Captive Domiciles Fear RRG Rules 'Railroad'

By Dick Goff

There is rising discontent among state insurance regulatory departments that operate as U.S. captive domiciles over the apparent intention of the National Association of Insurance Commissioners (NAIC) to railroad standards that will be tough on risk retention groups (RRG). These standards would be the litmus test for NAIC accreditation of the affected state insurance departments.

As background, NAIC formed two panels – the Risk Retention Group Task Force and the Risk Retention Working Group – to deliberate nationwide standards that RRGs should be required to observe.

I think this is a blatant step to undermine the federal preemption of state regulations that has been the anchor of risk retention enabling legislation by Congress in 1986. That law updated a 1981act of Congress that allows members of professions or industries to form their own insurance companies when availability or affordability of traditional insurance was a problem for them. RRGs have been a solution to the medical malpractice problem and have addressed important risks in the nursing home and transportation industries, just to name a couple of notable examples.

Congress intended that RRGs would be exempted from state regulation. Any RRG licensed in one state could be free to operate in every other state. Now the states, through NAIC, are trying to gain control of RRGs by forcing acceptance of standards that govern traditional insurance companies that market to the broad public.

NAIC's RRG Task Force is specifically considering application of its existing Part A standards to RRGs in the announced interest of improving their safety and viability, but without any real evidence that there are pervasive problems with safety or viability. Of its eight members, the only current captive domicile that licenses RRGs is Vermont. Other captive domiciliary states applied for membership but were not chosen in the NAIC selection process.

A recent issue of Risk Retention Reporter, a newsletter serving the RRG community, stated that the District of Columbia has requested that it and other captive domiciles be given full voting rights on the NAIC Risk Retention Group Task Force.

"It is imperative that the makeup of the Task Force be representative of regulators that regulate RRGs as traditional companies and as captives," RRR quoted Dana Sheppard, director of the Risk Finance Bureau for the District of Columbia Department of Insurance, Securities and Banking who said he filed his request with the NAIC executive responsible for state accreditation.

"Additional captive domiciles should be given full voting rights on the Task Force if the work of

the group is to become part of the NAIC accreditation process," Sheppard was quoted.

Other captive domiciles noted by RRR to feel snubbed for Task Force membership were Nevada, Hawaii and South Carolina. Nevada insurance commissioner Alice A. Molasky-Arman made her state's application for membership and denial by NAIC a significant part of her message to the annual conference of the Nevada Captive Insurance Association.

RRR reported that Eleanor Kitzman, director of the South Carolina Department of Insurance, said that South Carolina had requested participation on the Task Force and that she believed that Task Force member Vermont could adequately represent captive RRG concerns.

Montana's view of the current RRG regulatory environment was provided by John Huth, captive insurance coordinator, along with Steve Matthews, chief examiner, and captive insurance examiner Bob Durand.

"We hope the NAIC expands captive domicile membership on the two RRG committees now operating," Huth said. "RRGs operating as captives are so different from traditional commercial insurance companies that the NAIC panels need to know the sound business reasons for flexibility in areas such as using letters of credit, accounting methods and others."

"We're concerned that action taken by the NAIC may take away some of the alternative mechanisms that make RRGs work so well for their owner-insureds," said Matthews, who was manager of regulatory oversight for captives in South Carolina before moving to Montana. "It's important for regulators to be able to appreciate the differences between RRGs formed by involved and informed members who understand their risks and the capacity of their RRG and RRGs formed to market to insureds. Regulators should then have the flexibility to regulate accordingly."

"Letters of credit, for example, allow RRGs to get started while they are raising their capital," noted Durand. "Regulators should remember that letters of credit work in their interest because they are the only entities that can draw down on them in times of financial necessity. Regulators don't have that degree of control over a traditional insurance company's capital."

The NAIC RRG Task Force scheduled a phone conference call meeting in November that took the place of the planned September meeting in New Orleans that had been canceled due to Hurricane Katrina. The phone conference was open to all interested parties and instructions on registration were relayed at the annual conference of the Captive Insurance Council of the District of Columbia and other domiciliary business group meetings.

The phone conference attracted a large number of people representing organizations such as SIIA and various state captive groups including CIC-DC and the South Carolina Captive Insurance Association.

The first item Task Force chair Betty Patterson of Texas treated was expanded membership.

She said that she was not authorized to expand membership of the Task Force that had been formulated through the NAIC selection process.

In that phone conference, Task Force members voted approval on a number of “sliced bread” Part A standards selected by Patterson and held off on discussion of the significant and controversial standards until its next in-person meeting. The three main Part A standards that RRGs most object to entail eliminating letters of credit as financial reserves, forcing RRGs to report in statutory accounting rather than GAAP, and barring offshore reinsurance.

The reasons these issues are important to RRGs were never allowed to be discussed during the NAIC Task Force conference call. And it was never evident that members of the Task Force knew the many positive, beneficial examples of RRGs. No testimony was allowed to surface about the fact that states regulating RRGs as captives maintain a far better solvency record than states regulating RRGs as traditional insurers.

Rather, the NAIC RRG Task Force discussed a few technical issues that had no significant opposition from the RRG community, and then closed off the phone conference about 20 minutes earlier than scheduled.

The NAIC RRG Task Force will reconvene behind closed doors at the NAIC annual meeting this month in Chicago. There, they can do anything they want to.

I can understand why members of NAIC are incensed at this high-handed treatment by their own organization.

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