

Flexibility and collaboration

Jeff Simpson of Stewart Law discusses the factors that initially attract captive owners to Delaware, such as a well-developed service sector and its cutting edge captive statute

Everyone in the captive insurance industry, it seems, is talking about Delaware. It is not just talk. Dozens of new captives have been, or will be, formed in Delaware in 2010. With 2010 not yet over, the pipeline is already starting to fill for the first and second quarters of 2011.

From my position as a Delaware attorney advising clients on the formation and operation of captives, I have a unique opportunity to understand what is driving this interest in Delaware. Certainly, the things that have always made Delaware an attractive jurisdiction, the corporate and entity laws, the courts and judiciary, and the well-developed service sector, are all part of the reason. Also important are the recently revised captive statute and the unique and enormously popular series LLC captive. However, the hundreds of conversations I have had over the past year with clients and prospective clients have convinced me that there are other factors of equal importance in Delaware's recent emergence. In particular, Delaware is even

more attractive because the collaborative regulatory team together with flexible statutes encourages and empowers creative customisation in captive planning. In other words, Delaware is an easy domicile in which to do business and try new ideas.

Collaboration

The ever-present challenge for regulators is to find the balance between facilitating business and regulating reasonably. The Delaware regulators meet this challenge by collaborating with captive owners to design and implement creative solutions to business problems within a framework of thoughtful application of regulatory principles.

Regulatory team

The Delaware captive regulatory team brings together several relevant disciplines and experiences which enable them to collaborate with each other and with captive owners to consider new ideas, digest sophisticated transactions



Jeff Simpson is an attorney with The Stewart Law Firm. He practices in Delaware and Nevada, and is a member of the Legislative Committee of the Delaware Captive Insurance Association. He regularly advises captive insurance companies.

and apply regulatory guidelines from a realistic and practical point of view. My clients have been pleasantly surprised and universally impressed by the earnest sincerity, depth of understanding, and ultimately the results of this collaboration.

Pre-application discussions

The team routinely makes itself available to meet with or participate in conferences with prospective captive owners at all stages in the development of a captive programme. In fact, they encourage early inquiry so that their regulatory feedback can help avoid sticking points and so that ideas can progress constructively. Again, my clients are universally appreciative of these meetings and have found them to be more than helpful.

Flexibility

In addition to the collaborative regulatory environment, the modern Delaware captive programme is built on flexibility. The 2005 overhaul of Delaware's captive statute focused on creating a framework that would provide for reasonable and up-to-date regulation while giving captive owners the freedom to test new ideas and giving Delaware's Insurance

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Commissioner the freedom to allow those new ideas to be tested. The result has been a domicile that encourages and rewards creativity.

The captive statute

The captive statute itself is built for flexibility. It provides for almost any type of entity, including alternative entities like LLCs and statutory trusts, and even non-Delaware entities, to be licensed as Delaware captives. It also provides opportunities for captive owners to choose from numerous traditional captive structures, to operate on a calendar year or a fiscal year, to choose any of several accounting regimes, and even to use any of several different forms of capital.

Additionally, it provides for the licensing of special purpose captive insurance companies (SPCs). SPCs give the commissioner the authority to license captive programmes that would otherwise not fit within the definition of any particular type of captive. The chief purpose of this provision is to enable the licensing of programmes or structures that have a strong business case, but that simply had not been thought of or presented at the time the captive statute was implemented. SPCs have become vehicles for creativity, mechanisms for implementing new or novel captive concepts, and are the conduit for series LLC captives.

Series LLC

Series LLCs look and feel very similar to what the captive industry knows as segregated cell or protected cell companies. Compounding the flexibility of the captive statute, the series LLC is, itself, a remarkably flexible vehicle. Its foundation in freedom of contract offers opportunities to structure and govern the company as the parties see fit instead of as a statute requires. The flexibility benefits of a series LLC captive manifest themselves in numerous ways including fee and cost efficiencies, premium tax efficiencies, and capitalisation efficiencies.

Customised results

Thanks to Delaware's collaborative regulatory team and flexible environment, the adage: "If you've seen one captive, you've seen one captive," is perhaps truer in Delaware than anywhere else. The numerous customisations that have either been implemented or are currently under development in Delaware offer unparalleled opportunities to establish creative and efficient captive programmes. Some of these custom features include:



Protected core capital in series captives

Statutory minimum capital and surplus, sometimes called regulatory capital, is always important to captive owners. The general rule for series LLC captives is that regulatory capital is required only at the core level and not for each series so long as this regulatory core capital is exposed to the liabilities of insolvent series. However, depending on the captive owner's needs or objectives, the company can be structured so that its regulatory core capital is protected from the liabilities of insolvent series so long as each series maintains an appropriate and agreed minimum level of regulatory capital. Thus, a series LLC captive can be designed so that no regulatory capital is required in the series, or a predetermined amount of capital is required in the series, or series regulatory capital is determined on a case-by-case basis. The flexibility provided by this customised capital approach, and therefore, the opportunity for creativity, is enormous.

Benefits programmes

Delaware is uniquely positioned in that members of its captive regulatory team have life and health backgrounds. That fact alone places Delaware among the most appealing captive domiciles for benefits programmes, but because these captive regulators who understand benefits are able to operate in Delaware's collaborative and flexible environment, the door has opened to some leading edge benefits planning. Delaware has entertained captives planning to issue life insurance and has licensed programmes intended to be accounted for as life insurance. More traditionally, Delaware welcomes captive programmes structured for group medical plans with the intent of deriving the same kinds of risk

management and cost saving benefits historically associated with property and casualty captives.

Efficiencies for programmes with commonality

Another benefit of Delaware's collaborative approach and flexibility is the opportunity to customise efficiencies. As the captive market pushes down from the Fortune 500 through the middle market so that captive programmes are now accessible by closely held businesses, family enterprises and even professionals, cost and administrative efficiency become paramount. Delaware is sensitive to this business reality, and the collaborative approach has resulted in some attractive efficiencies. For example, Delaware recently licensed a series LLC programme structured to be economically viable for participants with only \$350,000 annual premium. Also, to the extent many captive managers, consultants or planners tend to attract clients from a particular industry or with a particular risk or financial profile to participate in similarly structured programmes, this commonality can be used to create efficiencies in the approval process. Many repetitively used documents or mechanisms, such as policy forms, trust agreements, pro forma formats, coverage packages, pooling vehicles and the like can be pre-approved to speed the review process.

Risk Retention Groups

In a world where risk retention groups are routinely beaten down, they continue to fill an important role for alternative risk transfer, and many planners continue to view them creatively. Delaware recognises the role of well-managed and carefully underwritten risk retention groups (RRGs) and focuses on the soundness of the insurance programme while offering the business people as much flexibility in planning and structuring as they are able.

Flexibility to be creative

Captive owners appreciate Delaware's corporate and entity laws, its courts and judiciary, and its well-developed service sector, and they are excited about its cutting edge captive statute and the recent introduction of the series LLC captive, but those facts are what mostly drive their initial inquiry. What ultimately brings captive owners to Delaware are the flexibility to be creative and structure their programme in a manner that best suits them and the collaborative input of the regulatory team that helps them prevent issues and solve problems in the design process. 🍷