ART COLUMN FOR OCTOBER

We need to outsmart everybody

By Dick Goff

As the brethren gather in Chicago at SIIA's annual conference this month they will study "Outsmarting Reform" to equip their companies to succeed despite – and in some aspects even because of – the federal Affordable Care Act (ACA). What we need next will be courses on "Outsmarting Regulation" at the state level.

Taken individually, regulators may generally be described as talented, energetic and often astute people with enough background in insurance to equip them to make the rules that we in the private sector will follow. Or at least that's the way it's supposed to work.

The problems arise when the state minders get together in groups such as those sponsored by the National Association of Insurance Commissioners (NAIC) or conferences put on by the various states to study captives and other aspects of alternative risk transfer. There, they tend to engage in one-upsmanship in their regsfests titled "Can you top this?"

That's the only way I can describe a recent discussion during the Vermont captive conference. Heads were nodding (I assume in agreement, not drowsiness) when the bright idea was surfaced that captives and risk retention groups should be subjected to the NAIC's Own Risk and Solvency Assessment (ORSA) regulation process that will embrace commercial insurance companies beginning in 2015.

NAIC members like ORSA because they invented it and promulgated it to the states via their members. Now they would like the same process to cover captives and RRGs following the argument that it would provide a standardized captive company assessment tool.

One panelist explained that ORSA requires companies to assess their own risks in a four-step process that identifies major risks, establishes a process to measure the effects of risks, manages and mitigates the major risks and documents the results.

But hold everything! Captives and RRGs are already doing this under the auspices of their domiciliary states. It's just a prudent component of companies' mind-and-management practice. Captives' self-analysis culminates in annual actuarial review statements that are already part of the states' regulatory financial oversight.

By adding another layer of regulatory busywork with ORSA, NAIC members would be demonstrating that either (1) they are not confident of their abilities to individually regulate captives in their home states, or (2) they don't trust their peers in other states to do the job right.

Put most people out in a resort location for business conferencing and you'll find a balanced measure of recreation and socializing. But insurance regulators appear to find their fun in group forensic examination and creation of better handcuffs for ART structures. I worry about them.

ART Outperforms Commercial

ART should be the least of insurance regulators' concerns according to the report issued recently by A.M. Best, the organization that may be closest to pure objectivity in assessing our industry.

In 2012, U.S. captive insurance companies, on average, saw their loss-adjustment expense ratios drop 5.7% from 2011. A.M. Best noted that the five-year combined ratio for captives of 92.3 compares extremely favorably with the commercial composite of 103.3.

The captives' operating ratio of the same five-year period is tighter at 76.0 versus 88.5 for the commercial casualty composite.

A.M. Best's news release commented, "It is well known that captives' investment portfolios tend to be significantly more conservative…than typical investment portfolios for commercial casualty companies."

The 200 captive companies analyzed by A.M. Best were most heavily engaged in coverage for medical malpractice, general and auto liability, property, workers' compensation, inland marine and other lines in a broad range of $2 million to $3.5 billion in surplus.

Note to state domicile captive regulators: if it ain't broke, please stop trying to fix it.

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