

***IT'S TIME TO CONSIDER, OR RECONSIDER, DELAWARE AS A PREFERRED  
DOMICILE FOR CAPTIVES***

*Michael W. Teichman, Parkowski, Guerke & Swayze, P.A.<sup>1</sup>*

If you are considering the formation of a captive insurer, Delaware law provides some special advantages that you should consider when choosing a jurisdiction of domicile. If you rejected Delaware in the past in favor of another jurisdiction, now may be a good time to revisit that decision.

Delaware's captive insurance statute, chapter 69 of title 18 of the Delaware Code, was substantially revised by legislation, HB 218, signed into law this summer. The combination of special features already present in the statute, along with new features added by this legislation, make Delaware an excellent choice for domiciling your captive. Consider just a few of the benefits to forming or redomesticating your captive to Delaware:

***Flexibility of entity type:***

For many years, Delaware law allowed captives formed under the laws of foreign jurisdictions to become domiciled and regulated here as if these entities were organized under Delaware law. This unusual feature has allowed Nuclear Electric Insurance Limited, one of the largest industrial insured captives, to domicile in Delaware for regulatory purposes but to retain Bermuda as its jurisdiction of incorporation. However, in the past Delaware captives were limited to the corporation as the only permissible form of organization. With the passage of HB 218, captive insurers may now be organized as limited liability companies, partnerships, limited partnerships or statutory trusts. This represents the first time that Delaware law has expressly allowed an entity form other than a corporation to assume insurance risks. This also represents a substantial advantage over competing jurisdictions, including Vermont, which generally do not allow this broad variety of entity forms.

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<sup>1</sup> Mr. Teichman is a Director in the firm of Parkowski, Guerke & Swayze, P.A. He practices in the areas of insurance regulation, corporate and administrative law.

**Accounting treatment:**

The revisions to Delaware's captive statute expressly allow a captive to prepare its annual report under generally accepted accounting principles ("GAAP"), statutory accounting principles ("SAP") or international accounting standards ("IAS"). Although many jurisdictions provide varying degrees of flexibility as between GAAP and SAP, Delaware is the first to expressly allow the use of IAS.

Delaware had previously eliminated all restrictions on a pure or industrial insured captive's investments; accordingly, the new provisions in HB 218 permit a captive using SAP to record as "admitted" those assets that SAP would otherwise require be "non-admitted" and thus ignored for purposes of the insurer's balance sheet.

**Captives owning captives:**

Although Delaware law previously extended great latitude to the ability of a pure or industrial insured captive to make investments of all types, under the new statute, Delaware captives of all types are expressly permitted to own the securities of, or interests in, another captive. This allows a parent company or industrial insured group greater flexibility to segregate risks in multiple captives and to arrange those captives vertically in the corporate structure rather than horizontally. More important, the ability of one captive to hold another captive means that a captive can set up subsidiary captive as a "special purpose reinsurance vehicle" for extraordinary purposes that might include issuing catastrophe bonds for use in covering the parent's exposure to otherwise uninsurable risks, such as natural disasters and terrorism.

**Writing non-captive business:**

Delaware law allows industrial insured and association captives to write risks other than those of the members of the association or industrial insured group. This extraordinary and unique provision remains, allowing a captive to write up to 50 percent of its business outside the captive group. What is new is that the Delaware statute additionally allows a pure captive to insure the risks of "controlled unaffiliated business," *i.e.*, risks that are not those of the captive's

parent or affiliates, but are, instead, the risks of an unaffiliated entity that has a contractual relationship with the captive's parent or affiliates.

**Minimal bricks and mortar:**

So, what's it going to cost? you ask. The new legislation restructured and simplified the premium tax scheme, which now provides a modest .2% (+.1% for reinsurance) tax capped at \$125,000.00 for direct written business and \$75,000.00 for reinsurance. This is considered to be comparable to tax burdens imposed by other jurisdictions. What one must also consider in addition to premium taxes is the ongoing "bricks and mortar" requirements that a jurisdiction imposes in return for the privilege of being domiciled in that jurisdiction. Here, Delaware shines. A Delaware captive is required to maintain its principal place of business in Delaware. Notably, however, there is no requirement to retain a Delaware based "captive manager" – although for smaller captives without an indigenous staff, retention of a manager in Delaware will satisfy the principal place of business requirement as well as provide the expertise and resources necessary to operate the company. While a Delaware captive is also required to have at least one meeting of its governing body in Delaware, another provision of Delaware law may serve to ease this requirement. The Delaware General Corporation law provides that directors may participate in a board meeting by conference telephone or other communications equipment, which participation constitutes the "presence in person" of such director. Accordingly, a Delaware captive organized as a corporation can comply with the Delaware board meeting requirement even though most of the directors are participating by phone from outside Delaware.

If a Delaware captive does choose to have employees in Delaware, the new statute provides some additional incentives. A captive employing five full-time employees in Delaware is exempt from the requirement to hold at least one board meeting annually in Delaware. A captive employing at least 25 full-time employees in Delaware will have its premium tax capped at \$50,000.00.

**Protected cells:**

This is one aspect of captive insurance where Delaware law clearly lagged behind that of other jurisdictions. No more. Delaware has now adopted “sponsored captive” provisions much like those in place in other preferred jurisdictions. Accordingly, Delaware captives may be organized to serve multiple members, each of which has the ability to segregate its risks in a protected cell that is insulated from the liabilities of other cells. The new statute makes clear that the Commissioner has the authority to take remedial action, specifically including rehabilitation or liquidation, against a single cell in the event that cell becomes impaired or insolvent, without such action spilling over into other, financially sound, cells. More important, members of a Delaware sponsored captive need not be members in a particular association or industrial insured group in order to participate in a sponsored captive.

**What does it mean?**

Delaware’s captives statute contained a number of advantages prior to its recent re-enactment that, for one reason or another, went largely unnoticed by the industry. These advantages remain and, with the passage of HB 218, a number of new and important advantages have been added. If you are thinking about forming a captive, or redomesticating an existing captive, Delaware should be on your short list.