

## **The rise and fall of captive domiciles**

By Dick Goff

Historian Will Durant told us all we need to know about history in one sentence when he wrote, “Nations are born stoic and die epicurean.” As a nation’s wealth and self-indulgence increase, the effort to succeed declines, and another country comes along to eat its lunch.

As a corollary for the ART industry which is governed by states where laws have been enacted to establish them as captive insurance “domiciles,” we can say, using some important qualifiers: Captive domiciles tend to be born entrepreneurial and, if they fail, fail bureaucratically.

In recent decades we have witnessed explosive growth of captive domiciles among U.S. states and the District of Columbia, now numbering 32 at my last count. Some of these have taken off like a Saturn rocket (a device dating from the time the U.S. still had a space program, but that’s another subject).

The archetype entrepreneur-statesman is Ernie Csiszar who came from international business success around the turn of this century to serve as the insurance commissioner of South Carolina. He immediately set about to make the state a captive insurance domicile, preaching to the legislative and executive branches about the dynamic economic development climate a captive domicile would nurture.

We saw vigorous growth of South Carolina’s captive industry, but within a few years the state’s political leadership changed, and changed again, and Ernie went on to fame and fortune elsewhere. Now, as the kids say, nobody goes there anymore.

Within the decline of any captive domicile – I’m not picking solely on the fine Palmetto State – observers find less interest among insurance regulators in bringing new business and fostering economic development, and more interest in the characteristics of bureaucracy which are protection of the organization, inbreeding staff and slavish devotion to rules.

So, the mindset of many regulators has shifted over the years from “what can we do to bring your business to our state?” to “what can we do to avoid making any mistakes?”

Such states reward the regulators who regulate most. Licensing processes become longer. Applications that are most familiar to the staff have the best chance of timely approval while novel programs applying new laws are resisted. This is just human nature on display by people who have seldom if ever worked in the private sector and find no sense of urgency in their mission.

Even worse, some regulators don't understand the structure or intent of their own states' statutes, so they may impede new applications out of ignorance. Much worse, some regulators understand the statutes but arbitrarily chose not to allow them to be applied by new licensing applicants. There is no practical way for the industry to fight this version of City Hall.

But every now and then, a breath of fresh entrepreneurial air is felt on the land as new or revived captive domiciles are established and operated by experienced, knowledgeable regulators. Look to Montana a few years ago and Tennessee last year.

The most chilling effect on captive domicile regulators is exercised by the National Association of Insurance Commissioners, the proverbial elephant in the corner of the room that everyone would like to ignore but think they can't. The three things you have to know about the NAIC is that 1) it considers itself a standard-setting organization (its own words in correspondence with government agencies and its website); 2) it bullies states into acceptance of its standards through the threat of withholding its “accreditation;” and 3) it has a skeptical view of captive insurance, most notably risk retention groups that enjoy federal exemption from state oversight and so encroach on the turf of NAIC members.

All this by a simple trade organization that has no government authority of any kind. The industry was pleased to see California Republican Congressman Ed Royce stand up to the NAIC earlier this year by challenging its “standard-setting” claim and asking for information “as a means of reconciling the NAIC's own inherently inconsistent statements about itself.” The NAIC said it would respond “in due course.” We weren't holding our collective breath.

But in the meantime the NAIC's toxic attitude toward captives drifts into every state department of insurance where staff regulators know their bread is buttered by the commissioner, and the commissioner's bread is buttered by the NAIC. Hence, the more timid regulators hesitate to approve applications of programs that sometime in the future may be addressed by an as yet unwritten NAIC "standard."

The NAIC's grip on state insurance departments is not yet universal. New York has told the NAIC "thanks, but no thanks" and nothing bad has happened to it. Have you noticed an exodus of insurance companies from the Empire State? Neither have I.

And we still have some entrepreneurially-spirited captive domiciles that recognize new beneficial applications of advanced captive laws and encourage the growth of companies and jobs they can bring. Electronic communications make progressive domiciles anywhere in the country as close as our own desks.

*Dick Goff is managing member of The Taft Companies LLC, a captive insurance management firm and Bermuda broker at [dick@taftcos.com](mailto:dick@taftcos.com).*