The Risk Retention Reporter

Present

Risk Retention Legal and Regulatory Compendium

A comprehensive guide to state actions affecting RRGs and PGs

2011

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Risk Retention
Legal and Regulatory Compendium

Auto Dealers Risk Retention Group vs. Poizner

Auto Dealers RRG was a Montana-domiciled RRG that provided stop-loss contractual liability for California auto dealers. In mid-2007, the RRG began writing business in California after the state mandated waiting period of 60 days. However, two months later, California denied Auto Dealers RRG's registration. While trying to work out their differences, Auto Dealers continued writing business in California until the state issued a cease-and-desist order in December 2007. Auto Dealers went to court and received a temporary injunction in order to continue providing coverage to their members. California's main argument for denying Auto Dealers' registration was that the RRG was providing "contractual liability," not tort liability which the state claimed is the only type of liability allowed by the LRRA. Auto Dealers responded that the California state commissioner, Steve Poizner, exceeded his authority as non-domiciliary state regulator by "denying" the RRG's registration and issuing a cease-and-desist order to a RRG not domiciled in his state. Following an amicus briefing by NRRA, the federal judge granted a preliminary injunction in favor of Auto Dealers and issued a memorandum order that largely adopted NRRA's position. In the middle of 2008, a court trial was set for September 2009. However, in late July the Auto Dealers Board voted to withdraw its lawsuit against California due to financial considerations. Instead the RRG set-up a fronting carrier to be able to do business in California. In late 2009, the RRG merged into a traditional insurer and ceased operating.

Calif. Denies Registration for MT RRG Insuring Medical Stop Loss

November 2007

The California Department of Insurance (CDI) has denied the application for registration of Ad-Comp Med RRG, Inc., a Montana-domiciled risk retention group licensed to provide contractual liability for California auto dealer franchises who qualify under ERISA self-funded employee group medical plans. (RRG was later renamed Auto Dealers RRG.)

The Liability Risk Retention Act requires that, prior to operating in a state, RRGs must submit a copy of their plan of operation or feasibility study which has been filed with their domiciliary state.

While the LRRA contains no such waiting period, under California Insurance Code Section 132, RRGs must wait 60 days from the date that the CDI determines required documentation has been submitted. The provision has not been challenged in court, although some RRG experts assert that it is clearly preempted by the LRRA.

According to Richard Goff, managing member of Towson, Maryland-based The Taft Companies, which serves as the RRG's captive manager, Ad-Comp RRG's application was filed on August 1, and after complying with the 60 day waiting period, the RRG began writing business. Goff says that, "Life was good until sometime in October" when the RRG received notice that it was not registered. Goff notes that, "California has not told us not to operate," and he has advised his clients to "continue business as usual."

Goff says that the RRG and California are currently in ongoing discussions, adding that, "We are confident that we are going to work through this with California (so that) everybody wins."

In response to *RRR*'s questions to the CDI seeking the legal basis for the denial, the CDI stated that, "Given California's legal framework for the insurance industry," the RRG's "request for registration" was denied on several grounds. The first of these is that, "Ad-Comp has not established that it is licensed exclusively as a liability insurance company in a state in the United States." According to Jill Jacobi, CDI senior staff attorney who oversees RRGs, Ad-Comp's certificate of authority "does not evidence that it is licensed as a liability insurance company." Under the LRRA, RRGs are required to insure the "liability exposures of its group members."

Tal Redpath, captive analyst with the Montana Department of Insurance, explains that certificates of authority or licenses issued by Montana for domiciled RRGs do not specify lines of authority and thus do not explicitly state that the RRG is insuring "liability." However, he notes that the name includes the words "risk retention group" on the license, and that Montana law defines a RRG "as a captive insurance risk retention group formed under the laws of this chapter and pursuant to Title 33, chapter 11," which require that a RRG provide liability to its members.

The CDI also denied the application because, "Ad-Comp proposes to write and issue insurance policies in California that are not liability insurance authorized by the federal act, but are, in fact, first party coverage." Jacobi notes that the CDI reviewed the RRG's

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NRRA vs. Brown

In 1995, Louisiana enacted a statute that would require non-domiciled RRGs to undergo an extensive application process in order to register to do business in the state. Within a few months, Louisiana legislature passed a bill that required capital and surplus requirements of foreign RRGs as well as a deposit or bond of $100,000. NRRA and three RRGs doing business in the state sued Louisiana charging that the requirements were contrary to the LRRA. Louisiana countered that the provision in the law requiring the capital/surplus requirements was a financial responsibility law and excepted from preemption by the LRRA. In June 1996, U.S. District Court granted a motion for partial summary judgment on behalf of the plaintiffs. Louisiana appealed the decision, and in May 1997, the U.S. Court of Appeals upheld the lower court's decision on behalf of NRRA.

Louisiana Limits Registration of Foreign RRGs to Certain Months

July 1995

The Louisiana Department of Insurance will not accept applications from risk retention groups domiciled in other states from October 1 to March 1, beginning this year and extending indefinitely. The action does not apply to Louisiana-domiciled RRGs, of which there are none at the current time. Under the 1986 Liability Risk Retention Act, a RRG must provide notice to state insurance departments of their intent to operate in a state. The reason given for the restriction, which Louisiana characterizes as a "moratorium," is provided in Louisiana's hefty RRG registration packet, consisting of 30 pages, which explains under *Common Questions*, "There are several reasons for this moratorium. The year end financial information available from applicants is 'stale' and outdated by this time. Therefore, the Department has chosen to wait until updated information is available before accepting applications. In addition, this time gives the Department opportunity to review the forms and procedures to determine what changes, if any, can be made to streamline the application process."

Anticipating that some RRGs may try to get in under the wire, the next question and answer state: "Q. Since the Department does not accept applications from October 1 to March 1, will a partial application or letter of intent serve to meet this deadline if the remainder of the application follows? A. No. As indicated in the instructions above, only complete applications are accepted. Therefore, filing a partial application or letter of intent would not meet the filing deadline."

As for the time frame for review, assuming the application is filed with in the permissible time period, the answer states, "The review process can be expected to take from ninety (90) to one hundred twenty (120) days from receipt of a complete application."

In addition to the timing requirements, RRGs must submit biographical affidavits on all officers and directors of the company and on all individuals owning 10% or more of stock, if a stock company. NAIC biographical affidavits will not be accepted. Fingerprint cards (FBI/NCIC standard cards) must be submitted, as well as a domiciliary state questionnaire and a copy of the most recent market conduct examination report certified by the domiciliary state. Louisiana has also proposed legislation which would regulate foreign RRGs, requiring them to have minimum capital and surplus of at least $5 million, regardless of the capital and surplus requirements in the RRG's domiciliary state and to post a bond of $100,000. Several industry representatives view Louisiana's actions towards RRGs (and PGs) as an invitation for legal action and consider it just a matter of time until this comes to pass.

Louisiana Law Sets $5M Surplus Requirements for Foreign RRGs

August 1995

Louisiana's governor signed into law a bill, on June 28, 1995, that requires foreign risk retention groups—i.e. RRGs chartered in other states—to "possess minimum capital and surplus requirements of at least five million dollars." In addition, the new law requires that foreign RRGs post a cash deposit of $100,000 or execute a bond in favor of the insurance commissioner in that amount. Foreign RRGs will also be required to submit to the insurance commissioner the RRG's plan of operation, as well as a fee of $1,000 to cover the cost of examination of review of the RRG's financial statements.

The newly enacted law was proposed by Louisiana State Senator, Donald Hines as Senate Bill 1375. The new law appears to fly in the face of the Liability Risk Retention Act which provides in Section 3902 that, "Except as provided in this section, a RRG is exempt from any State law … to the extent that such law …

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State of Penn vs. Corcoran Revisited: Reality vs. Perception

Richard G. Liskov Counsel, Chadbourne & Parke

May 1994

Eight years after Congress broadened the Liability Risk Retention Act (LRRA) to encompass commercial and professional liability coverage, it is somewhat surprising that only one case to date has addressed a central question under the LRRA: To what extent does a state retain authority to regulate the nationwide rates and policy forms of licensed insurers covering the members of a multi-state purchasing group (PG) who reside in that state? The one case is, of course, Insurance Company of the State of Pennsylvania vs. Corcoran, 850 F.2d 88 (2d Cir., 1988). As the NAIC proceeds to revise its regulators' handbook on risk retention and purchasing groups, both sides of the ongoing debate over the scope of state regulation of PGs would do well to reflect on what facts the *Corcoran* case did—and did not—involve and what the federal courts in that case did—and did not—decide.

The Factual Situation

In the spring of 1987, State of Penn, a New York-licensed insurer, sought to take over the book of professional liability coverage for nurse practitioners employing a nationwide purchasing group domiciled in New York. The company inquired of the New York Insurance Department whether the Department construed the LRRA's purchasing group preemption section (15 U.S.C. § 3903(a)) to exempt State of Penn from New York's usual rate and form approval requirements. Not surprisingly, the New York Department responded, in a letter that became part of the court record, that in its view the LRRA did not preempt those requirements. The Department's letter added one qualification: the Department could not disapprove a PG's forms and rates if the PG's insurer "can show that any advantage being offered to the group or its members is based upon their loss and expense experience."

At about the same time as this communication the Department also issued a Circular Letter—which is not a binding directive but an advisory indicating the agency's position to the insurance industry—which stated:

"This is to advise insurers that the federal Liability Risk Retention Act of 1986, in connection with purchasing groups, does not relieve an authorized insurer of the form and rate filing requirements of the New York State Insurance Law.

Therefore, any authorized insurer that has written, or is contemplating writing, such policies, . . . should . . . obtain prior approval from the Department of forms and rates, where approval of such forms and/or rates is required by the Insurance Law, before such insurer begins or resumes issuing such policies, certificates, or other evidence of insurance . . ."

Rather than await the Department's disapproval of a particular rate or form that reflected a genuine advantage to PG members, State of Penn proceeded directly to federal District Court and sought a preliminary injunction against any application of Article 23 of the New York Insurance Law to State of Penn's purchasing group rates and forms. The insurer argued that § 3903(a), the preemption section of the LRRA, prevented New York from applying any of the provisions of Article 23 concerning rates or forms, quoting Congressional committee reports from 1981 and 1986 regarding preemption of state laws that would prohibit or hinder the ability of insurers to cover purchasing groups. New York countered by citing LRRA § 3903(g), which preserves all state laws that are not preempted by § 3903(a), and by quoting passages from the legislative history that repeated the point.

The District Court agreed with the Department, refusing to enjoin all operation of Article 23 in respect of purchasing group insurers' rates and forms. State of Penn appealed to the Second Circuit Court of Appeals, which unanimously affirmed the District Court. Contrasting the LRRA's broad preemption provisions affording risk retention groups near total freedom from state regulatory oversight outside their domiciliary jurisdictions, the Second Circuit found that the LRRA's preemption provisions applicable to purchasing groups and their insurers were more narrowly tailored, with only the eight specified exemptions listed in § 3903(a)(1)-(8) available. As none of these provisions by their terms barred application of all state regulatory authority over purchasing group rates and forms, the Court ruled that there was no statutory basis for the broad relief requested by State of Penn.

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State Regulators Already Have Adequate Authority to Address GAO Concerns

Robert H. Myers, Jr., Partner, Morris, Manning & Martin, LLP
and General Counsel, National Risk Retention Association

February 2006

The report by the Government Accountability Office entitled "Risk Retention Groups: Common Regulatory Standards and Greater Member Protections are Needed" has prompted the National Association of Insurance Commissioners to action. The NAIC has two groups working on risk retention group issues resulting from the GAO report. Ironically, the prudent exercise of existing state regulatory authority is capable of dealing with the issues raised by the GAO.

The GAO Report

The GAO's principal conclusion is that there is a need for increased uniformity among the regulatory capabilities of the various states. RRGs are domiciled in one state but operate in many states, which creates the opportunity for "regulatory arbitrage"—a practice where RRGs seek states with the "most relaxed standards."

The first area of GAO concern involves financial reporting. Traditional insurers are required to report using statutory accounting, which is not entirely uniform as the NAIC *Accounting Practices and Procedures Manual* allows for deviation through "permitted practices." The NAIC working groups are currently entertaining the concept that RRGs, most of which use GAAP accounting, should be required to report on a statutory basis, so that nondomiciliary states can understand RRG financial statements under a uniform accounting system.

The second area of GAO concern is corporate governance. The report dwells on the need for RRGs to be controlled by their insureds and finds that the failure of some regulators to enforce this requirement has permitted some RRGs to engage in financially risky behavior.

The third area of GAO concern relates to the finding that some RRG members do not fully understand the regulation of RRGs, including the lack of guaranty fund protection. Even though federal law permits states to require notification on the policy of lack of guaranty fund protection, the GAO believes that further disclosure to insureds would be desirable.

The GAO's recommendation for these concerns include:

> *Mandating financial contributions by insureds on an annual basis in more than a "nominal" amount*
>
> *Enforcing the requirement that only insureds vote and control the RRGs*
>
> *Mandating that the majority of directors be "independent" (meaning not related to promoters or captive managers)*
>
> *Providing to the Board of Directors an accelerated right to terminate management contracts, and imposing under federal law a fiduciary duty on a captive manager or other "insider" to act primarily for the benefit of insureds and only secondarily for the benefit of the "insider".*

State Regulatory Authority

The Liability Risk Retention Act is premised upon the concept of "lead state regulation" in which the state of domicile of the RRG has full authority under its laws to regulate the RRG while other states are limited in their regulatory authority. A traditional commercial insurer cannot issue insurance in any state other than its domicile unless it is licensed by such other state. By contrast, a RRG does not need to be "licensed" to provide insurance in a non-domiciliary state but may do business in such state under federal law so long as it makes the necessary filing specified by the LRRA.

In fact, state regulators have more authority over RRGs than is generally understood. The GAO report indicates that "[w]hile many regulators did not believe LRRA safeguards were adequate, few indicated that they had availed themselves of the tools LLRA does provide non-domiciliary state regulators". For example, only five non-domiciliary state regulators indicated that they had ever asked domiciliary states to conduct a financial examination of a RRG.

A fundamental precept of the LRRA is that a RRG must be controlled by its insureds. The GAO report has proposed a series of "solutions" to ensure that insureds retain such control. However, the implementation of at