How Montana Has Become a Captive Domicile Hotbed in Recent Years

by Janet Aschkenasy | August 1, 2013 at 6:00 am

Montana passed its first captive law over a decade ago. Since then, legislative changes, a low cost of living in the region and the commitment of state regulators have helped to make Big Sky Country an attractive option for U.S.-based captives.

And now a newly minted statute, designed to better facilitate the pooling of different risks under a single "protected cell" captive structure, is expanding the definition of what a Montana captive can be.

A Banner Year in 2012

A total of 34 new captive insurance company licenses were issued in Montana last year, bringing the total number of licensed captives in the state to 114 as of December 31, 2012.

In comparison, Vermont licensed 32 new captives in 2012.

Of course, Vermont is a captive industry veteran, having passed its so-called Special Insurer Act more than three decades ago, and touted a total 984 captive licenses overall by the end of last year.

"Though Vermont easily maintains its lead, once Montana catches up in longevity as a captive domicile, it may well surpass it," said Dick Goff, president of the Montana Captive Insurance Association and captive manager with the Taft Companies, where he has an office in Helena, Montana. "Discounting 831(b) [micro]captives, Montana is the largest captive domicile west of the Mississippi."

New Legislation for Series LLC Captives

Like Vermont and Utah, Montana allows the formation of so-called cell captives, which have "firewalls" protecting multiple cell captive members from the liabilities of other members. In an effort to further establish these sorts of firewalls, in April, the state became the second U.S. captive domicile outside of Delaware to allow Series LLC captives.

Using the Series LLC legal form, captive audits, as well as certain tax commitments, can be pooled more easily and efficiently for protected cell captives. It is also important to note that the minimum premium tax in Montana applies to business written by all the cells, instead of each one individually.

"Let's say a cell captive writes direct premiums of $500,000 per cell, and there are three cells," said Brenda Olson, managing director at captive management firm Aceterrus Insurance Resources in Bigfork, Montana. "The effective tax rate for pure captives in Montana is 0.4% on the first $20 million of premium." Thus, a state calling for taxes on each cell would require each one to pay the minimum state premium tax—normally $5,000 apiece or $15,000 in total for three cells. Instead, the cost would be just $2,000 per cell—$6,000 in this case. "It's important for risk managers to understand how these costs will be applied to them," she said.

Olson likes to use the example of a condominium to describe the cell captive structure. Just as each condo apartment resident has separate ownership of a piece of the entire building, cell members are kept separate from other cells under a single captive cell umbrella, which retains the captive license.

"Just as there would be a condo developer," Olson said, "here there is a sponsor of the core cell captive." That sponsor forms the cell captive with initial funding before selling off different units—the "cells"—that are used for various types of insurance business.

"Unit A might be providing property insurance for a real estate organization," she said. "Unit B could be providing professional liability insurance for midwives. Unit C could provide cyber-risk liability insurance for an ISP provider. Through the legal structure of the cells, what we're able to do is create firewalls between these 'condo' units, so if Unit A suffers a catastrophic loss we're able to contain that loss to that unit or cell without the other cells being impacted." The Series LLC legislation has furthered this effort. Before Series LLCs were permitted, a separate LLC had to be formed for each and every cell. Now, protected cell captive sponsors can create just one LLC and have the ability to issue a unique series of preferred ownership interests to individual cells.

What Kinds of Coverages?

In addition to their work with defining Series LLC captives, Montana captives are currently providing several strains of professional liability coverages to doctors, hospitals, attorneys and others.

"Montana has an interesting cross section of captives providing both professional and commercial coverage," Goff said. These include lawyer professional liability, doctor and hospital medical malpractice, contractor general liability, and self-insured employer group medical stop-loss.

Olson said that another benefit of establishing a captive in Montana is that the administrative costs for doing business in the state are relatively low. Captives generally need to submit to annual CPA audits. Annual audit fees for pure captives in the state average around $6,000. The Cayman Islands, and even certain U.S. domiciles, may charge as much as $20,000 to $35,000. "Montana's wage base is pretty low compared with other states," she said. Thus service providers in the state tend to charge less.

Top 30 Captive Domiciles
(by number of captives)

1. Bermuda
2. Cayman Islands
3. Vermont
4. Guernsey
5. Anguilla
6. Utah
7. Barbados
8. Luxembourg
9. Nevis
10. Delaware
11. Hawaii
12. District of Columbia
13. British Virgin Islands
14. South Carolina
15. Dublin
16. Kentucky
17. Nevada
18. Isle of Man
19. Montana
20. Arizona
21. Turks and Caicos
22. Singapore
23. New York
24. Sweden
25. Labuan
26. Switzerland
27. British Columbia
28. Puerto Rico
29. Missouri
30. Curaçao

Minimum captive license renewal fees in Montana are also competitive with other U.S. captive headquarters. Montana has a $300 renewal fee—a fraction of Arizona's $5,500 cost and cheaper than renewal fees in Nevada ($550) and Vermont ($425).

Praise for Regulators

Many captive managers appreciate the consistency and quality of the state's captive regulators, according to Goff. For instance, he said that Montana Insurance Commissioner Monica Lindeen has "very selectively" chosen new personnel to regulate captives while maintaining a clear separation between the insurance department and the alternative risk department. "I applaud her for it," said Goff.

In fact, Montana's core captive regulators are the same individuals who have been on the job since the state's birth as a captive domicile in 2001. The only major change occurred when Steve Matthews took over the captive regulation helm from John Huth in 2008 after the Montana Captive Insurance Association appointed him captive insurance coordinator of the Montana State Auditor's Office.

"Steve Matthews has made it his career's goal to promote the captive environment in Montana," said Dan Hansen, client account manager and regulatory compliance coordinator with ALPS Risk & Insurance Services in Missoula, Montana.

Captive managers in the state are quick to applaud Matthews' efforts and his willingness to step in quickly in a pinch when necessary. Olson recalled one particular situation she had to contend with when one of the captives she was servicing needed to substantially increase its coverage limits for an insured Montana property in order to meet the demands of a third-party lender. "I received a call from the CFO at about 11 in the morning letting me know the limits needed to be revised-and asking what could be done to get regulatory approval by 2 p.m. the very same day," she said. "This was a material change increasing the existing limit of $250,000 to a $1 million limit per claim."

Olson quickly contacted Matthews to see what could be done. She explained the situation and was able to supply him with the captive's latest financial statements, and "received the regulatory green light in less than 10 minutes…I was able to get back to my client well before the deadline." She was thrilled and added that Montana regulators' ability to help captive customers with their changing business needs is simply "phenomenal compared with what I've seen in other domiciles."

The U.S. Advantage

In addition to its unique qualities, Montana shares certain advantages with other stateside captive domiciles. As state governments offer increasingly attractive incentives to establishing local captives, U.S.-based risk managers are often seeing lower formation costs and simpler tax structures here at home.

James Murray, director of Aon's captive and insurance management operation in Burlington, Vermont, has received the impression from some of his clients that company board members and other constituents may simply feel uncomfortable when a captive is offshore. The client perception in some cases is that the firm could be seen as "hiding something" by headquartering their insurer in a non-U.S. locale. "We've been involved more and more with bringing captives that were offshore, onshore," said Murray. "Typically the onshore captive is the surviving entity." He also noted that not only does it tend to be easier to comply with U.S.-based regulation as opposed to that of an offshore domicile, but it is easier from a perception perspective for a U.S.-based organization to have a captive that is headquartered domestically.

Beyond that, Montana's impressive natural beauty and recreational opportunities—from fly fishing and whitewater rafting to downhill skiing and mountain biking—further increase the state's appeal for some captive managers. As Hansen said, when the need arises to fly to a different state to address issues or hold meetings involving your captive, it doesn't hurt to be able to create some "memorable adventures" beneath the gorgeous Big Sky.

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