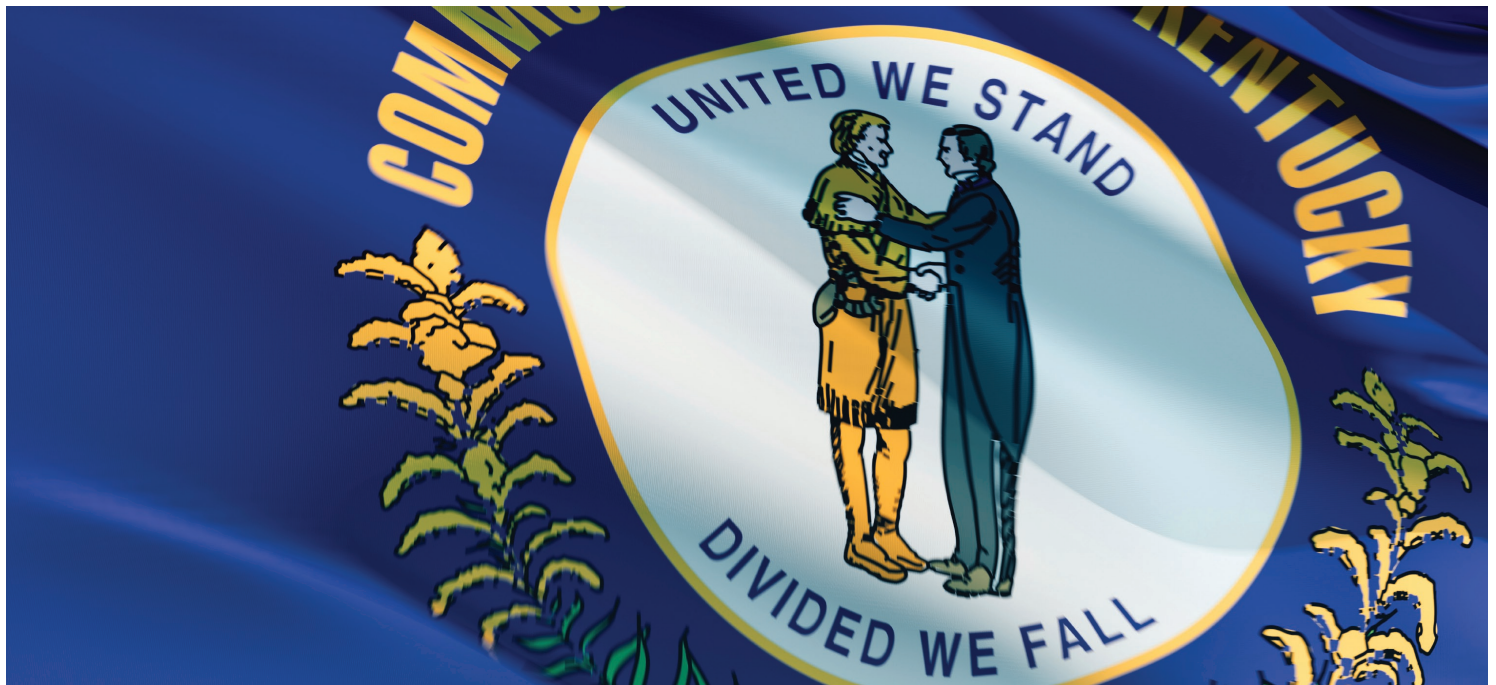


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Kentucky courts Middle America's captives

US Captive looks at what is fuelling the impressive growth in the number of captives in the Bluegrass State.



Since establishing its first captive in 2002, the State of Kentucky has come a long way.

Kentucky now has 76 licensed captives. Nine joined its market in the first three months of this year, following on from the 31 that were licensed in the state in 2008.

Even in the current economic downturn, there are signs of rate hardening, particularly in reinsurance. The state is well positioned for continued growth for three reasons, says Russell Coy II, captive co-ordinator in the Kentucky Department of Insurance.

“Firstly, many smaller privately held business owners seem focused on preserving and protecting their business, rather than on growth,” says Coy II. “Secondly, we see continued interest in redomestication of small business captives from offshore domiciles to cut costs. And finally, there is still a great deal of interest in captive formation from business owners located within our region.”

Kentucky’s initial captive law was passed by the 2000 General Assembly (Senate Bill 245). The law was updated again in 2006 and it recently passed a resolution supporting the industry. It is no coincidence that Kentucky has rapidly become one of the US’s principal captive domiciles. Coy II is a full-time co-ordinator overseeing regulation and licensing of captives, alongside market development, and the 2006 legislative efforts have made it more competitive in the marketplace.

The well-crafted captive law is supported by an informed administration. This coincides with a regulator that is firm, but flexible. Captive owners are engaged and satisfied in the

marketplace. Coy II also believes that the state has a broad range of knowledgeable and experienced professionals and service providers to cater for the requirements of a modern captive.

“We have a number of ‘embedded’ service providers, which are located here and have a vested interest in the long-term viability of Kentucky as a domicile,” says Coy II. “For example, we have two captive managers based in Kentucky: The Underwriters Group in Louisville and Valley National Administrative Services in Northern Kentucky in the Cincinnati/Covington/Newport area. We also have two accounting firms with a great deal of captive experience: Mountjoy & Bressler, and Munninghoff & Lange. In addition, there are two attorneys who specialise in this area: Steve Goodman (Lynch Cox Gilman & Mahan) and Chaz Lavelle (Greenebaum Doll & McDonald).”

As a low-cost, convenient state, Kentucky is fast becoming the domicile of choice for Middle America.

“What sets us apart is our location. Kentucky is one of the most accessible locations in the country,” according to Coy II. “It straddles the Mason-Dixon Line and the Midwestern gateway. It is served by five major interstate highways and is located within a day’s drive of over two-thirds of the US population. In addition, we have three international airports nearby.”

Stuart Ferguson, president and founder of the Kentucky Captive Association, has seen the growth in the number of captives from the beginning.

“In 2002, we were operating the Automobile Dealers workers’ compensation captive, which was based in Grand Cayman,”

“As a low-cost, convenient state, Kentucky is fast becoming the domicile of choice for Middle America.”

says Ferguson, who is managing director of The Underwriters Group, the management company of the captive. “We had a fronting company issuing local policies and ceding a primary layer offshore.”

Underwriters has been a third-party administrator (TPA) and programme administrator for almost 70 years, with the perfect skill set to manage captives. The front insurer that Underwriters was using decided to change strategy. It no longer wanted to work with groups with more than 14 members. As Ferguson looked around for a new fronting company, it quickly became clear that it would be difficult to find a suitably priced alternative.

“I recalled that as part of the economic development package to lure Toyota to move its North American HQ to Kentucky, our legislature had enacted a captive law,” says Ferguson.

Ferguson worked closely with officials at the Department of Insurance, who were keen to put the idea of a Kentucky captive into action. A feasibility study was undertaken and an onshore direct writing captive was set up for the programme. The Automobile Dealers Management Insurance Co., the association captive for both the Greater Louisville Automobile Dealers Association and the Kentucky Automobile Dealers Association, was licensed in December 2002. The structure allowed the captive owners to continue their programme and services to their members.

It wasn't long before Ferguson helped found the Kentucky Captive Association (KCA), which was formed as a non-profit in 2003 to promote the state's captive industry and to act as a unified voice for local captive owners and service providers.

In 2004, Underwriters took over management of Kentucky's second captive, and the market has continued to expand ever since.

“We now have many channels of service professionals working to make businesses aware of captives, how to use them, and how to form and operate them,” says the KCA head. “We have enjoyed growth from new captive formations, as well as transfers from other domiciles for reasons of cost, convenience or service. Our ability to work well with the client, actuary, accountant and attorney has allowed us to deliver programmes on a timely basis. We know there are many fine domiciles out there and we are working hard to grow Kentucky as a leading domicile of choice.”

The captive association has grown so much in popularity that it recently took its show on the road. On October 30, 2008, the KCA sponsored ‘The KY Captive Insurance Classic’ at Churchill Downs, in conjunction with its annual executive education conference. The six-furlong horse race was won by Emma Guth in 1:11:51.

Attorney Lynch Cox Gilman & Mahan, PSC is a Louisville, Kentucky-based law firm with over 30 years' experience in establishing US and international captive insurance companies. “Our top priority is the client,” says LCG&M attorney Steve Goodman. “We work to creatively fulfil our client's risk management needs, while being sensitive to their cost parameters. In addition, we provide all ancillary services needed for our clients, including asset protection, income tax and estate tax planning.” promote the state's captive industry and to act as a unified voice for local captive owners and service providers.

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From a legal perspective, Goodman emphasises the complexities in forming a captive. "Too often, we see companies with poor short-term strategies and execution related to their risk management activities," says Goodman. "Engaging competent counsel that has experience with captive insurance companies is critical, not only at the formation of the company but also throughout the life cycle of the captive, to ensure business goals are achieved."

Mountjoy & Bressler certified public accountant Lee Groza is the partner in charge of the firm's insurance services group and has been in the insurance race for some 16 years. He has worked with numerous Kentucky insurers and their owners on a variety of issues, ranging from consultation with the Kentucky Department of Insurance to audit, tax and financial planning work.

"Kentucky offers experienced regulatory staff who consistently demonstrate a willingness to work through the resolution of an issue," says Groza. "This business-friendly environment has been a tremendous benefit to our domestic captives."

Captive insurance structures once were the preserve of large corporations. But that has changed.

Due to a greater understanding of the costs and benefits associated with captive insurance, many small to medium-sized businesses have realised that these benefits are just as accessible to them," adds Groza. "As a result, we have seen a considerable increase in both the number of licensed Kentucky captives and the amount of inquiries about exploring captive solutions. The pure captive segment appears to represent the most significant growth area."

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Amid the current economic uncertainties, Groza expects companies to continue to explore cost-saving opportunities. A properly structured captive can "help better manage insurance costs, increase cash flow and provide significant tax incentives and benefits", he says.

"Current tax law supports the use of captive insurance companies to manage risk," says Groza, who cautions potential captive owners about rushing decisions. "Thorough examination is required. The captive must be properly structured to comply with certain provisions that govern the taxation of insurance companies. The captive insurance alternative is not for everyone, and the path should involve careful consideration and a comprehensive analysis. Even the simplest mistakes can nullify many of the intended financial benefits."

Contact information

Stuart Ferguson – stuartferguson@uscky.com
George Gorin – georgeg@uscky.com

The Underwriters Group
P.O. Box 23790
Louisville
KY 40223

Phone: (502) 244 1343
Fax: (502) 244 1411