Where to Domicile an Insurance Company?

Ann M. Frohman, Esq.
December Issue 2018

The strategic decision of where to domicile an insurance company for purposes of regulatory oversight is a complex exercise requiring thoughtful analysis. If the fit is not appropriate, it can derail management's ability to execute on strategic goals. Choosing to be regulated by one state insurance department verses another – or going offshore - appears peculiar at first blush. First, can one really choose a state in which to locate a corporate domicile? The approach to the analysis depends on whether the company is a start-up or currently in operation as there are risks and considerations common to both, but also others that must be carefully analyzed with a start-up insurer that may differ from mature insurers.

While there are some differences in methods regulators use for examinations of insurers, most laws regulating solvency of insurers are similar across the nation. For the most part, state insurance regulators cannot engage in a race-to-the-bottom by promoting lax financial regulation without risking loss of a coveted status of being accredited by the National Association of Insurance Commissioners (NAIC). The elaborate system of requirements imposed upon each member state are rigorous. Failure to maintain accreditation is rare due to serious repercussion on domestic insurers if accreditation is lost.

Nevertheless, location of a corporate domicile is extremely important in today's global insurance environment where competition is keen in underwriting, pricing and investing. Today, US regulators and many international supervisors have much closer-knit communications and relationships with other regulators around the world. For instance, the State of Iowa Insurance Division worked closely with the New York Department of Financial Services, as well as with the former Chinese Insurance Regulatory Commission on Anbang. For insurance company leadership, a wrong step that results in a poor relationship with a state insurance regulator may be communicated rapidly with other regulators and become difficult to manage. By the same token, a positive relationship with a well-respected regulator can prove beneficial in the long term.

Regulators, like insurance companies, have their areas of expertise. Some are better supervising large global companies, and others are better with smaller ones. Some regulators are strong and specialize in regulating companies that offer life and annuity products and private equity structures, others are strong in regulating companies that focus on reinsurance. Some regulators find a niche regulatory role, such as Vermont with captives and tend to stick to their knitting in the area of expertise. Understanding of technology platforms and artificial intelligence may be important to some company advancing underwriting with pricing algorithms using predictive analytics. Knowing which regulators have the skills to understand the business model should be at the forefront for these companies. Also, be on alert if a regulator recruits companies to domicile in a state where the regulator says it can do it all. Resources and budgets remain challenging for most US state insurance departments and this may not be the case. Some state economic development offices recruit companies to redomicile even with questionable resources, where others are strong in resources yet may not look for business out of concern for the optics.

If a domicile is selected where the state insurance regulator is less familiar with trends and practices on matters important to company management, the management will be required to educate the regulatory staff. While this is not unexpected, getting it right is more important than ever. This is because the system of state insurance regulation is evolving into a complex network of peer review and oversight. A decade ago, an insurance regulator would focus on the optics of its position in anticipation of review on examination or by the accrediting arm of the NAIC. Today, there are more optics and burdens on state insurance regulators. Peer-to-peer regulatory communication are expected through financial surveillance via NAIC working groups such as the Financial Analysis Working Group. Moreover, the supervisory college and the holding company structure urge strong communication among regulators even with coordinated regulatory deference to the "lead" state on executing decisions. For these reasons, a state insurance regulator must be vigilant in understanding mechanics of a transaction so it can explain and defend a position with its peer regulators in the US and abroad.

This peer review certainly can be a good thing if the domestic regulator is knowledgeable and communicates well. It can be a hard road if the regulator is not comfortable with being a leader on an issue, regardless of the reason leading to this situation. When this occurs, company management must make it a top priority to assure communications are framed in a manner that can be re-explained. Management must also be keenly aware to keep all regulators informed with identical information so that a well-intended strategy does not take on a misinterpreted understanding. Finally, for time sensitive financial transactions, such as reinsurance, acquisitions, dividends, and/or Form D and financial reporting, this complex communication loop requires better advance preparation for discussions with regulators. Management must match up with the expectations of the regulators. Some regulators require that company management anticipate the information they will need to make a decision and have focused, relevant and granular information ready rather than piecing it together after the request. Other regulators are focused more on being responsive and have no difficulty defining expectations on a case-by-case review. Knowing when too much information is unworkable verses not enough may be an art depending on the state in question. Still, having the right match on knowledge, expectations and communications makes all the difference.

Bringing a product to market can be equally challenging or rewarding if the state reviewers have expertise on the product area. Many state rate and form analysts are seasoned and know their business very well. Do not underestimate them. Doing so can lead to regret and a long road back to earning trust. On the other hand, if the staff turnover regularly, it can be more difficult to get a decision out of a regulator due to either hesitancy on the part of staff to make one out of concern that they need to get the decision right. The process slows because the staff need to consult experts either that may be consultants or other insurance department staff or NAIC staff.

The following item outlines a launch point of factors for consideration for assessing where to domicile an insurance company. This is not intended as legal advice on any specific state. It is best to discuss this topic with a specialist in insurance regulatory matters.

I. Understanding the Corporate Strategy

a) Is a new company being formed with a start-up focus?
b) Is the company being redomiciled from another state or an off-shore location?
c) Is the company in the process of being acquired under a Form A review?
d) How will redomestication be perceived? If the reason for redomiciling an insurance company is to exit a strained relationship with a regulator, redomestication should be examined carefully. A strategy that is viewed as an effort to circumvent a legal position of a regulator will do more harm than good and redomestication should not be part of any corporate strategy in such situations. Forum shopping is not acceptable to insurance regulators for purposes of achieving specific legal treatment.

II. Key Elements that Drives Corporate Strategy

a) Investment – Returns/Diversification
b) Operations
c) Tax
d) Reinsurance

III. The Holding Company Structure

a) Public company
b) Private Company – Private Equity, Individual, Foreign, etc.
c) Mutual Company
d) Mutual Insurance Holding Company
e) Reinsurance Company
f) Employer
g) Global
h) Size
i) Start Up Tech Focused or Mature Old Line?

IV. Finding the Right State Insurance Regulator/Corporate Strategic Match

a) Life/Annuities or Health Focused Priorities with Company
   1. Tax
   2. Accounting
   3. Operations
   4. Investment
   5. Global
   6. Other regulatory considerations

b) Property and Casualty Companies
   1. Employer Risk Management – Captive Investment
   2. Surplus Lines

3. Global
4. Insurtech

V. Environmental Scan of Business Climate

a) State Insurance Departments

1. Is the Insurance Department within the State being considered recognized as a lead regulator among its peers on concerns that are important to company strategy?
2. Are commissioners/staff historically short-term or long-tenured?
3. Are commissioners/staff accessible or does it take weeks to get on the schedule?
4. Are commissioner/staff focused on matters that do not impact your business?
5. Does the state regulator take time to review and fully consider circumstances, exceptions, and communicate well?
6. Does the regulator apply decisions consistently over the long term, or does it flip under pressure of stakeholders or follow other state insurance department decisions without engagement?
7. Is the insurance department adequately staffed to meet critical timeliness? Are they struggling to staff vacancies?
8. Do they regularly outsource work other than examinations; do these cause knowledge gaps, inconsistent and/or slow decisions?
9. Has the Insurance Department indicated it has been challenged to meet NAIC accreditation?

b) State Political Climate

1. Is the insurance commissioner elected or appointed?
2. Does the insurance department have consistent backing from administrations regardless of party change?
3. Is the insurance department subject to constraints and downsizing similar to other agencies or is it able to budget resources apart from general funding constraints placed on other agencies?
4. Does the state have financial challenges that could strain insurance department resources?
5. Is insurance important politically to the state and does the administration show interest?

c) Legislative Climate

1. Is the legislature historically conservative, reasonable and supportive of the Commissioner and NAIC models?
2. Is the legislature reasonably supportive of the insurance industry?
3. Is the legislature business friendly regardless of party and quick to pass bills?
4. Does state have a strong federation or industry association that works well with the Administration and Legislature?

d) Are policyholders treated fairly or are decisions skewed for or against them?

e) Does court system process cases in a short time frame or is there back log?

f) Are there unique business corporation laws to be considered?

g) Tax Considerations

1. Is premium tax rate attractive with retaliatory considerations?
2. Is premium tax rate at risk politically?
3. Is premium tax rate historically long-standing or a recent modification?

h) Does state offer reasonable employment environment?

1. State Investment Expected/Required and is this based in statute or a soft expectation?
2. Is Commissioner/Governor expectation of jobs and/or investment in state meet company strategy?
3. Caution: Watch optics and be mindful of ethical considerations and statutory requirements. Landmines are everywhere in this arena and one skilled in this arena should be consulted.

For More Information
Ann M. Frohman
402-438-6612
Ann@frohmanlaw.com

An attorney and former insurance regulator for the state of Nebraska, Ann Frohman creates and implements insurance advocacy strategies for large and small insurance clients, as well as provides legislative and corporate transactional expertise before governmental entities.