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Reporter

GAO Report—Where Do We Go From Here?

This is the second in a two-part series covering reaction to the GAO report. In this article, Mike Lynch, deputy commissioner – Captive Program, Nevada Division of Insurance; Sean O'Donnell, director of financial examinations – D.C. Department of Insurance, Securities and Banking; and David Provost, deputy commissioner – Captive Insurance, Vermont Department of Banking, Insurance, Securities and Health Care Administration offer their views.

The Government Accountability Office (GAO) issued its long-awaited report on Risk Retention Group regulation January 9, 2012. The GAO 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.

Risk Retention industry spokespersons expressed disappointment that the GAO did not go far enough. The critical question now is where do we go from here?

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

We asked the three regulators a number of questions to inform the debate on whether the GAO report went far enough. Here are their 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 regulators believe the LRRA's silence on the issue means that non-domiciliary states can impose their own requirements. What is your view?

Lynch: I have not had any significant/major complaints brought before me regarding the foreign insurer/RRG registration process. That being said, there are some domiciles that require a great deal of information from both the insurer and the domestic state in order to facilitate their own registration process, and I can appreciate how this may be a source of frustration for some RRGs.

O'Donnell: My view is that submission of the documents specified in the LRRA is all that can be required by a non-domiciliary state. The best way to resolve these different interpretations is to amend or clarify the LRRA.

Provost: Section 3902(d) of the Act clearly specifies the documents to be submitted to the chartering state and equally clearly says that before it may offer insurance in other states, the RRG shall submit a "copy of such plan or study." Not a copy plus extra information; not the same information in a different format; a copy. Plain simple language. It is too costly for small companies to battle endlessly in the courts to resolve this. Therefore, the only solutions I see are either additional language or a federal regulator to settle the disputes, or both.

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?

Lynch: I think it is a common belief that some formal form of "registration" is required, if for no other reason than to inform the respective domiciles who is proposing to write various lines of insurance in their states. Each state certainly has its own way of doing business, and this "registration" process may take many different "shapes." I am not aware of any dispute on this issue.

O'Donnell: I am aware of DC RRGs that have encountered delays writing in non-domestic states with a protracted "registration" process. I am also aware of RRGs that have incurred additional legal and administrative costs while attempting to address registration requirements that go beyond requirements stated in the LRRA.

Provost: The varying requirements have proven to be a major inconvenience for RRGs that operate under a Federal Charter and need only provide a copy of their plan of operation to states they plan to operate in (Section 3902(d) (2) (a) LRRA). RRGs often experience resistance, rejection, or no response from other states. All of this adds to the cost of operating the RRGs. The lack of uniformity is something that must be considered during the feasibility process when forming a RRG and may deter a RRG from operating in some states to the detriment of potential policyholders.

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?

Lynch: The Act is reasonably clear on the issue of fees. However, I think it is mutually understood that some form of fee to cover the minimal expense associated with the registration of a foreign RRG is acceptable and defensible.

O'Donnell: My view is that the LRRA does not clearly state whether fees are permissible and that it should be amended or clarified to clearly state the intent regarding fees.

Provost: The LRRA is silent as to fees that the various states may charge for administrative costs involved when a RRG operates in their state, but it does expressly permit states to levy premium taxes. I'll leave it to attorneys to settle whether the silence regarding any charges other than premium taxes equals a prohibition against fees. We do not charge a fee to RRGs or PGs, finding that the minimal costs we incur to look at foreign RRGs are more than offset by the premium tax.

RRR: Federal courts have disallowed some fees but have not held that all fees non-domiciliary states charged were necessarily prohibited. Does this argue for uniform federal standards or should it be left up to individual states?

Lynch: The process of regulating insurers is best left to the states. This has been demonstrated over and over again. I think the notion of federal regulation for RRGs is moot.

O'Donnell: This argues for some type of uniform standard. Leaving it up to the individual states to decide will lead to continued lack of uniformity and disputes between RRGs and non-domiciliary states. My view is that the LRRA should be amended or clarified to clearly state the intent regarding fees.

Provost: Registration fees imposed by the states don't seem unreasonable if they are commensurate with the minimal costs incurred by non-domiciliary states with respect to RRGs and don't try to make up for the fact that the RRG is not a licensed insurer under the full scrutiny in that state.

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?

Lynch: Again, the Act is reasonably clear. There are certain areas, like those mentioned, that could challenge the conservative nature of some domiciles. Nevada allows both types under certain conditions.

O'Donnell: I think the best way to resolve the coverage issue differences is to amend or clarify the LRRA to clearly state the intent regarding the types of liability insurance that RRGs can provide.

Provost: I think the mentioned coverages are clearly permitted under the LRRA, but they may not have been contemplated by the drafters. Although I qualify this with "be careful what you wish for"—I do think a clearer definition of allowed coverage would be an improvement to the Act.

RRR: LRRA does not preempt state authority to apply financial responsibility standards as long as those standards do not discriminate against RRGs. The GAO pointed out that different interpretations by federal courts on what constitutes discrimination 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?

Lynch: I think that any statutory clarification would be greatly appreciated by all states. Barring that, additional legal clarification would go a long way in helping resolve this issue and bring more consistency to the regulation of RRGs seeking to write certain lines that involve some form of financial responsibility component.

O'Donnell: Again, I believe the best way to resolve these different interpretations is to amend or clarify the LRRA to clearly state the intent.

Provost: A dispute resolution process may be the only way to handle these different interpretations and claims of discrimination against RRGs. Clearly, if different federal courts are providing different opinions, more clarity in the Act is needed.

RRR: Non-domiciliary state regulators must rely on domiciliary regulators to establish minimum capitalization and solvency requirements. Some states allow RRGs to maintain minimum capital and surplus through letters of credit. Some states do not believe this provides adequate protection to policyholders. Do you think this issue can be resolved by the NAIC?

Lynch: Letters of Credit provide an excellent method to ensure those funds are available to pay claims. If anyone can explain how cash in the bank under control of the insurer is better, I would love to hear their answer.

O'Donnell: Yes, I do think this issue can be resolved through uniform, baseline standards developed by the NAIC. During a December 2011 conference call of the Accreditation Committee, the RBC standards for RRGs were unanimously adopted, and at the March 2012 NAIC meeting, its Accreditation Committee's decision was adopted by the NAIC Executive Committee and Plenary. As a result, the NAIC Accreditation standards applicable to RRGs now formally recognize LOC's as assets.

Provost: Those states that accept LOCs as admitted assets and capital have found them to be very effective. In Vermont, we have been very successful with our authority to accept capitalization in the form of letters of credit issued in the prescribed form from qualifying banks with the Commissioner as beneficiary.

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?

Lynch: No. I think it has been adequately demonstrated that some domiciles will simply want more oversight of RRGs.

O'Donnell: I do believe these actions by the NAIC will help to resolve disputes between non-domiciliary states and RRGs.

Provost: These actions may lessen disputes but not resolve them altogether. Certain states will continue to have varying interpretations of RRG laws and regulations.

RRR: GAO's survey found that 32 state regulators oppose amending 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?

Lynch: At this time, Nevada has no opinion. If the Act is amended to allow it, Nevada would act accordingly.

O'Donnell: The recent application of enhanced financial solvency oversight requirements, as well as pending RBC and corporate governance standards for RRGs should help to allay concerns regarding the ability of certain RRGS to successfully write property insurance as an enhancement or accommodation offered to their members. However, new RRGs organized solely to write property insurance, or expansion of commercial property business by certain existing RRGs, could result in concerns and challenges for the RRGs and for regulators.

Provost: Commercial property insurance is an appropriate expansion of the LRRA. Many states are concerned that RRGs are not adequately capitalized to write property insurance. The authority to include property insurance in a RRG should not be assumed to be an open invitation to enter that line of business. The regulator will have the authority to grant approval for some RRGs and not for others.

RRR: The GAO recommended that Congress consider legislation to clarify provisions of 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?

Lynch: If I were operating a RRG, I would prefer that the federal act be amended versus relying on NAIC to issue new standards.

O'Donnell: I believe federal legislation is needed to resolve these questions. I do not believe these questions can be resolved to the satisfaction of all regulators and RRGs by the NAIC.

Provost: Federal legislation is the preferred mechanism. Lacking such clarity, we will continue to have differing opinions among the states, which is incompatible with a federal preemption of state laws. Business can't prosper in an uncertain regulatory environment.

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