NORTH CAROLINA 2015

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Introduction

North Carolina has exploded onto the scene as one of the latest US jurisdictions with captive legislation and is already boasting significant growth in the number of captives being created or re-domiciling there.

The newly formed regulators have grappled with how to make a practical law for captives that would fit with North Carolina's specific governing structures. The creators of the North Carolina Captive Law claim to have taken the best aspects of its competitors' regulatory structures to create an effective and appealing insurance domicile.

North Carolina more generally is currently enjoying growth in many sectors and is ranked the ninth largest US economy by GDP. This solid financial foundation, combined with a willing and competent administration, have so far shown it to be an ideal environment to develop a captive insurance sector.

In the *Captive Review North Carolina Report* we speak to leading industry professionals, some of whom were central to the development of the one-year-old captive law, as well as those enjoying the boom in business it has created.

These experts also analyse the captive law in detail and discuss what features are needed to make a domicile successful, growth forecasts within North Carolina for the next 12 months and expected regulatory reform.

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RECIPE FOR SUCCESS

Martin Eveleigh, of Atlas Insurance Management, speaks to *Captive Review* about why North Carolina has the right ingredients to be a successful captive domicile

Written by
Martin Eveleigh

Martin Eveleigh is the chairman of Atlas Insurance Management. He serves as a director of the North Carolina Captive Insurance Association and sits on the Alternative Risk Transfer committee of the Self-Insurance Institute of America. He is based in Charlotte, North Carolina.

When North Carolina announced the launch of its captive insurance programme in 2013, some questioned whether there was room for yet another entrant into an already crowded US captive marketplace. Fair question, but how crowded is the marketplace really? While close to 40 states and territories have captive legislation, by the end of 2012 perhaps 10 had licensed a meaningful number of captives from outside the state. Of those 10, there were at least three where new formation activity was minimal. Not such a crowded marketplace after all. But still, would it help to have another captive domicile? The truth is that there is a continuing and growing demand for captives and the supply side of the equation (the domiciles) has been looking stretched.

Of course, quantity isn't everything. Quality also counts and for a new captive domicile to attract business and entice the sometimes cynical captive management community, it must show that it really has something to offer. The

"The truth is that there is a continuing and growing demand for captives and the supply side of the equation (the domiciles) has been looking stretched"

best domiciles demonstrate commitment, enthusiasm and pragmatic professionalism. In North Carolina, all three have been very evident from the outset, due in large measure to the leadership given by Commissioner Wayne Goodwin, whose public speeches about the captive programme reveal an enormous passion for its success. Not that a domicile is all about its regulator. Regulators are empowered by legislators. In North Carolina, no legislator opposed the original captive insurance legislation passed in 2013 and in 2014 the General Assembly found time in its schedule to pass amendments to the Act. Suggestions for further improvements are expected to be sympathetically received in 2015.

While commitment and the ability to deliver are key to convincing the market to bring business to a new domicile, there is another important factor that helps shape perceptions. It is the way in which the public and private sectors work together. Over the years, two outstanding captive domiciles have evolved to meet changes in the market and the economic and regulatory environment and have done so successfully by maintaining a strong partnership between public and private sectors. The Cayman Islands and Vermont have shown the crucial importance of regulators talking to and listening to captive service providers and of introducing necessary change in a collaborative way. The North Carolina Captive Insurance Association and the Department of Insurance enjoy just that type of collaboration and the communication between private and public sectors is excellent.

Tone and a real commitment to making a captive programme work create a potentially winning environment. The proof of the pudding, though, is in the eating. How does North Carolina demonstrate its commitment? Two actions of the Department of Insurance stand out. First, the North Carolina captive programme has been very well resourced with a dedicated team of six experienced insurance regulators reporting to director of captive insurance, Debbie Walker, and the very active daily involvement of the senior deputy commissioner and deputy commissioner. With additional department staff available to be drafted as necessary, the North Carolina Department of Insurance will be able to handle captive approvals and ongoing regulation in house.

Secondly, Debbie Walker and other representatives of the department have travelled extensively across the country and appeared in public many times in support of the development of the captive programme. The commitment is real and the regulators are accessible.

"Tone and a real commitment to making a captive programme work create a potentially winning environment. The proof of the pudding, though, is in the eating"

It has also been striking that these very experienced insurance regulators have so readily and willingly understood that a different approach is needed when dealing with captives as opposed to open market insurers. With 58 risk-bearing entities including protected cells already licensed at time of writing and at least 70 expected to be authorised by the end of 2014, there is already sufficient experience to say that regulators in North Carolina are, in practice, business-friendly and flexible but by no means push-overs.

These early numbers indicate that the NC captive programme is fast reaching critical mass and is headed for success. Where will that success come from? Generally, increasing demand for captives from around the country offers North Carolina a clear opportunity for new business growth. The state is open for all types of captive business. It is also apparent that captives have re-domesticated to North Carolina and that this process is likely to continue with captives migrating both from other US domiciles as well as from offshore jurisdictions. Most of these re-domestications have been of captives insuring risks outside the state.

There is every reason for North Carolina to be optimistic about the growth potential from within the state. North Carolina is the ninth largest US economy by GDP. In Charlotte, it has the second largest banking centre in the country. The Research Triangle Park at Raleigh and similar, developing parks or campuses near Charlotte and Winston-Salem are home to large and medium-sized expanding business. In 2014, The Pantry Inc. a North Carolina publicly traded company, formed a captive in the state, and other major companies in North Carolina are expected to follow suit by forming or relocating captives in or to North Carolina. No other state with an economy the size of North Carolina's has seen a captive programme achieve critical mass and attract so much business from outside the state so quickly. Risk managers in North Carolina have been paying attention.

The close attention being given to the captive programme by senior regulators means that a wealth of experience in many lines of insurance business, including all property and casualty lines, life, health and surety can quickly be brought to bear. North Carolina is expected to continue to benefit from a good share of the fast-growing enterprise risk segment of the captive market. It has also already authorised captives writing WC, GL and auto liability as well as medical expense, surety and extended warranties. Growth is expected on a broad front but perhaps particularly in workers compensation and health insurance.

Early success; a sizeable domestic economy; real commitment and enthusiasm on the part of the Department of Insurance; the expertise and willingness to welcome all types of captives from within the state and without; and a very strong partnership between private and public sectors that will ensure consistency, all combine to set North Carolina on the path to being a major, sustainable captive jurisdiction.

INCORPORATED CELLS WITHIN PCCS

Wesley Deaton, managing partner at Pendleton, Pendleton & Deaton, PA, in Denver, talks to *Captive Review* about how North Carolina's Captive Insurance Act is set to benefit the sector

Written by
Wesley Deaton

Wesley Deaton is the managing partner of the Denver, North Carolina office of Pendleton, Pendleton & Deaton, PA, and is the head of the firm's business and transactional department. Deaton has practiced law in the Charlotte area for more than 16 years and has been recognised in his area for his business, banking and transactional practice.

North Carolina designed its Captive Insurance Act to be user-friendly for captive insurers, captive management companies and clients who desire to set up their own captive insurance regime. As part of this regime, the state has allowed the creation of a protected cell captive structure, and has further allowed for the innovation of incorporated cells within the protected cell captive structure. For the right client, an incorporated cell can provide increased structural flexibility.

A protected cell captive (PCC) is a creation that allows a number of insureds who have agreed to participate in the PCC (the participants) to take part in a captive insurance company while at the same time having each participant's particular assets segregated into a separate cell (the protected cell). Each protected cell's assets are statutorily protected from the claims arising from each other protected cell. The PCC creates cells for the participants and manages the day-to-day insurance operations of each cell. A traditional protected cell has some attributes of a corporate entity. For example, each cell is accounted for separately, its assets are protected from the claims and liabilities of other cells and, absent an agreement to the contrary, the protected cell can be migrated from one PCC to another. However, a traditional protected cell is not a legal entity. North Carolina is one of a few jurisdictions that have revised the protected cell captive by allowing the creation of fully incorporated cells within the PCC. Unlike the traditional protected cells, an incorporated cell is by definition a separate and distinct legal entity. The incorporated cell must meet all other requirements of a captive insurance company and shall have its own directors and registered office. Though the incorporated cell, like a protected cell, participates within the PCC structure. It has its own separate and distinct legal existence and is somewhat akin to being a pure captive company under the control of the PCC.

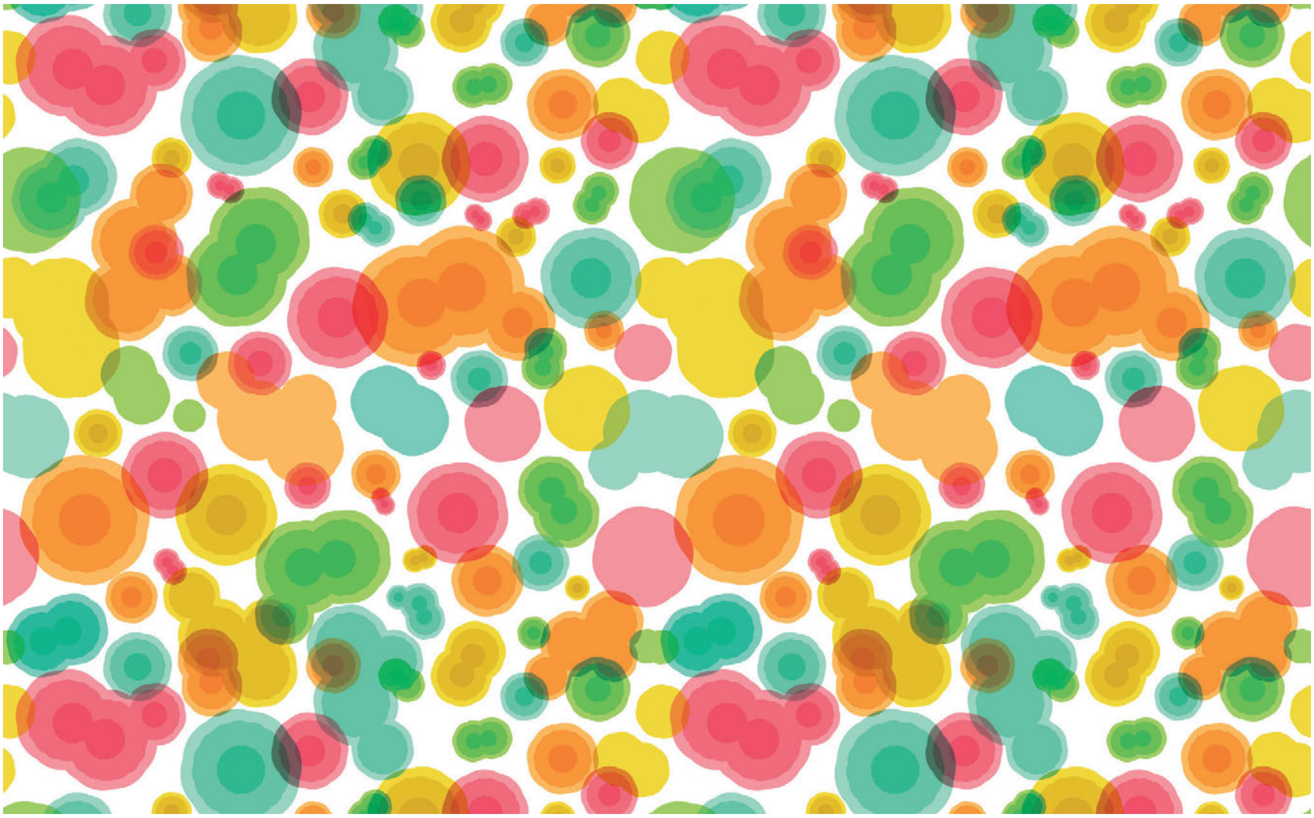
> "The incorporated cell may give captive clients additional flexibility when entering into a captive regime"

The incorporated cell may give captive clients additional flexibility when entering into a captive regime. As with a protected cell, a client may create an incorporated cell and take part in the managed structure of a PCC, thus benefit from economies of scale. In addition, however, an incorporated cell can offer a client additional protection, control and end-use freedom.

The North Carolina Captive Insurance Act specifically provides that: 'No asset of a protected cell shall be chargeable with liabilities arising out of any other insurance business the protected cell captive insurance company may conduct.' N.C.G.S. §58-10-510(g).

Though this provision creates a 'liabilities' firewall between the different cells, many clients would be more comfortable with a cell that has its own corporate entity. This incorporated structure then provides the cell not only with the statutory protection of the Captive Insurance Act, but the long-standing protection traditionally accorded corporations in North Carolina's statutory and common law.

An incorporated cell also gives the client potentially more control over the day-to-day operations of the cell. A traditional protected cell is a creature of both the statute and the participation agreement entered into between the PCC and the client. As such, the PCC will traditionally maintain most of the control over any protected cell within its structure. The incorporated cell, however, may have its



own separate board of directors and officers (depending on the terms of the organisational documents of the PCC. According to the North Carolina Captive Insurance Act, an incorporated cell will, by default, have the same directors, secretary and registered office as the PCC unless the organisational documents of the PCC provide otherwise), allowing for potentially greater day-to-day management control by the client, if they so desire.

A lot of potential

The most important flexibility that an incorporated cell may potentially offer a client is the potential for that cell to more cleanly disassociate from the PCC and either migrate to a different PCC, or even become its own captive insurer. By statutory definition, an incorporated cell has to meet all of the other requirements of a captive insurer, including, but not limited to, organisational and financial requirements. Unless otherwise prohibited by the PCC's participation agreement with the incorporated cell, that cell has three ongoing options:

1. It may continue in a participation agreement with its current PCC.
2. It may migrate to and participate with a different PCC.
3. It may spin off into its own captive insurance company.

Also, because an incorporated cell is its own separate entity, it has far greater freedom and ability to contract with other entities (including other cells) than it would a traditional protected cell.

Therefore, an incorporated cell regime of PCC can potentially let a client have its cake and eat it too; the client may reap the benefits of economies of scale and management experience by participating within a PCC structure. However, the client can, if it later decides to assert more control over the process, move its cell or even disassociate from the PCC in order to become its own, fully functioning captive insurer. Using an incorporated cell, a client may start out small as part of a PCC and grow, if it decides to, into a full-fledged captive insurer. The choice is with the client.

Of course, an incorporated cell is not a one-size-fits-all solution for clients. For one thing, the heightened regulatory requirements will require additional cost, maintenance and expense over what a traditional protected cell would cost. Furthermore, not all clients want to deal with the added responsibility of maintaining corporate formalities and having to take additional responsibility for the decisions of the cell. After all, for some of them, that's why they wanted to be part of a PCC structure to begin with; ease of use and less daily responsibility.

Finally, an incorporated cell's inherent flexibility could be limited by the relationship entered into with the PCC. If the PCC's bylaws or operating agreement do not provide for a separate board of directors, then the cell is by default going to have the same directors as the PCC. Though all cells have the right to migrate from a PCC and though an incorporated cell further has the right (subject to Department of Insurance approval) to disassociate and become a standalone captive, those rights can be waived in the applicable participation agreement with a PCC. Therefore, if a client is considering entering into a PCC and creating an incorporated cell, it should understand whether its participation agreement with the PCC limits the rights the incorporated cell would otherwise have to migrate and/or disassociate from the PCC.

North Carolina's Captive Insurance Act has, within its protected cell captive provisions, provided for the use of incorporated cells. Though this innovation is new, and currently limited to a handful of jurisdictions, it offers a number of benefits to the right client. The client can take part in the benefits of a protected cell captive, while at the same time maintaining control, as well as the right to become its own stand-alone company in the future.

THE PROS IN NORTH CAROLINA

Phillip England, of Anderson Kill, and Randall Beckie explain the differences in the regulatory regimes of US domiciles to *Captive Review*

When choosing a captive insurance domicile, no factor is more essential than whether the regulatory regime accommodates your captive's business plan. The more complex the plan, the more expert regulatory oversight matters. A high-volume captive domicile becomes that way when the service providers who operate there start mass-producing captives. Our captive insurance clients want custom tailoring at off-the-rack pricing. Following are some observations regarding some new captives domiciled in North Carolina.

Written by
Phillip England

Phillip England is a shareholder at the law firm of Anderson Kill in its New York office where he chairs the firm's tax and captive insurance group practice. England received his J.D. at the University of North Carolina at Chapel Hill School of Law and his LL.M. at the New York University Graduate School of Law (Taxation).

Written by
Randall Beckie

Randall Beckie, CPA, has provided tax consulting support to Anderson Kill's tax and captive insurance group practice and leads Frontrunner Captive Management.

Three new planning ideas

Here are three captive insurance solutions that work in North Carolina and not just anywhere:

1. Co-insurance cell captives:

Co-owners of a business might well prefer to create a separate captive for each stakeholder. Example: senior owns 80% of the business, junior owns 20%. To preserve fairness, for every $100 of captive insurance premiums that the business pays, $80 should go to the senior's captive while $20 should go to the junior's captive. The challenge is: operating two captives could cost twice as much as one. Unless they are co-insurance cell captives.

In some domiciles, each cell captive is subject to triennial regulatory examination, which mainly consists of an audit. However, we have seen triennial exam fees exceed what a captive manager gets paid! On the other hand, in North Carolina, a triennial examination would be conducted at the regulators' discretion, not just for the sake of doing it. Therefore, provided that the captive management service team maintains a captive's compliance with reporting requirements (regulation involves (A) relying on the annual independent audit of the captive, which can be relatively inexpensive, and (B) requiring and carefully reviewing business plan amendments), it will be spared the cost of triennial regulatory examinations. This can make the difference between whether it is cost-effective to set up multiple co-insurance cell captives in the first place or not.

Giving each stakeholder his own co-insurance cell captive is important for exit planning. A captive can make a non-taxable liquidating distribution into a parent company, including an S corporation parent that holds investments. This redeployment of a captive's accumulated earnings and profits into a holding company's asset portfolio works where the holding company owns 100% of the captive prior to liquidation (even if only moments before). In contrast, where one captive has multiple owners, as a practical matter, their exit from the captive would involve recognising taxable income in the form of dividends or capital gains.

2. Guaranteed renewable accident & health insurance programs:

Many employers subsidise employee health benefits. Health claims volatility is manageable via commercially available group health insurance or stop loss insurance. What is not commercially insurable is the risk of medical cost inflation, which has long outpaced consumer price inflation.

> "A high-volume captive domicile becomes that way when the service providers who operate there start mass-producing captives"

A guaranteed renewable A&H captive insurance programme lets an employer level its funding for projected inflation of health benefit costs. The employer's premiums that pre-fund projected inflation are (with planning) tax-deductible. Meanwhile, the captive may (with planning) recognise contract reserves that more than offset its underwriting profits. For many businesses, a guaranteed renewable A&H policy would generate more captive insurance premiums than any other coverage type. Guaranteed renewable A&H facilitates the employer's budgeting, steers clear of ERISA complications, improves the affordability of providing healthcare subsidies by the employer, and saves on taxes in several different ways. Why don't more employers do this with their captives?

One impediment has been that a couple of leading US captive domiciles take the view that guaranteed renewable A&H should be regulated as if it were a type of stop loss insurance. Stop loss insurance regulation, if it were to apply, provides that coverage cannot attach at less than $20,000 per capita or less than 110% of expected group claims costs. Those restrictions collide with the economics of a level premium guaranteed renewable A&H policy.

The North Carolina regulators take an arguably more enlightened view. In North Carolina, captive insurance of guaranteed renewable A&H is what it purports to be, without being recast as stop loss insurance. Moreover, for a captive A&H policy that really is simply stop loss insurance, that too may be allowable in North Carolina, provided (generally) that the captive insurance coverage runs to the employer and not directly to the employees.

The difference with regulation in North Carolina stems from the regulators' understanding of the intent of the captive insurance statutes. Read literally, the captive insurance statute says no captive can directly provide health insurance. Understood contextually, the statute was arguably intended to allow a captive to insure an affiliated employer's healthcare funding risks without having to participate in a state guaranty fund, as commercial health insurance companies would.

3. Captive life insurance programmes: Subject to careful planning and thoughtful regulatory review, a special purpose captive in North Carolina would seem to be able to issue certain types of life insurance to an affiliated business, such as key man life insurance, that the business needs in order to fund a stock redemption by an owner/manager when he dies. Captive life insurance may be the lifeline for business succession planning.

North Carolina State Capital building, Raleigh

"The opportunity that interests our clientele is that North Carolina can let a captive issue life insurance, which is the opposite of letting a captive invest in someone else's life insurance product"

In some domiciles, issuance of a life insurance policy by a captive is strictly forbidden. On its surface, the North Carolina captive statute says no captive may directly provide life insurance. But once again, in North Carolina the regulators understand the captive statute to be intended to spare captives from participating in a life insurance guaranty fund of the sort that is mandatory for commercial life insurance carriers.

Enabling a captive to issue life insurance and guaranteed renewable A&H insurance allows a captive to become a life insurance company for tax purposes. A life insurance company can avail itself of the small life insurance company deduction under tax code §806. That special deduction (which can approach $1.8m) can offset investment income that is earned in connection with the life insurance or guaranteed renewable A&H insurance business.

Some US captive insurance promoters are in a gold rush to tout §831(b), sometimes unfortunately with more enthusiasm for sales than with support for arm's length premium pricing. Sometimes the use of §831(b)s can be a trap for the unwary. On the other hand, hardly anyone talks about letting life insurance captives earn investment income in a tax-efficient way. Letting captives earn low-taxed investment income is important because business owners can create related-party investments that their captives can invest in at yields that surpass the financial markets.

In North Carolina, a captive can invest its assets in cash value life insurance products, an opportunity for life insurance salesmen. But to us, the opportunity that interests our clientele is that North Carolina can let a captive issue life insurance, which is the opposite of letting a captive invest in someone else's life insurance product.

New impression, old neighbourhood

Among US captive insurance domiciles, North Carolina is a new kid on the block, which gives it the advantage of learning from others' mistakes. Historically, captive regulators elsewhere have seen it as none of their concern if a captive over-prices its premiums. Presently, as the IRS scrutinises captive managers' underwriting practices, we may all soon see there is no safety in erring on the high side. Always remember the IRS can spot the difference between fast and loose vs careful, substance-oriented planning. North Carolina has a good support system for fostering a quality, expert regulatory environment.

NORTH CAROLINA: PAST, PRESENT AND FUTURE

W. Y. Alex Webb and Jesse Thomas Coyle, of Webb & Coyle, discuss with *Captive Review* the development of North Carolina as a jurisdiction and their predictions for the future

Written by
Alex Webb

Alex Webb, attorney (NC 1973), CPA (NC 1975), board certified specialist in estate planning and Probate Law (1987), Chair NC Bar Association Tax Section Council (1994-95), and Chair NC Captive Insurance Association (Founder in 2012) (2012–2014). Tax planning and controversy, estate planning, asset protection planning, and captive insurance company representation.

Written by
Jesse Thomas Coyle

Jesse Thomas Coyle, J.D., LL.M. (Taxation), licensed insurance agent (life, health, long term care), and licensed investment advisor, is a partner at Webb & Coyle PLLC in North Carolina, and his practice focuses primarily on estate planning, business planning and tax planning for his high net worth clients.

Captive Review (CR): How did you become involved with captives?

Alex Webb (AW): I started working with 501(c)(15), closely held insurance companies (CHICs), 13 years ago. They were difficult to use since they are tax-exempt entities. With the change in the law in 2005 to favour 831(b)s, I exclusively used 831(b)s.

CR: So, which domiciles were you attracted to?

AW: I like the South Carolina regime, but also Delaware and District of Columbia were very attractive because of the flexibilities that they allowed, particularly in the case of Delaware with SBUs.

CR: What caused you to work on getting North Carolina to become a new captive domicile?

AW: I hated to see North Carolina lose out on the economic development aspects of captives. I was determined to change that.

To stimulate interest in captives, my CPA partner, Jeff Smith, and I prepared a speech (*Captive Insurance Companies: Swiss Army Knife of Tax Planning*), which we delivered to 100 tax lawyers and CPAs from both North Carolina and South Carolina in May 2012.

CR: What happened next?

AW: 2012 was an election year in North Carolina. Through the good offices of a retired tax lawyer friend and former state representative, Richard Lane Brown, III, I had a meeting and presented a captive white paper to then Candidate McCrory, now Governor McCrory. Next, again through Lane's help, I had a meeting with Insurance Commissioner Wayne Goodwin, who was running for re-election. When I presented the white paper to him, he said: "My goodness, I have been trying to get this done for the last several sessions of the legislature. We need to make this happen. North Carolina needs this."

CR: Is that when the North Carolina Captive Insurance Association was formed?

AW: Yes, on 19 October 2012 we formed the NC Captive Insurance Association (NCCIA). The nucleus of the group at that time was my law partner, Jesse Coyle, my CPA partner, Jeff Smith, Lane Brown, and his friend Thomas L. Adams. Tom, who is an accomplished association manager, had just retired to North Carolina. We were able to talk him into coming out of retirement to help us get the NCCIA started.

CR: How did the NC captive law come to be?

AW: A seminal meeting was held on 24 September 2012 in Commissioner Wayne Goodwin's office. Jeff Smith, Lane Brown and I met with Commissioner Goodwin, Assistant Commissioner Louis Belo, senior deputy, Ray Martinez and the commissioner's legislative counsel, Rose Vaughn Williams. The commissioner was very enthused about the captive project and Martinez and Williams were tasked with getting things started.

CR: What was the legislative process like?

Jesse Coyle (JC): First and foremost, you have to remember that there is no one version of a captive law and North Carolina's would have to be unique in certain ways to fit within its own governmental structure. Once the legislation was in a form that could be submitted, we had to find sponsors in both the House of Representatives and in the Senate. Interestingly enough in January 2013, Alex had met Representative Linda Johnson at a Republican Party caucus held in Pinehurst. She was immediately attracted to the importance of having good captive legislation. Ultimately, she became, and still remains, one of our best legislative advocates for the captive programme. A legislative kickoff meeting arranged by

Representative Johnson and Lane was held with the chairman of the House Insurance Committee, Jerry Dockham, on the evening of 26 February 2013. Representative Dockham had once owned a retail insurance agency; he also became an enthusiastic supporter. In the Senate, we got the support of Senator Apodaca after the initial bill sponsor, Wesley Meredith from Fayetteville, NC put the bill in the senate hopper. We were able to ultimately get both houses to pass the legislation unanimously. We consider that most remarkable and beneficial.

CR: So when was the law passed and when did it become effective?

JC: Two bills were introduced: House Bill 473 and the companion identical bill was Senate Bill 476 (later merged into HB473). HB473 was filed in the house on 28 March 2013. It was ratified by the General Assembly on 13 June 2013. The governor signed it on 19 June. Unfortunately, the funding was part of a large 'reserve' and the funding for the captive program was not released until 15 October 2013.

CR: How did you make it known to the service providers and the insurance industry generally (and the public) that North Carolina had a good captive law that needed to be given serious consideration?

JC: In coordination with the NCDOI, the NCCIA decided to have a 'meet the regulators' session. Over 65 folks attended a one-day session in Raleigh on 10 December 2013. Incidentally, shortly before that, Webb & Coyle had been hired to form the first protected cell captive by Synergy Captive Strategies and Martin Eveleigh with Atlas Insurance Management, had been engaged to form the first three pure captives.

CR: That is very late to get started on forming captives, especially in a new, inexperienced domicile, is it not?

JC: Yes it was, but because of their flexibility and pro-business attitude and their dedication to making all this work without a lot of red tape, the department was able to get these four captives created in less than thirty days.

CR: So, where are we now in 2014?

AW: We now have 29 captives, so that is an additional 25 captives so far this year. In that group, there are: four more protected cell companies; one pure captive for a publicly traded company (Cellarium Insurance Company); one special purpose captive called Cattleman's Surety, LLC; and 16 pure captives by way of re-domiciliation from Nevis. We have Jeremy Colombik of Management Services International to thank for those re-doms. The department is projecting at least another 11 more captives being licensed in North Carolina either as new formations or re-doms before the end of the year.

> "Because of their dedication to making all this work without a lot of red tape, the department was able to get these four captives created in less than thirty days"

CR: What does the future hold for North Carolina captives?

AW: Even though the road is uncertain, the future looks bright. Consider the following:

- The North Carolina Captive Insurance Act is one of the best statutes in the country and the NCCIA is working tirelessly with the NCDOI to make sure that it stays that way via technical corrections acts (first one passed in May 2014), legislative amendments, and useful regulations. We are working now on legislative improvements to be introduced in 2015.
- The NCDOI has proven itself to be composed of business minded regulators that are there to help cut red tape, not make it.
- NCCIA is the leading captive trade group in NC.
- While the IRS is expected to audit captives more and more, especially offshore captives, simultaneously the number of business owners that are aware of captives and understanding of their legitimate business purposes is expected to go up exponentially.
- North Carolina can expect to successfully compete for this captive business.

WHAT MAKES A GOOD CAPTIVE DOMICILE?

Norman Chandler, of Captive Insurance Management LLC, updates *Captive Review* on what makes North Carolina a good captive domicile

Written by
Norman Chandler

Many of you may be asking the question: what makes a good captive domicile? With nearly 40 US states now having captive legislation and over 20 offshore domiciles, this question becomes a central issue for many captive and potential captive owners.

In our experience, domicile selection should be evaluated on the following criteria:

- Service and commitment to the industry
- Good laws
- Low taxes and solid regulation

Let's examine each of the criteria individually.

Service and commitment to captives

Is the domicile committed to captives? Sometimes this is easy. If you call a captive domicile about making a captive application and you are referred to a different domicile, you should probably take the hint – it's probably not the domicile for your captive.

However, sometimes, it may not be so easy to determine service and commitment. When it comes to service from the regulators in a domicile, look for these things:

- Does the domicile have staff dedicated to captives?
- Is the domicile staff experienced with captives?
- Are they responsive when you ask questions?
- How quickly does the domicile handle new captive applications?
- Has the domicile appropriated funds to market the domicile?

While this list isn't all-inclusive, it should give you a good indication of the mindset of the domicile.

Good laws

One of the biggest differentiators between domiciles is the actual captive law. The type of captive that you have, or hope to form, will have a great bearing on which domicile has the right laws for you. Generally, you want your captive's domicile to have a modern captive law.

For example, if you want to form an association captive, you should make sure that the domicile allows association captives – not all do. Likewise, if you want to start a cell captive, the requirements vary greatly. Some domiciles require an insurance company to sponsor a cell captive. Other domiciles have done away with this requirement.

Initial capitalisation is also a consideration. Initial capitalisation varies widely. Generally, offshore requirements are less strenuous than onshore domicile requirements. US domiciles generally require initial capital for a cell captive of $250,000 to $1m or more. Depending on your captive's business volume, these differences may not matter. However, for some captive owners, initial capitalisation is a big issue.

Low taxes & solid regulation

When it comes to taxes on captives, generally taxes are higher onshore. Many US domiciles have premium tax rates that begin at 0.4% of premiums. Some domiciles have caps on premium taxes. Therefore, if your captive writes $100m in premiums, a premium tax cap is probably important in your domicile selection.

Other domiciles have no premium taxes but instead have regulatory fees.

In most US domiciles, the only state taxes levied are premium taxes. Domiciles that charge premium taxes or fees and other income or franchise taxes may have a higher cost of doing business.

Another big issue with US taxpayers is compliance with Federal tax law in regards to captives. In tax court, some offshore captives

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have lost their argument to be taxed as an insurance company because they are 'loosely regulated'. The loose regulatory environment argument has not been successful to this point with regards to onshore domiciles. Generally, most businesses prefer less regulatory oversight; however, with captives, this may not be the best strategy. As always, you should have tax and legal experts advise you when forming a captive.

One of the more overlooked aspects of domicile choice is the domicile's history of regulation. Questions to ask to evaluate solid regulation include:

- Has there been a consistent, positive attitude towards captives?
- Does the regulatory environment change when the domicile's chief regulator changes?
- Have captive laws been consistently interpreted and applied?
- Is there a commitment to being a top domicile?
- Does the domicile stay modern by updating its laws and regulations?

You may also consider if the domicile is growing. Lack of growth may mean fewer resources designated to captives going forward.

North Carolina

So what about North Carolina as a captive domicile? Let's see how it stacks up.

• Service and commitment to captives

North Carolina is a new entrant to the captive world. North Carolina's captive act was effective 1 July 2013.

One key component of the North Carolina legislation includes a financial commitment to captives. As a result, if you've been to any of the large risk management or captive conferences in the US since the passage of the law, you've probably seen North Carolina captive regulators promoting the domicile at those events.

North Carolina has a full-time director of captive insurance and several staff that assist with captives. The director and staff are experienced US insurance regulators and have been easily accessible via phone, email or in person.

New applications are handled quickly and efficiently.

• Good laws

Because North Carolina's Captive Act is so new, the law was written with many of the modern features of captive laws.

The Captive Act allows for various types of captives, including incorporated cell captives, and has moderate capitalisation requirements. Most captives have initial minimum required capitalisation of $250,000. Of course, initial capital required may be higher depending on your captive's business volume and type of risks involved.

• Low taxes & solid regulation

North Carolina matches other US domiciles with premium tax rates that begin at 0.4% of premiums.

The maximum premium tax is $100,000, one of the lowest in the US.

North Carolina captives are not subject to an income or franchise tax and generally have no fees with an initial licensing application.

One of the more interesting features of the North Carolina law is the absence of required, regular examinations conducted by the North Carolina Department of Insurance. This feature has been heralded by many. Others have expressed caution. Either way, it generally means lower costs in operating a North Carolina captive.

In regards to keeping its law modern, an update to the Captive Act was signed into law in 2014 and it is expected that another update will be signed into law again in 2015. So far, North Carolina is showing a commitment to keeping its laws and regulations updated for changes in the industry.

Summary

North Carolina has made a strong entry into the captive world by taking on favourable characteristics of successful captive domiciles. It has shown tremendous growth in the number of captives licensed since its Captive Act became effective. I expect that North Carolina's growth will continue based on the domicile's track record so far.

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Frontrunner Captive Management is at the leading edge of US captive tax planning and product design. Clientele includes Fortune 500 companies, large and small closely held companies, and other captive managers and client-facing advisors to whom Frontrunner provides insurance tax expertise, know-how and back office support. Popular solutions include life/health insurance captives, insurance of financial-type risks, and enterprise risk underwriting for 831(b) captives that includes transfer pricing support.

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If you are a captive manager, wealth advisor or potential client seeking legal guidance regarding North Carolina captives, we can help. Our firm can assist you in every legal aspect of the captive insurance process, from formation, to continuation, to termination. We represented the first successful captive formed in North Carolina, and have been advising captive clients ever since. Please contact us, if we can be of service.

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