

## Is the War between States and Risk Retention Groups Near an End?

*by Len Crouse*

### **A preferred alternative for smaller organizations**

Before risk retention groups (RRGs) were created as part of the Liability Risk Retention Act (LRRRA) of 1986, smaller organizations that couldn't afford to create pure captives, with their accompanying start-up costs, were at the mercy of their only other source for liability coverage: commercial insurers.

Since then, many smaller organizations have come to depend on their ability to write affordable liability insurance through RRGs. This ability can mean the difference between a profitable, risk-efficient organization and one having to choose between absorbing more risk or watching profit margins shrink when forced to buy insurance through commercial outlets—especially during hard markets.

And that's assuming that the coverage your organization needs is even available commercially during hard markets.

### **Federal rights ignored**

Unfortunately, some states force RRGs to either make insurance choices they would rather not or run through rings to use an RRG to finance this risk. This is contrary to the intent of LRRRA, which is supposed to allow a risk retention group the right to sell liability insurance in any state where it registers, assuming it meets the requirements of its home domicile. Some states have long ignored this federal right and, unfortunately, federal law doesn't provide a way to enforce that right.

Now, after decades of yes-you-can, no-you-can't state regulation of RRGs, risk managers are hoping that uniformity in RRG regulation and enforcement of LRRRA provisions will become a reality as action on multiple fronts moves forward.

### **Multiple approaches**

Leading the way in the battle to ensure regulatory uniformity is the National Risk Retention Association (NRRRA), which has unceasingly defended the right of RRGs to do business according to federal law. In February, the group requested a court order to prevent discrimination of RRGs in Nevada and, a month later, wrote the Government Accountability Office (GAO) to request federal enforcement of LRRRA.

The GAO has been gathering information for months from both sides in this dispute, even taking the unprecedented step of meeting with representatives of RRGs and the captive industry at the Captive Insurance Companies Association's (CICA's) annual conference this past March. Risk managers told the GAO about how various discriminatory practices discourage them from writing business or force them to pay additional unnecessary costs. In some case, states have even illegally blocked non-domiciled RRGs from writing liability insurance at all. A GAO report that backs RRGs' accounts of their difficulties with some non-domiciliary states could jump-start federal legislation that ideally would include enforcement of LRRRA.

On this final front, it is hoped that bipartisan introduction of legislation, hoped for last year, will bring finality to this issue in 2011. Federal bill HR4802, the Risk Retention Modernization Act of 2010, was introduced in the House last year but couldn't attract a Senate sponsor. The bill is expected to be reintroduced in both the House and Senate this year.

### **Why not use commercial markets?**

Whatever comes of all this activity on various fronts, uniformity of state regulation of RRGs matters greatly to the small and mid-sized companies and organizations that depend on this risk financing mechanism for affordable coverage. Despite today's somewhat soft market rates, fluctuations of commercial rates and lack of availability have been commonplace in past hard markets.

Rates and availability are only two reasons why trade and professional associations and groups will band together to buy insurance. This power in numbers approach works equally as well whether insurance is bought by members of an RRG or another type of purchasing group, but RRGs offer added benefits for progressive organizations.

### **Benefits of retaining some risk**

Purchasing groups don't assume the majority of risk—the commercial insurer issuing the group its insurance does. In return for accepting this risk, the commercial insurer receives the financial benefits of good claims experience—thus the incentive to better claims experience isn't always apparent to groups that buy commercial insurance. But RRGs retain a portion of their risk, so those with a disciplined risk management approach that results in fewer and less severe claims can reap the savings rather than passing them along to a commercial provider.

Investment income also can add to the bottom line of companies that are members of RRGs, while the ability to tailor fronting and reinsurance adds flexibility to organizations insuring through these risk retention vehicles. These benefits—better risk management, flexible design and the potential to add to company profits—ideally should drive organizations to consider an RRG, with the benefits apparent during a hard market a secondary consideration. However, many companies may decide against an RRG option when confronted with the maze of obstacles some domiciles erect to discourage it.

### **Discriminatory practices**

When RRG risk managers and principals recently met with GAO representatives, they detailed the subtle ways states discriminate against them, such as demanding extra fees or additional filings for non-domiciled RRGs. This sometimes costs thousands of extra dollars and untold additional hours of work. Most RRGs acquiesce—and many states know they will—simply because the added, albeit illegal, costs are still cheaper than taking on an expensive court battle. But not every RRG gives in.

A case between Vermont-domiciled RRG Alliance for Nonprofits for Insurance (ANI) and the Nevada Division of Insurance is pending in Nevada district court. The insurance department issued a cease-and-desist order to ANI for writing first-dollar auto liability insurance, even though the RRG is registered in approximately half of all U.S. states and has been registered and writing policies in Nevada for a decade. Now, Nevada wants a certificate of authority, too.

To pick this particular captive as a test case seems curious, considering ANI is well-rated by A.M. Best and is domiciled in Vermont, the gold standard for captive insurance regulation.

If ANI eventually wins this case, it may or may not have wider-ranging implications. In the past, RRGs, with the help of the NRRRA, have won court cases versus specific states. Yet, violations of LRRRA continue to occur. If the courts can't permanently resolve these issues, the federal government may need to provide the eventual solution.

### **GAO report due**

Part of that solution may be in the next report to Congress by the GAO. At its unprecedented meeting with RRG risk managers at CICA, GAO representatives not only heard about violations of LRRRA, but how the industry took the steps recommended by the GAO in 2005 when the federal agency issued its last report on the subject.

Six years ago, the GAO published findings noting a lack of uniform state regulatory standards as a problem. The last report also cited inconsistencies in ownership control and governance, necessary to protect policyowners, as other potential problems for RRGs. Since then, the National Association of Insurance Commissioners has addressed virtually every issue the GAO raised with model laws, and its Risk Retention Group Task Force subgroup is considering what accreditation standards should apply to states serving as domiciles for RRGs.

### **Best shot at a solution?**

If the GAO considers the combination of steps already taken and the industry's willingness to adopt past recommendations, it may report back to Congress that federal legislation is needed that provides an enforcement mechanism when states ignore LRRRA. With the force of a GAO report behind them, RRG principals hope this bill advances beyond the House this year.

The bill introduced into the House last year provided an enforcement mechanism by giving oversight authority to the Federal Insurance Office. If enacted as it was written last year, the bill also would provide federal arbitration for disputes between RRGs and non-domiciliary state regulators, while standardizing corporate governance rules from state to state. Another provision would also allow risk retention groups to write commercial property insurance.

### **Conclusion**

Will LRRRA modernization become law, complete with a federal arbitrator to handle disputes? Who knows? The argument about states' rights versus federal law is as old as the United States itself, so it certainly is a contentious issue.

What is clear is that this battle between states and RRGs has lasted long enough. This is an issue that needs closure. Enforcement of the Liability Risk Retention Act is needed to give RRGs a level playing field in all states. Only enforcement of the LRRRA and a dispute resolution mechanism will provide that stability.

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