CAPTIVE
REVIEW

ANGUILLA REPORT 2012

EXPERIENCE
As the fifth largest captive domicile, Anguilla understands business needs

LEGISLATION
Anguilla's Financial Services Commission ensures it remains a top-flight captive domicile

OPPORTUNITY
The domicile's low capital requirements allow for medium-sized businesses to flourish

FEATURING
Anguilla Finance / Artex Tribeca Partners / Capstone Associated Services / Webster Dyrud Mitchell

Why Anguilla still makes sense

Stewart A. Feldman CEO and general counsel of **Capstone Associated Services** discusses the continuing importance of Caribbean domiciles

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is a tax attorney and chief executive officer of Houston-based Capstone Associated Services, Ltd. Since 1998, Capstone has formed in excess of 120 captive insurance companies and maintains staffed offices in The Valley, Anguilla, British West Indies; Wilmington, Delaware; and Houston, TX.

There has been a proliferation of US domiciles adopting captive legislation over the past several years. The push began in the early 1980s with Vermont aiming to create jobs in an otherwise remote part of the country and several other states have followed suit. States hungry for revenue have jumped at what they perceive is an opportunity for a new source of both revenue and local jobs, given the fact that 50% of the US property and casualty insurance market is written through captives. We believe that these states will soon realise their false hope. As several jurisdictions have already discovered, enacting captive legislation and regulation requires significant investment in infrastructure. Legal advisors have already recognised the problems associated with US domiciles' efforts to collect taxes and fees without being adequately staffed or experienced in captive insurance regulation.

Domestic jurisdictions with captive legislation now include: Alabama, Arizona, Arkansas, Colorado, Delaware, District of Columbia, Florida, Georgia, Hawaii, Illinois, Kansas, Kentucky, Maine, Montana, Missouri, Nevada, New Jersey, New York, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont, Virginia and West Virginia. Most have just come online in the last few years. With the adoption of the Dodd-Frank Act's Non-admitted and Reinsurance Reform Act (NRRA) the number of states with enabling captive insurance legislation will increase.

At the same time, more middle-market companies are looking to captives as a risk planning alternative. Long the bastion of the largest publicly held companies, captives are now recognised as viable for the substantive, closely held businesses that seek to supplement current property and casualty coverage. For the business owner, a captive provides the insured with greater influence over the financial health of the insurer. This takes away the risk of having coverage negated due to poor investment decisions by conventional insurers or due to their propensity to deny claims, especially significant commercial losses.

> "ENACTING CAPTIVE LEGISLATION AND REGULATION REQUIRES SIGNIFICANT INVESTMENT IN INFRASTRUCTURE"

Selecting a domicile

Capstone is one of the country's oldest and largest sponsors of 'intermediate sized' captive insurance companies (property and casualty premiums of less than $1.2m per year). These insurers operate under Section 831(b) of the Internal Revenue Code. Having formed over 120 captive insurance companies in multiple domiciles over the past 14 years, Capstone well understands the importance of choosing the right domicile.

Not all domiciles are created equal. Because a captive as an insurer has ongoing exchanges with its regulators, the chosen domicile must have a competent staff equipped to address regulatory issues in a timely manner. High on Capstone's criteria when evaluating a domicile for a particular captive is that jurisdiction's expertise, staffing levels and commitment to regulating intermediate sized captives as opposed to major conventional insurers. Industry expertise with the insureds' businesses is also a consideration.

Role of the non-US domiciles

Since the founding of the Lloyd's of London insurance marketplace in 1688, England has been among the most influential reinsurance markets in the world along with Bermuda and other UK overseas territories. These jurisdictions continue to dominate the captive insurance markets, with Anguilla specialising in captives for mid-market companies.

Most US states' recent captive push is based on a 'for profit' motive. For example, Vermont has a gross receipts tax on premiums and extracts local jobs from its regulated captives, creating more than 1,400 jobs for this largely rural state. These jobs are typically held by professionals with an average pay that is considerably higher than the average salary earned by Vermonters. To ensure local captive job formation, the state requires companies to have a Vermont-based captive manager.

Other US states have similar 'job creating' provisions in their regulatory structure. Montana and South Carolina require onsite meetings with the objective of promoting tourism, which has nothing to do with the business purpose of the captive and, in fact, drains its resources. These added burdens of domestic domiciles are at odds with effective and efficient captive arrangements and are not usually seen in offshore jurisdictions.

Similarly, states hungry for tax revenue have focused on unique or faddish innovations, such as segregated cells or protected cells, without thinking through the regulatory and taxation implications of these solutions. This can lead to insureds being caught in potentially undesirable situations.

When US domiciles are inexperienced and understaffed

The economic crisis in the US continues to adversely affect onshore domiciles. Having concluded that their captive bureaus aren't profitable, some states have left them without leadership, resulting in decisions to exit the captive business. Those who are active in the captive arena understand that a captive is a living, breathing insurance company with ongoing issues. The captive needs responsive regulators that can make timely decisions with regard to captive management. Operating in short-staffed states has proven to be very difficult.

The recent establishment of captive businesses in these US domiciles has led to a poorly developed regulatory structure, leaving much uncertainty about how issues will be handled because these jurisdictions have little history or experience. When considering the appropriate domicile, Capstone evaluates a jurisdiction's regulatory scheme and its performance over past decades.

Implications of the Dodd-Frank Act

The Dodd-Frank Act has created a new set of industry questions and is a cause for concern among US-based captives. Under the NRRA, having a captive in Vermont when the insureds are located in, for example, Pennsylvania, will open up the captive arrangement to double taxation: Vermont taxes the Vermont-domiciled captive, and Pennsylvania (the home state of the insureds) taxes the insureds on the same premiums. This is an untenable situation which the NRRA seems to have created with poorly chosen language while US domiciles were asleep at the switch. Yet choosing the insured's home state creates another series of concerns. The NRRA has already led to a migration of captives out of traditional US domiciles like Vermont. In contrast, this issue is of little concern to captives based in Anguilla and in other offshore jurisdictions.

In summary, the choice of a captive domicile, like the design of a high-rise's foundation, is a serious undertaking and calls for a disciplined, up-front evaluation.

Anguilla as an offshore domicile of choice

From formation and licensing to responsive regulatory oversight, Anguilla has met Capstone's expectations. Others in the captive marketplace seem to have reached a similar conclusion, as evidenced by Anguilla's growth over the last few years as the domicile of choice for smaller captives.

In cases where there are time-sensitive filings, there is willingness on the part of the Anguillan Registrar of Companies and Financial Services Commission (FSC) to accommodate reasonable deadlines and to put its onsite regulators on task to handle the extra work and meet these deadlines. The insurance regulator is both committed to the regulation of captives and is well versed in such.

The Anguilla Insurance Act and the Insurance Regulations also provide a sound regulatory framework for the operation of captives. Anguilla excels in enforcing its captive framework in a fair and consistent manner. The FSC's focus has been on providing a secure, practical regulatory framework for the safe and sound operation of captive insurance companies, and not on creating and maintaining a regulatory minefield strewn with bureaucracy. Its rules are a balance between good regulation and a recognition that coverages are being written to affiliates of the captive's owners. The FSC has responded in a timely manner to requests for interpretations and rulings on technical insurance issues.

Before forming its first captives in Anguilla, and before migrating dozens of captives there, Capstone conducted thorough due diligence. We have not been disappointed and today Capstone is among the top two captive managers in Anguilla.