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Reporter

GAO Report—Where Do We Go From Here

This is the first in a two-part series covering reaction to the GAO report from industry and regulatory perspectives. In this article, Joseph Deems, Executive Director of the National Risk Retention Association, offers his views.

The Government Accountability Office (GAO) issued its long-awaited report on risk retention group regulation in January, 2012. The report called on Congress to clarify registration requirements and fees imposed by some non-domiciliary states and to define specifically the types of coverage permitted under the LRRA.

Industry spokespersons commended the recommendation but expressed disappointment that the GAO did not go far enough in affirming the authority for RRGs to operate nationally with strictly limited regulation by states where they are not licensed. The critical question now is where do we go from here?

The Risk Retention Modernization Act (H.R. 2126) has been introduced in the House of Representatives, but has not gained sponsors in the Senate. Will the GAO report stimulate action to schedule hearings in the House and to obtain sponsors in the Senate?

We asked Joe Deems, executive director of the National Risk Retention Association (NRRA) a number of questions to inform the debate on whether the GAO report went far enough and how it will affect efforts to enact legislation that would resolve continuing disputes over the preemption issue. Here are his answers:

RRR: The RRG industry generally takes the position that submission of the documents specified in the LRRA is all that can be required by a non-domiciliary state before allowing a RRG to operate in that state. Some state regulatory agencies believe that the LRRA's silence on the issue means that non-domiciliary states can impose their own requirements. What is your view?

Deems: NRRA has experimented with every device known to man to convince certain states that their regulatory rights were clearly prescribed, yet intentionally limited by the Congress in 1986. Overly broad and inconsistent registration requirements and excessive registration fees are the top issues confronting the vast majority of both RRGs and purchasing groups.

There is no question that a simple, inexpensive dispute resolution process, like arbitration, would rapidly resolve virtually 95 percent of the disagreements. In fact, I can see the use of a well-crafted mediation process to resolve both present and future disputes, because if handled correctly, it could serve as a guideline for future disagreements, even involving different parties in different states.

Simply stated, NRRA is willing to sit down with any state to make recommendations in its drafting of any regulatory changes that will affect its captive laws to assist in making them consistent with the LRRA. We regularly send representatives to NAIC meetings to assist in the drafting of guidelines for the industry. We do our very best to persuade the association to adopt guidelines consistent with the LRRA. We will continue to support legislation, including H.R. 2126, that is designed to help both the states and the industry on these issues. NRRA is willing to talk—and talk we will—to help everyone reach a common ground of understanding.

RRR: The GAO report documented widely varying registration requirements in different states. What is your opinion on how this affects RRGs that do business in a number of states?

Deems: The widely different requirements are extremely burdensome to RRGs. The forms vary. The fees vary. The additional registration "requirements" vary. California, for example, employs a "review" process that can entail several rounds of inquiries that can take from one to three years before registration is "confirmed." California Code Section 132 prohibits RRGs from writing business on less than 60 days written notice. In some states, RRGs register and never hear back from the departments—for years!

The bottom line is that many RRGs employ companies that spend a significant amount of time enduring the pain and suffering of registering their clients in the different states, normally at extraordinary expense to the RRGs. You have to pay for the consultants, the captive managers, sometimes the lawyers, and obviously, the fees. They add up to thousands of dollars for entities that were designed by the federal law to be allowed to function in all the other '49' states if they are compliant with their domicile regulations. Do the math!

RRR: The GAO report points out that fee structures vary from state to state. While many RRGs believe some fees go beyond what is allowed by the LRRA, some state regulators believe the fees are permissible. Your views?

Deems: Obviously, in our fragile economy, fees are a source of revenue for the states, so it's understandable that they are going to opt for the greater, rather than the lesser approach. Of course, they can charge fees that are reasonable, but I've seen states double or triple their fees for registration and/or renewal in one year. That's unacceptable. NRRA will challenge those states.

RRR: LRRA is silent on the specific types of liability insurance that RRGs can provide. GAO reported that some regulators believe insurance lines such as contractual liability and stop-loss coverage were not permitted under LRRA. How do you think the coverage issue should be resolved?

Deems: There is no question that any type of liability coverage is allowed by the LRRA. That includes contractual, stop-loss, or anything else. The definition of what constitutes "liability" insurance is one of those "red herring" issues raised by those states that have traditionally demonstrated an ideological bias against risk retention groups. Legislation to resolve these questions may be the only answer.

RRR: The GAO stated that different interpretations by federal courts on what constitutes discrimination under the LRRA's financial responsibility requirements can further contribute to an uncertain regulatory environment. Should this question be answered in an amendment to the LRRA or left to arbitration under the proposed modernization legislation?

Deems: There is no question that the financial responsibility provisions of the LRRA allow certain limited regulatory rights to any state that can demonstrate that a particular risk retention group is financially impaired to the point of jeopardizing its ability to pay claims. That is a legitimate state purpose. Proof of discrimination is a legal question normally handled by the courts. Our proposed legislation attempts to resolve that problem by creating a dispute resolution mechanism that can be afforded by both sides.

RRR: Although RRGs write most of their business outside their state of domicile, non-domiciliary state insurance regulators must rely on domiciliary regulators to establish minimum capitalization and solvency requirements. Some states allow RRGs, unlike traditional insurers, to maintain minimum capital and surplus through letters of credit. Some non-domiciliary states do not believe this provides adequate protection to policyholders. Do you think this issue can be resolved through uniform, baseline standards to be developed by NAIC?

Deems: Probably, but my prediction is, knowing the NAIC, that should be decided by approximately 2020.

RRR: NAIC revised accreditation standards for RRGs to align more closely with those of traditional insurers including financial solvency oversight, accounting requirements, and risk-focused examinations. NAIC also is integrating corporate governance standards for RRGs into accreditation standards. Do you believe these actions by NAIC will resolve the disputes between non-domiciliary states and RRGs?

Deems: No. Some states are systematically trying to convince other states to join their crusade to prevent RRGs from doing business in many, if not most, of the states. NRRA supports corporate governance standards, financial solvency oversight, and risk-focused examinations. We have been working with states to help find ways to reduce the costs of these examinations. Indeed, we incorporated the NAIC corporate governance standards into our pending legislation. Why would we have done that if we were not trying to work with the states?

RRR: GAO's survey found that 32 state regulators oppose amending the LRRA to allow RRGs to write commercial property insurance while only five support the change. RRGs generally want RRGs to be authorized to write property insurance. What is your view on this question?

Deems: Allowing RRGs to write property insurance is an easy issue. If you meet the capitalization requirements to do business in your state of domicile, given the underwriting requirements, what could be the argument against it? What is the issue? You either have enough money to pay for the projected losses in the short term, backed up by reinsurance of course, or you do not. If you do not, you don't write property. London will reinsure loss portfolios here. Domestic reinsurers will do the same. It's a question of available capital. What's the beef?

RRR: The GAO recommended that Congress consider legislation to clarify provisions of the LRRA that apply to registration requirements and fees charged to RRGs by non-domiciliary states and to define specifically the types of insurance coverage permitted under the LRRA. Do you believe that federal legislation is needed or do you believe that these questions can be resolved by the NAIC?

Deems: NAIC as an association has no regulatory powers so these issues cannot be resolved by NAIC. In my view, the LRRA is clear in its provisions regarding registration requirements, fees, and allowance of all forms of liability insurance not excluded by the statute. Federal legislation is not needed to clarify these issues but is needed to create an enforcement mechanism. That's what our proposed legislation is designed to do.

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