, which means that I'm responsible for the various North American captive domiciles as well as Bermuda, Cayman and the Caribbean. Aon Insurance Managers manage over 1,300 captives on a global basis. We have 32 captive domiciles. We are the world's largest captive manager. Our captive clients tend to be a very diverse group—all different vehicles from very small captives writing maybe less than $1 million in premiums to some very large entities writing over $100 million in premiums on an annual basis.

MC DONALD: William P. White has an interesting background both in regulation and on the other side. Mr. White, welcome.

WHITE: Thank you, Lee. I've been in the industry for a little more than 30 years, primarily as an insurance and reinsurance underwriter and I've held positions both with Gen Re and Munich Re over those years, along with being a consultant with Milliman and Robertson. I ran a practice there for about five years. Most of my work over the past few years has been with the alternative risk transfer segment of the insurance industry. A few years ago I started a small firm, Prism Strategies, LLC, to do consulting work, working with businesses and governments in the alternative risk transfer area for those that were participating in developing captives and looking at alternative risk transactions. I was the original director for the Washington, D.C. domicile and began that captive domicile, grew it to its original set of about 50 captives. And most recently I was the director for captives in Delaware. We took that domicile from an original five captives that had been there for about 24 years and in a two-to-three year period we got them up to about 42 captives. So both of those states now have a good base for captive activity and I'm very pleased with that.

MC DONALD: Great. Thank you. And, Howard Mills, you almost have a similar story. You've got a foot in regulation and a current career in the private practice. Welcome. Fill us in on some of your activities there.

MILLS: I've been with Deloitte for three years. I'm a director in our U.S. insurance group and I work with all of our large U.S. and global insurance clients. Prior to coming to Deloitte I was the superintendent at the New York State Insurance Department. And prior to that — I'll mention this because I think it's very relevant to our discussion today — I was a state legislator in Albany. And as a state legislator I sat in on the insurance committee, of course, writing the laws, governing the insurance industry in New York State. So I was exposed to captives in that capacity and — I'm sure we'll get into this in greater detail — but by way of introduction I'll say that when I became superintendent, one of the issues that I really tried to push was a reform of the captive laws in New York State because I thought that New York State could have done quite a bit to make itself more competitive. Unfortunately I failed in convincing my former colleagues in the state legislature. My ideas fell victim to the Albany dysfunction and gridlock, so we weren't able to push those reforms through. So I've seen the issue of captive insurance companies and the competitiveness of a domicile from both the legislative angle and the regulatory angle and now, of course, at Deloitte, serving our clients from the industry angle.

MC DONALD: And finally, we have Joel Chansky. Joel is with Milliman. Could you fill us in about yourself and your organization?

CHANSKY: I'm a property and casualty actuary with Milliman. I've been in the property/casualty insurance field for nearly 30 years. I worked at a primary company for a couple of years, then a reinsurance company for about five years doing actuarial work and investment work and I've been with Milliman for over 20 years. At Milliman in the property/casualty area we work not only with captives, risk retention groups, self-insurers and the alternatives market, but we also do quite a bit with traditional insurers. Although the practice that I work on in the Boston office focuses heavily on alternative markets. Our geographic proximity to Vermont led us there and now we do quite a bit of work there as well as Bermuda. As a segue into our topic today, with the proliferation of all these new domiciles we've been working in a lot of other places that we never would have anticipated 20 years ago.

MC DONALD: And, I'd like to introduce Meg Green. Meg is an editor with BestWeek and she just finished a package that we have in this week's editions, all of our editions, U.S./Canada, Europe and Asia/Pacific. Basically, we'll start with you, Meg, and then we're going to draw Howard into this very early. The premise here is that we're seeing a pickup in competition. Domiciles have become to the insurance industry. They would like to have activity situated there. What are we seeing at this point as far as activity and what seems to be driving it?

GREEN: States really like to get into the captive domicile business. It's a good source of revenue for a lot of them and it brings in good employment and it's good, clean employment, there's no pollution risk or anything like that. A number of states enjoy the revenue, the premium tax that comes in. If you look back in 2007, the then governor of Vermont, Jim Douglas, said the captive premium tax brought in just about as much revenue as the state lottery system. So, I think that got a lot of people's attention as far as starting a regulatory structure.

MC DONALD: I want to broaden it a little more. We're talking about more than captives here. We'll be talking about carriers too. In fact, one of the recent headlines was Willis announcing they're going from Bermuda to Dublin. In general, is that playing out on a worldwide stage?

GREEN: It is. A number of companies are redomiciling around the world as they're looking for perhaps a better tax structure, but also they're looking at regulation. Ireland is very popular right now because it's part of the European Union and setting up shop there gives you access to all of Europe.
MCDONALD: OK. Howard, you have the regulator view and so has Bill White. We’re seeing an appetite for insurance. What are the domiciles looking for and what’s driving the activity here that you can see?

MILLS: Well, I agree a lot with what Meg said. It’s a great industry to recruit and from a position of the domicile, and now we’re talking of course about the elected leaders, the political class it’s brargoing rights. It’s something to be able to say, look, we created jobs, we recruited jobs, we brought jobs into our state and when a company decides to redomesticate and leave, of course that becomes a major black mark upon an administration or a governor. You don’t want to see jobs leaving your domicile, your state, your jurisdiction and going somewhere else. So, and I think especially in this environment - in the last year and a half what we’ve seen especially in the financial services industry, the ability to become competitive to bring more financial services industry jobs into your state because they are good jobs. They’re good paying jobs. They’re “clean” jobs, as you say. They’re no impact other than a positive impact. It’s just a very attractive thing from the point of view of the jurisdiction in trying to make themselves competitive and if they get that movement coming in, it’s a very good story and gives them a lot of good credit with the voters.

MCDONALD: Nancy, going back five, 10 years or longer, is this a new environment?

GRAY: It’s absolutely a new environment I would say in the last 10 years. We really have seen an expansion in the number of captive domiciles, especially in the U.S. It’s not just in the U.S.; we’re seeing it on a global basis as well but certainly in the U.S. We have close to 30 states now looking to compete for this captive insurance company business. Going back into the ’90s if you were a U.S. corporation you had basically three captive domiciles to select from–Bermuda, Cayman or Vermont. And so now with 30 states now trying to compete for that business it’s a different market place.

MCDONALD: Again, I want to hold off on captives just a minute here. Let’s stick to carriers at this point. In addition to Willis’ move, which I thought was fairly unusual for a large broker we did see some large carriers move internationally – a bunch out of the U.K., some across continents, things like that. Are we seeing any trends emerging? What are they citing as their reasons?

GRAY: They’re actually not saying all that much. A couple of year ago you saw a number of companies going to Bermuda. And now it seems that some are seeking other locations. A number of U.K. companies are moving out of that region.

MCDONALD: Is taxation a major issue here?

MILLS: I don’t think there’s any real mystery. These companies have a fiduciary responsibility to shareholders if they’re a public company to do what’s right for the company and I think it’s purely a matter of competition, of looking for competitive, favorable tax structures, for a regulatory regime that’s beneficial. I don’t necessarily mean a lesser of a regulatory regime. You know in a lot of these instances these companies are not necessarily looking for the softer regulatory regime, they’re looking for a better regulatory regime. The level of professionalism and the complexity that the regulatory regime is able to deal with, with regard to their company, is an attractive thing. Obviously they don’t want the toughest regulation in that it constricts their ability to operate, but they’re looking for a regulatory environment that’s favorable. I do think at the end of the day it all comes down to dollars and cents and the tax structure and their ability to be competitive is the major driver.

MCDONALD: Bill, I’ve heard you mention that as well.

WHITE: Yes. There are a couple of things going on here. First of all there are some concerns about the fallout from what has been a very terrible situation with credit capital within the financial markets. And I think most businesses are seeing a situation where they’re sort of getting a feel from various regulatory authorities about what their concerns might be. There’s a tendency when something this dramatic happens to err too far on one side or the other. My opinion of regulation has always been - and this is to your point about not necessarily looking for the softer thing – it’s clarity and consistency that businesses are looking for. And when you get a situation where it becomes apparent that the regulatory domicile that you’re in is not as clear about what they’re going to do or they’re not consistent in their treatment of businesses or you have some reason to believe they may not be, then that’s going to create the situation where you move.

MILLS: Lee, you mentioned some rather dramatic redomestications and leaving the United States. The problem that the United States has right now is we’re in the midst of a regulatory reform movement. We don’t know quite how it’s going to shake out. I think we have to let the healthcare issue be settled before they focus on the regulatory system. I would venture a prediction that the state regulatory system is not going to go away and there’ll be some new layer of a federal involvement through an office of national insurance, whatever we finally get. The world has for a long time looked at the U.S. system of regulating insurance as a very confusing, overlapping and multi-jurisdictional place, so moving out of the U.S. shouldn’t be all that surprising. For some of these global concerns, as Bill pointed out, they’re looking for consistency and going to an outside jurisdiction may offer them that.

MCDONALD: If we stick with the non-captive insurers for one last question, some of the things that drive other businesses than insurance are business climate, litigation, things like that. Does that affect the insurance industry? I’ve seen some recent stories... states attorney generals suing in-state insurers. Things like that where at a certain point an insurer might say, I don’t know, maybe I should be here. Does that come up at all? I’m not saying litigation, but business climate.

MILLS: I certainly think so. Elliot Spitzer had a huge impact on the industry. He’s changed the political tenure in that. A very successful model was established, despite what happened to him once he got into his tenure—that
an attorney general can, by being tough on industry, really get great political credibility. And that is a very big concern. We’ve seen it in Connecticut; we’ve seen it in other states. . . . very aggressive attorneys general are an issue now. That’s not to say that everything that the attorneys general are doing is wrong. And what I try to do as a regulator, Bill, and I’m sure you can relate to this, is you have to regulate to protect your consumer. You have to regulate to keep the industry honest, but you also, to be a good regulator has to regulate in such a way that you maintain a favorable environment for the conduct of business, or else you won’t have anyone to regulate.

MCDONALD: Joel, I’d like to bring you in at this point and let’s start talking about captives. Which is the most portable and active of the new domicile locations? A couple of years ago we only less than a handful of viable captive destinations. Now we are more into the dozens certainly. What is the impact of that and is that a trend that is going to go even further?

CHANSKY: The impact has been a dispersion of captives really throughout the country. We’ve seen over the last five to seven years as Nancy correctly mentioned. There were only two or three U.S. domiciles of any consequence and now we can count close to 10 that are viable and I believe there are over 30 that actually have laws. So the consequences are there are a tremendous amount of choices. It puts people like Nancy in an interesting position, trying to navigate through all those choices for their clients and customers, trying to decide what is the best match. Do I see that continuing? I’d actually be surprised if states continue to try to come in. I feel like we’re almost at a saturation point. Not to say that another state won’t put a captive on the books tomorrow, but I think there are plenty of choices and if we look at the number of captives in some of these domiciles that have passed laws, there are several that have none or one or two. There really isn’t any lifeblood to those states to grow that situation or change it at all.

MCDONALD: Nancy, to follow up on Joel’s point, how do you play the matchmaker game? You have a client that’s considering a captive and now you need to put them somewhere. How does that work?

GRAY: From our standpoint, it’s very important to understand what’s motivating the client. What factors do they consider in the domicile selection process? Among the three major factors that we see many of our captive clients focused on is cost. Cost is always an important component of decision. There’s also geographic preference, as well as the stability of the regulatory environment. That’s very important. A lot of our clients want to make sure that they have that stability if they’re going to license a captive insurance company in that state. Some clients are weighted more heavily toward cost or geographic preference as well as the stability of the regulatory environment. That’s very important. A lot of our clients want to make sure that they have that stability if they’re going to license a captive insurance company and in that state. So we have that discussion with our clients to try to determine what is the best domicile based on their decision points.

MCDONALD: By geographic preference are you talking about they’d like to be close to where they are, or it’s just a great location, or . . .

GRAY: Certainly. If you’re a West Coast company it might make more sense for you to select a West Coast domicile. Or for that matter Hawaii is selected by many captive clients. The Asian market selects Hawaii as a captive domicile. So we tend to see there’s a preference because one of the requirements is that you have to have an annual meeting in that chosen domicile. It becomes much easier for them to travel to a domicile that’s geographically closer to their company.

MILLS: Something that Nancy just said reminded me of one of my major frustrations back to when I was superintendent trying to change our captive laws in New York. There are a number of public sector entities in the state of New York, the MTA, for example, that formed captives and went to a domicile other than the state of New York because New York hadn’t updated its laws, so they found a more favorable domicile. The MTA, I believe, is in Washington, D.C. I used to say how crazy is this? You have a public entity that is paid for by the taxpayers and here they have this opportunity to create a captive and set up jobs and create economic activity and they’re shipping it out of state because the legislature hasn’t updated its captive laws. In the public sector it can get really crazy because, obviously, if it were at all competitive, Nancy, I’m sure the MTA would have come to you and said we really need to be in New York. And you’d say, you know what? You can’t be in New York and here’s why. It’s crazy.

GRAY: New York is a good captive domicile; however, it’s not a significant industry for them so they haven’t focused really on the legislative aspects of updating their captive law. It is out of date. Originally when it was passed it mirrored Vermont in many ways in terms of the captive laws but some of the other domiciles have come along and progressed their captive law to make sure it’s keeping up with the business needs of the captives owners. Some states have had more difficulty. But, again, Vermont has the reputation. It’s been around for close to 30 years now, so it has built up the infrastructure and the legislative support and it’s meaningful in terms of economic dollars to the state.

MCDONALD: OK. Bill, you’re sort of the “Johnny Appleseed” of the captive world. You’ve helped two domiciles get going – Washington, D.C. and Delaware. How far is this going and do you see more captive activity on the way from states and non-U.S. domiciles that don’t host captives. Is there still an opportunity to get established and make it work their while?

WHITE: I think the point was made by someone earlier that we may have reached a saturation point in terms of availability. Choice is always good in terms of having as much of a selection as possible. But what’s even more important is the point that you just brought up, about what the regulation really looks like and how in sync it is with
business needs. That is a key element in terms of developing any kind of regulatory domicile. And I think that for most of the states here in the U.S., the domestic domiciles, they've done exactly what you've said. Everyone just took Vermont's captive law, copied it or maybe tweaked here or there to fit their particular situation or they particular needs, depending on which element of their state actually pushed for getting something done in terms of captive domicile. You have to look at both sides of this. There's the business side of it and then there's the government side of it. The regulatory authorities, depending on whether they're elected or they're appointed, are looking for a way to put a good face on economic development and that's at the heart of all these regulatory domiciles when you're talking about captive legislation. So, to the extent that their interests are aligned with business to do that, it can either be a very narrow definition of what's expected from that captive domicile or it can be a much broader one, depending on, again, who on the business side has brought this to the table. So, I think in the current atmosphere we're probably not going to see a lot of new captive domiciles coming on stream, but I would expect that we'll see a lot more work being done on the regulatory aspects of it, to try to get it in tune with what's a new reality in the financial markets.

GRAY: One thing that's very important to recognize is that a risk manager is sophisticated and a captive owner is a sophisticated insurance buyer and they really should not be regulated like a traditional insurance company. And that's part of a regulatory environment that the captives or the various captive domiciles need to remember when they're regulating captive insurance companies.

WHITE: That's a very good point. One of the things that has been a drag on the development of these domiciles, is that while there's a captive statute sitting there, the actually implementation of the regulations is really based on how have we been regulating the traditional insurance companies within that domicile. In some instances I think it's fair to say that you'll see states that have captive laws where they put the window dressing there, to say, we're easy to reach, we're doing all these things, we have this infrastructure, we can do all of this stuff. But, at the same time, when you start to work within their process, their regulatory strategy is really based on looking at captives as though they're some subset and not a particularly different piece of their regulatory work and there's no real difference that actually exists between a captive company and a traditional insurance company. And underlying this, of course, is this whole idea of self-insuring and risk retention – which is not as clearly understood by most insurance regulators as it should be.

MILLS: And it may be the case that some of the economic upheaval and the economic difficulty that the states are seeing may also become a factor as the industry again looks for that stable regulatory regime, the expertise. We may have some turnover and a reshuffling of the sense of favorability.

MCDONALD: Joel, I'd like to bring you into the conversation here. Bill mentioned a minute ago that the way states entered the captive arena was by sort of cloning Vermont's law. How much diversity is there in captive law these days? Is what we've just described a common practice or are you seeing states and non-U.S. domiciles following seriously divergent captive laws and regulatory structure.

CHANSKY: Some of the diversity we're seeing is actually in the tax rates. One way for a domicile to differentiate itself from Vermont or any other domicile is to establish a different premium tax structure or to have no premium tax at all. There are actually a couple of states that just charge – relative to the premium tax – a fairly nominal fee. In one of the domiciles there's a wildcard law that's basically saying that we'll match any law in any domicile, subject the approval of the commissioner. It's sort of the ultimate flexibility. The domicile's been praised for having that flexibility and criticized for a 'we'll match the lowest offer' kind of a thing. It's not a secret that domicile is Washington, D.C. and they've done fairly well in bringing in captives. I think it was Howard who mentioned the flexibility of the law on an incoming basis that will allow various structures to be set up. It's not the only consideration and you want to make sure that it's just the right domicile, either geographically or that there's regulatory support five or 10 years from now because the captive is a long-term play.

WHITE: The wildcard provision actually is one of the things that we may see something on. I should explain why that provision is in the D.C. law. I had something to do with that. The idea was to recognize that business circumstances change. There are really three or four things you really need to consider if you are going to do something I was saying about making sure that interest between the business community and the regulator are well aligned. First of all, you have to have a regulatory strategy that focuses on long term objectives that look at not only immediate benefits but collateral benefits for that state if you're really trying to drive economic development. You have to focus on a partnership with the business community and you have to do this with knowledgeable people, both on the industry side and on the business side. This usually argues for an association that is going to be supportive from both the marketing and legislative sides or a captive regulator, a cooperative legislative body and a commissioner that understands how all of these pieces are supposed to work. Now, the provision, for instance, within D.C.'s law, and incidentally that same provision is in Delaware's law as well. The idea there was not so much that it was going to match the lowest price, but rather once you realize that we who are doing the regulating don't know everything, we haven't come up with all the best ideas, there may be a situation where there's a business need that should be addressed. That need has been brought to this particular domicile from a regulatory standpoint because that domicile has established itself as a knowledgeable regulator, cooperative with business, wanting to be part of the value proposition in putting together this captive. And so, this is a need that is not addressed directly by this captive statute, but back to my point again about clarity and consistency. If the effort here is to try and provide business access to self-insurance and right transfer in a reasonable
way in order to benefit both the client as well as the domicile. Then what you should do is look at this in terms of saying, well, we don’t have it now, but maybe we can take steps to make this change. That provision gives you that time. Because as you’re well aware, Howard, it takes a little while to get statutes done. So, maybe you operate with the bulletin saying we’re going to do this for this period of time, for this particular business circumstance, which is the “wildcard” provision and we will move to legislate, to support that after we’ve done the appropriate due diligence, worked with the business community and gotten this done.

GREEN: Bill, could you give us an example of how that wildcard was used?

WHITE: When I was in Delaware, the first special purpose financial captive that was put on the books was actually a redomestication. I’ve been away for a while so I can’t remember the provisions exactly. But the idea there was that we knew that that particular client was already a Delaware domestic company. It was a life insurance securitization. Using that provision we went on and licensed that company and that was at least three to four months before the special purpose financial provision that is a subchapter to the special purpose provision within the Delaware law. That was before that legislation was even introduced. But the idea there was we saw that there was a need – and this was in 2007 – we knew there was a need. We were already moving in that direction. We knew it was something that needed to be done. We had a domestic that wanted to redomesticate, had that work done in Delaware and wanted to proceed with forming a captive there. So, we used that provision to get that done.

MCDONALD: Nancy, I just want to take a question from a viewer who had sent it in. It’s a little more fundamental than we started but it’s good one to address and to tie it into why they might want to cite in a particular environment. Would you just lay out for us very quickly the benefits of forming a captive? And then when you do that as to why risk managers and brokers would put it in a particular location. You addressed that a little bit but the fundamental reason as to why you’re going to form a captive and how that fits in today’s domicile environment.

GRAY: Certainly. When looking at the formation of a captive insurance company it’s a risk management tool to manage your total cost of risk. You look at what’s available. You have to determine whether you’re going to self-insure a program or pass on your risk to the traditional insurance markets. What we’ve seen with past market cycles is that during hard market cycles it was very difficult for many companies to get the type of covers that they needed. Either the pricing was very high or capacity wasn’t there. So they turned to self-insurance and alternative vehicles, such as captive insurance companies, which allowed them to manage their risk better. It allowed them to manage how they’re going to insure those risks. So, captives are seen as a risk management tool to respond to changing market conditions. What we’ve seen in some of the past market cycles is that you might have the capacity, you might have the coverage there but you need to increase your deductibles. So a captive can provide that funding vehicle, the capital that’s required to fund for those losses on a long term basis. So, again, as the market cycles change, the captive vehicle can respond to those market changes.

MCDONALD: So if you tie that in to where you’re going to domicile that captive, does your choice affect how you form a captive? How much risk you put into that captive? What you do with that captive? Or, are they pretty much interchangeable at this point?

GRAY: They’re pretty much interchangeable. Certainly the deductible casualty programs—workers’ comp, general liability, auto liability—are the traditional coverages that run through a captive. The captives are also used to access the reinsurance marketplace more on the property side, so it provides additional capacity accessing. In terms of captive domiciles and location, it really doesn’t make that much of a difference. If you have a global risk then you might need to have a local insurer in some of the European union countries so you would form a captive maybe in Dublin or in Guernsey, where you can access coverage or be considered a local insurance company. Taxation does play a role in the formation of captives, income tax more than premium tax.

MCDONALD: We’ve talked about the growth of the captive domiciles and the spread there. Let’s go back to the big dogs, the guys who were there early and have a substantial number of captives. Meg, I’m thinking right now of Vermont, Bermuda, Cayman, some of those long-time, high-volume captive domiciles – how are they reacting? What are they doing?

GREEN: Well, Vermont prides itself on trying to be very aggressive within its regulation and this year they had a tax break for new captives forming. There’s talk that Maine is looking at doing a similar program, trying to get new captives a tax break next year. You’ve seen Bermuda trying very hard to get all the regulations up to par to try to meet Solvency II standards.

MCDONALD: They’ve had some recent announcements. Could you give us a bit more on that?

GREEN: Sure. In several areas they’re just trying to make sure they’re on the same page with the Solvency II requirements and there’s a bunch of jurisdictions working on that. Right now I saw Jersey, Guernsey and Isle of Man are also reviewing their structures to see that they meet the Solvency II requirements.

MCDONALD: Joel, just to continue in that same thought, if you are a large captive domicile, whether in the United States or out, is there such a thing as critical mass? Does size matter? Is their lead in terms of captive activity defendable?

CHANSKY: All of that. There is such a thing as critical mass and size does matter. There are a number of especially large corporations if they’re either redomesticating or those few large corporations that still haven’t set up a captive, if they’re looking to go to a domicile, it helps for name recognition to go to a Vermont. Frankly they are head and shoulders numberwise ahead of all the other domiciles in the U.S.
Or even down to the next tier, it helps to go to a reputable place. The Vermonts of the world and the others can tout their long history. They can also demonstrate turn around times and the regulatory staff they have can turn around financial examinations. And they're very quick to promote them. You see Vermont out on the road doing seminars all across the country. I think they were most recently in Denver, Colo. And Colorado has a captive law and Vermont's out there providing a captive educational seminar. Actually right now we're seeing some of the smaller but important domiciles in the western part of the country try to band together to form a regional captive conference. So, it's another way for them to try to differentiate themselves by allowing, in particular, service providers to attend a single conference instead of having to attend multiple conferences to peddle their wares.

**MILLS:** One thing I would add to what Joel was saying is that I think some of the domiciles outside the United States, obviously Bermuda and Cayman Islands, are looking at the political climate in the United States with a little bit of concern. Of course there's nothing wrong with domesticating, taking in, domiciling outside of the United States. It's perfectly legal and it's fine. I think that in the Cayman Islands and with the current political environment in Bermuda, some U.S. companies might be concerned about going offshore. And with the general public, that may have a kind of sinister connotation. I think the Cayman Island and Bermuda are watching the politics in the United States very closely and there are little things that some of the domiciles might need to look at. If you are a family looking to work in Bermuda, there are restrictions on how many children you can bring there. You can only have one car. Things like that are not insignificant. The bottom line that we're talking about today is that there's this very intense competitive environment and domiciles are competing. Things like quality of life issues, things like whether there are requirements that the board of directors meet. How many times do they have to physically go to the? Does the management of the captive need to reside in the state? Those types of things in a very competitive environment also count for something.

**MCDONALD:** Nancy, as you work with clients and you lay out options for them is there a question of onshore or particular locations that they are just reluctant to do?

**GRAY:** Yes. The onshore and offshore question comes up quite frequently. Not with just new captive formations but with our existing captive client base, trying to determine as to whether they're domiciled in the right location currently. Looking back from a historical standpoint, there were really good tax reasons to form in Bermuda pre-1986. And back then there really weren't any choices in the U.S. in terms of new domiciles other than maybe Vermont, at that point, had their captive law on the books. There were a scattering of other captive domiciles in the U.S., but primarily Vermont was from that standpoint, able to grow. The tax law changes that were instituted in '86, changed the tax benefits associated with domiciling Bermuda. So it made it more of a level playing field in terms of whether you were in the U.S. or an offshore captive domicile. Since then, of course, we've seen a lot of growth. We've gone through the Enrons, we've gone through Sarbanes Oxley, so there's more scrutiny in terms of domicile selection. What advantages does each captive domicile onshore/offshore offer to a captive owner.

**MCDONALD:** The U.S. government has what is in a sense workers' compensation insurance for defense contractors doing business overseas. And there's talk about forming a captive to put this business in there? How would they go about picking a domicile?

**GRAY:** It becomes very political in terms of which domicile for them to select. They would need to determine what they're trying to accomplish. Everything being equal in terms of a U.S. captive domicile, I would say, you know, it would most likely be in D.C.

**MCDONALD:** A viewer wrote in: What if the wildcard legislation is not passed and the captive is formed under that understanding. Would that pose some major problems?

**WHITE:** One of the things that's interesting about the way this works is the difference between statute and regulations. Statutes very clearly identify the intent of the legislature in terms of this particular law and this particular market segment. The regulations say this is how we are going to do it and there is a certain amount of leeway with each commissioner and any other regulator who's responsible for implementing the regulations in order to enforce that law. In the example I gave, should there have been a decision not to go forward with that, then we would have rescinded the bulletin and made whatever changes were needed. Then we would bring that captive in line with the existing regulation or work with them to redomesticate in order to give them an opportunity to go forward with their business.

**MCDONALD:** OK. Joel, I will address a question to you that came in from a viewer and perhaps Nancy would comment on this as well. Is there any particular reason, benefits or risks to going to Caribbean vs. the U.S.

**CHANSKY:** There can be some tax benefits depending on the structure of the captive. If it's a non-controlled foreign corporation it's out of the U.S. That wouldn't restrict it to the Caribbean but if it was out of the U.S. and it had the proper structure and ownership, the captive would not be subject to U.S. federal income taxes. That's one of the very specific benefits. Risks could be just like the risks we were talking about. If it's a smaller domicile or start-up kind of domicile, are they going to be there in five or 10 years? If it was a Cayman Island or Bermuda or a well-established domicile, I don't really see the risks, unless a storm made the islands.

**MCDONALD:** Nancy, anything to add to that?

**GRAY:** Well, just in terms of risk right now we're hearing a lot in terms of the administration as to what they want to do with some of these companies with U.S. insurance companies with affiliates offshore and that is raising a lot of concern as to what that will mean for some of these companies. That's one of the risks that we're facing and everyone's paying close attention to some of the rhetoric and some of the announcements coming out of D.C.

**MCDONALD:** I just want to add that we did just hear from the insurance commissioner in Hawaii, J. P. Schmidt,
and he has a question but I'll note a comment that he just sent in which is in line with Joel's comments about some of the domiciles giving seminars. J.P. writes, "I'll be in Japan next week for our regular seminar in Tokyo." Now for his question. What do you think of the NAIC task force on risk retention groups and captives setting some of the accreditation standards and providing education for some non-domiciliary commissioners?

MILLS: I think that anything that the NAIC can do to move toward greater coordination and greater consistency would be a good thing. The question is what pace can they move at and accomplish this? The NAIC tends to take a very long time to move toward consistency but I think that is the right direction to go. My question is can they do so quickly.

CHANSKY: I would agree that consistency is a good thing but if the regulation becomes too burdensome and doesn’t really quite fit the risk retention group’s profile, there could be some negatives. If they overrate the risk retention groups that could be a problem. But otherwise consistency is a good thing.

MILLS: We talked earlier about the fact that we are currently waiting to see what regulatory reforms come out. It could be that a year from now we'll have this discussion and there's this Office of National Insurance and that one of the missions of that office will be to promote consistency among the states. Again, the states are in competition right now. Some states may not want to play with this NAIC consistent approach because they feel that they are in an advantageous position. They want to remain competitive. They may not view consistency as a good thing and maybe this Office of National Insurance would get involved in something like that and try to build a more consistent structure around the country. That's speculation at this point. There's a lot yet to come out that will have a very big impact on this topic going forward.

MCDONALD: We have another question. I will not give the gentleman's name but he heads a risk retention group. He says they have 10 years of profitable operating experience in an industry that's not generally viewed as particularly favorable by insurance regulators. So, in other words, they're doing well for 10 years and they believe they are in a "mismatch" with their current domicile regulator. So you have 30 other domiciles out there or so. How do they narrow the field to find an alternative domestic domicile?

GRAY: It's very important to have some dialogue with the captive regulators early on in the process. You can get a sense from the regulators from that discussion in terms of expectations and that becomes one of the factors. If they do have experience in regulating risk retention groups the regulators will know what questions to ask. They'll know what information they will expect from you on a regular basis. So it's a process of making sure there is communication that is occurring with regulators and with the risk retention group on a regular basis. It's not just filing - doing the regulatory filings - and never having that dialogue and discussion on an ongoing basis.

WHITE: This whole situation with risk retention groups has been sort of a hot potato for quite some time. I was on that risk retention group task force when I was in Delaware. And there is an effort being made to bring greater consistency in terms of how risk retention groups are handled. But my view is that nothing is going to really clarify that situation until we go back to the actual federal law. The Liability Risk Retention Act - the original one in '81 and modified in '86 - there hasn't been any modification of it since. And, quite frankly, the risk retention task force grew out of a GAO report that - depending on your point of view - was somewhat heavy-handed in terms of not looking at all the various features of risk retention groups including how well they've done, how they've facilitated access to the market in getting some things done. So, I know there's a significant number of risk retention groups that are out there that feel like there is great inconsistency. Across the states there's been abuse of the federal law and no one is really sure what, exactly, needs to be done in terms of clarifying this. There were no enforcement provisions put into the LRRA - either version of it. There was going to be a new act, but certain things got in the way in September, 2008, and we haven't gotten back to it. This is somewhat on the back burner. From the risk retention group's standpoint, it's one of those areas that needs to be looked at and it can provide another tool, if you will, for risk finance. It doesn't necessarily have to be subject to competition in terms of one state doing a little bit different than another one. It was really enacted to address a very general need. That need is still there and I think we should go back and revisit it.

GRAY: There are so many good quality risk retention groups out there. I think what becomes the chicken and egg question with some of these captive domiciles is that they wanted to pass their captive law, they wanted to grow their domicile and I think that there were some risk retention groups that were probably licensed that shouldn't have been licensed in order to get their captive formations up. And I think that really was the focus in terms of some of the problems that we saw. Hopefully what the NAIC is doing is to make sure that there is good, consistent regulation across all risk retention groups because they do serve a much-needed need for many insurers.

MCDONALD: OK. We're about to close. We're coming to the end of our hour and I appreciate all the great comments we've had here. I can't really address any new questions. The last question we'll address - Joel, I'll bring you in and this will also be our way to thank you and to wrap it up. A quick question came in about whether there is a reason that this will also be our way to thank you and to wrap it up. A quick question came in about whether there is a reason that a client would choose a single cell versus a group captive. Any thoughts in that regard?

CHANSKY: Sure. The cell captive structure would allow the risk sharing to be either eliminated or minimized so that the cell structure puts walls between the various members of the group, where the group captive is really pooling all the risk. So if you want to get in bed with the other parties in the group, a cell structure is a way to go. You could also do a hybrid structure within the cell structure and set up maybe 10 cells for the big members or those that don't want to pool risk and have the 11th cell be for all the smaller ones. Cell structure can be very flexible but it does allow certain
types of risks or organizations to just separate themselves from the rest.

MCDONALD: Thank you, Joel. And, Nancy, last question for you and I don’t know if this would relate to particular domiciles. “Are you seeing much activity among employee benefits and captives and would that tie into any particular domiciles or types of structures?”

GRAY: We did see an increased interest in employee benefits last year and then with everything that happened in the fourth quarter, there was a slowdown of that. But that’s picking up again. And, really, employee benefits is geared if you want to use your captive for employee benefits it tends to be for a group long term disability or group life because you can go through an expedient process to get the DOL approval because it’s an ERISA regulated benefit so you need the Department of Labor’s approval to write it. I do expect that we’re going to see expansion beyond that, though. I think we have captive owners looking at potentially other types of employee benefits that they could write through their captive, but it’s going to be a longer process to get a DOL approval.

MCDONALD: Thank you, Nancy. And, Howard, last question for you is: Take us forward here. We’re seeing increased competition among domiciles. What do you think? Is that going to get even more intense and where could it go? A couple of years out, how do you think it might be different?

MILLS: Contradictory answer. I do think that we have saturation as we kind of talked about, but I still do think that you’ll see different states, particularly try to remain competitive, become more competitive, because of the attractions. We’re talking jobs, we’re talking revenue, we’re talking about an environment where the states are really struggling. Any source of new revenue and any chance for the political leadership to demonstrate that they’ve made their state more competitive and more attractive to business, is a powerful inducement. So I think we will continue to see a very competitive environment.

MCDONALD: OK, and Bill, last question for you: for the domiciles that succeed in the next couple of years, how will they have done it right?

WHITE: I think they will have done it right by first of all making sure that they have clearly identified what their objectives are with establishing captive statute and they have put in place the people and the resources to support that particular market segment, making sure that they understand the dynamics of that market, vis-à-vis the rest of the insurance market. And, that they’ve done a good job of forging a relationship with the business community – not only in their state but within the financial markets to address the concerns of both the current and emerging issues that deal with risk finance on an ongoing basis. That’s how you establish a domicile that going to be recognized as one that is progressive and capable of delivering the goods.

MCDONALD: Thank you Bill, thank you, Nancy, Howard, Joel, Meg, thank you to everyone who joined us. And we would like to thank the State of New Hampshire Department of Economic Development for their sponsorship of this event. To learn more about the advantages of considering New Hampshire as a possible location for insurance activities, visit the New Hampshire division of economic development. Their website is NHeconomy.com and the email for Michael Berjeron is mberjeron@dred.state.nh. I’m Lee McDon-ald with the A.M. Best Company.