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The
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Reporter

A Look Back at the Federal Liability Risk Retention Act

by Len Crouse, Partner, The Towner Management Group

When Rep. John Campbell and Rep. Peter Welch introduced H.R. 2126, the Risk Retention Modernization Act, into the U.S. House of Representatives in June, it raised hopes of righting some quarter-century wrongs and also brought back a flood of personal memories. My career as an insurance regulator, and most recently in captive management, has coincided with the rise and growing sophistication of risk retention groups.

I was chief examiner for the Massachusetts Department of Insurance's property/casualty insurance division when Congress passed the 1981 *Product Liability Risk Retention Act*. This law caught my eye only because I dealt with the occasional product liability commercial insurers, not because of familiarity with risk retention groups.

Like most early innovations in captive insurance, this bill became law due to a particularly hard market, this time in product liability insurance. The number of RRGs was small, so few domestic insurance regulators—myself included—really knew the difference between a risk retention group and a doo-wop group.

That began to change five years later. A hard commercial insurance market, which bubbled up and simmered down in the previous eight years or so, was now a major business story. This made finding or affording some lines of casualty insurance nearly impossible for smaller companies and organizations. In response, Congress did something it rarely does—it moved out of the way of the states and how they regulate insurance entities when it passed the *Liability Risk Retention Act* of 1986.

The 1986 bill expanded the lines of business a captive or RRG could write—although RRGs and PGs were still prohibited from offering workers compensation insurance and property coverage. It also expanded the types of organizations that could form insurance groups to include businesses and government entities, as long as group members had similar insurance needs and risks. All LRRA '86 required of non-domiciliary states was that they follow one key requirement of the act.

Crucially, the new bill retained a key provision of the 1981 act, stating that a RRG chartered in one state was exempted from most requirements of insurance regulators in other states of operation. The 1986 bill added that non-chartering states could increase oversight if chartering states didn't. This provision was not meant to subject risk retention groups or purchasing groups to unnecessarily costly and time-consuming busy work and filings in non-domiciliary states. But in the 25 years since, states have tried to circumvent the federal law, as the exemption obviously was not explicit enough.

That Was Then

Meanwhile, regulators would need to learn and understand this new insurance entity and its governing statutes from RRG domiciles. Admittedly, I was one of those regulators who had a lot to learn. Massachusetts registered its first RRG soon after LRRA became law, but my learning curve grew exponentially when I moved to Vermont in 1990 as director of captive insurance for Vermont's Department of Insurance. In the two previous years, sparked by the 1986 Act, the number of RRGs grew by approximately 50% and premium volume nearly doubled. Vermont, then as now, had about one-third of U.S.-domiciled RRGs and more than half of total annual premium.

For the remainder of the 20th century we learned firsthand that, despite this growth and the good intentions of LRRA '86, not all states were ready for this sea change. Vermont was ready. From the start, Vermont established and subsequently maintained a regulatory and legislative regime that remains the gold standard for captive insurance. Each year, through administrations of various political stripes, legislators worked with regulators and other captive insurance players to learn how to improve state statutes while building on the state's preeminence in this area.

Noticing this success, other states began passing captive legislation and attracting RRGs. Soaring numbers of formations and a hard market usually coincided with each other, as they did after passage of LRRA. Formations slowed for most of the 1990s, but challenges to LRRA accelerated, especially in the form of subtle discriminatory practices. For two decades, RRG formations and hard markets came and went, leading us to the first half of 2011, when there were 252 RRGs operating.

Through a quarter-century and the growth of RRGs and PGs, some states naturally experienced growing pains as they struggled to learn how to regulate this new type of insurance organization. In those earlier years, a few high-profile insolvencies—National Warranty immediately comes to mind—created concerns among non-domiciliary states and the National Association of Insurance Commissioners.

This Is Now

Were these states and the NAIC justified about those concerns? I believe so, but much has changed over the years. Opponents of a federal enforcement mechanism to arbitrate RRG and PG discrimination complaints should understand why the LRRA makes more sense today than ever.

First, state captive statutes have matured and evolved over time. Many newer captive domiciles took Vermont's captive statutes and virtually made them their own. They can't do better.

Second, the NAIC's captive insurance subcommittee members have worked to understand RRGs and captive insurance. In the early years, the NAIC tried to fit captive insurers and RRGs into an insurance cookie-cutter mold, but Vermont and Hawaii regulators argued to convince the NAIC otherwise. Today, NAIC staff and state commissioners better understand RRGs. They still insist that these groups demonstrate financial integrity and good governance, but no owners of well-governed RRGs will argue against those requirements.

Third, states have matured immeasurably in their ability to understand and regulate RRGs. When I first moved to Vermont, it was the only state with RRG-specific oversight. We conducted exams, desk audits, and quarterly surveillance, and required yearly outside CPA audits and actuarial opinions, too. Today, state regulations are relatively uniform, unlike during the formative years of RRGs.

Fourth, all parties must realize no person or organization can legislate fully against all failure. Despite our best efforts, the occasional insolvency will happen. Understand, though, the percentage of RRG insolvencies has been about the same as commercial insurer failures.

Finally, Congress is promising RRG regulation that includes a dispute resolution mechanism. This effort began in earnest in 2008, the year I joined The Towner Management Group's U.S. operations as a partner. While that bill died, another was introduced each following session, culminating with the latest bill introduced in June. However, with so many enormous issues on the table, it seems unlikely that Congress will address this issue soon.

What Next?

If no federal action is forthcoming, where does this leave RRGs and PGs? Has discriminatory action by non-domiciliary states waned as many chartering states'—and Washington, D.C.'s—regulatory structures improved? That's half of the answer, and certainly a positive response. However, the negative impact from those states that still discriminate against RRGs is the other half of the story. RRG members band together to achieve economies of cost and scale, and fighting long legal battles against non-domiciliary states doesn't fit into any financial or risk planning strategy, so they either give up the fight or incur unnecessary costs and delays.

The occasional group wages the good, albeit costly, fight against discriminatory practices, as the Vermont-domiciled Alliance of Nonprofits for Insurance Risk Retention Group continues to do with its battle to write first-dollar auto liability coverage in Nevada. Other more subtle forms of discrimination exist, from delaying approvals and charging additional fees to the outright ignoring of registration attempts. This needs to end.

Even if H.R. 2126 stalls in its tracks, the federal government would be wise to adopt one of the bill's major components. Existing federal infrastructure is already in place for an arbitration process to mediate disputes between states and RRGs, thanks to the Dodd-Frank Wall Street Reform and Consumer Protection Act. While this law has detractors, it created the Federal Insurance Office, with former Illinois Insurance Director Michael McRaith as its director. With this office already in place, it might make sense to use it as an arbiter to settle disputes.

A quarter-century ago, the federal government got out of the way with the LRRA. Today, this same government needs to become minimally involved—only when RRGs are denied their federal rights. What is needed now is not a heavy-handed approach that would regularly interfere with state regulators, but an arbiter, a voice of reason, ensuring the provisions of LRRA—and its eventual successor—are applied evenhandedly by states. A quarter-century later, it is time.

Len Crouse is a Partner with The Towner Management Group. Len was a former Deputy Commissioner of Captive Insurance for Vermont's Department of Insurance. Under Len's guidance, Vermont's captive insurance legislation became a model for other states. Len is also a member of the Government Affairs Committee of the National Risk Retention Association. In 2007, the Captive Insurance Companies Association presented him with a lifetime achievement award.

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