Captive insurance gems

Dennis Silvia and Tony Weller explain why risk retention groups are a viable solution in the insurance marketplace

Risk retention groups (RRG) have long been a viable solution in today's insurance marketplace for association, affinity and other group programmes. The most successful programmes have the ability to leverage specialised risk management, loss control and marketing and sales protocols to the advantage of the members of the RRG. One of the most powerful benefits for participation in a RRG is the long-term stability that they offer to their members. This stability manifests itself in consistent premium charges and the availability of coverages even during tough market conditions. More than that though the policyholders ultimately control the programme, customise the risk management programme; create best practices for participation and ultimately they share in dividends when the RRG is successful. Of course, no insurance solution is a panacea, but in the right circumstances an RRG is a powerful insurance tool.

RRGs were created by the federal Liability Risk Retention Act (LRRA) and are essentially liability insurance companies able to provide direct insurance coverages to their policyholder owners across the US. The RRG must be formed and licensed in one state but then can expand its operations into other states simply by providing notification to the new states. The LRRA preempted any state from created laws to "make unlawful, or regulate, directly or indirectly, the operation of a RRG". RRG have no requirements for insurance rate or policy form filings to be submitted an approved in any state. Of course, there are some practical considerations to the operation of an RRG like homogeneity of risk, limitations on third-party liability coverages and the fact that policyholders are the owners and only owners can be policyholders. RRGs cannot provide any first person coverages like coverages on insured owned property, nor can they be used to satisfy the requirements to purchase workers' compensation insurance. In this framework, RRG programmes have flourished even in the face of some states wanting to curtail their operations. While states do not have the ability to impact RRG operations that are duly licensed and regulated in another state there has been a lot of pressure exerted through the National Association of Insurance Commissioners (NAIC) to promulgate RRG governance standards. The NAIC has promulgated model laws that have stepped up the oversight and regulatory management of RRG and have used its ability to sanction an uncooperative state to see that these laws are implemented in the domiciles of RRG across the country.

All of this has served to improve the operational characteristics of RRGs and to make them a stronger force in the alternative insurance marketplace.

There are some complications to RRGs as compared to the captive insurance marketplace in general. These sophisticated insurance companies require higher levels of capitalisation to form, in most states at least $1 million, but depending on the coverages being written and the expected to premiums in the aggregate potentially much more. They require professional management more akin to a commercial insurance company than their captive insurer cousins that they are most closely related to. However, they issue policies directly to their owners, so they must maintain robust and effective underwriting standards, but because of the nature of their third-party liability insurance offerings claims adjudication is directed to non-owners and creates a degree of difficulty that demands professional handling for efficacy and compliance with claims settlement regulations. Finally, the financial reporting protocols for RRGs are comprehensive. When the proper partners are chosen these are all hurdles that can be overcome successfully.

A captive manager that has a consulting arm should be the first partner chosen when exploring the opportunity that a RRG might present for the particular insurance solution being sought. Putting together a bespoke framework for the structure of the RRG is critical including sourcing reinsurance partners to limit downside risk and mitigate capital requirements, determining pricing for the RRG coverages with the help of a qualified actuarial firm, designing underwriting guidelines, creating meaningful risk management and loss control protocols and searching for the best domicile all lay a foundation for successful RRG operations. Once a plan is formulated and approved then the captive manager's job is to transition to implementation of the programme within the dynamic of successful operations and compliance.

Even when a RRG has been successfully operating for several years it's not time to become complacent. Like any business enterprise a RRG needs to be dynamic and in touch with the changing needs of its policyholders, reinsurance pricing, technology improvements and the quality of its service providers. The captive manager can play a key role in ensuring that a RRG is monitoring all the facets of its operations and considering changes that would improve and diversify its offerings. By utilising an ongoing review process the RRG can quickly change its policy offerings to meet the needs of its policyholders and potentially attract new policies to participate. Analysis of actuarial results as the programme matures, can inform changes in pricing that either make the RRG more competitive by lowering rates, or ensures the longevity of the programme by adjusting rates upwards. The reinsurance market is always fluctuating and the decision point between buying reinsurance capacity and retaining layers of risk moves annually. Technology related to policy underwriting and issuance is seeing dramatic improvements and needs to be evaluated regularly.

Cedar Consulting has been involved in the alternative risk marketplace since 2005 and its experience actually extend back into the early 1990s. While many companies have moved away from providing management services to RRGs we have been building our staff and capabilities to be able to provide sophisticated consulting and management services for the current body of RRGs and to assist new RRG programmes to evaluate, license, implement and administrate their insurance companies.

As a new entrant to the captive insurance management arena we will have a primary focus on group captive and RRG programmes. Our consulting arm has over 25 years of experience in evaluating and implementing successful group programmes. Our captive management administrators come from the commercial insurance marketplace having provided accounting and administrative services to successful small commercial insurance company operations. In addition, our business partner, Citadel Re provides reinsurance capabilities to the RRG marketplace to mitigate down side risk in the programmes and to potentially mitigate capital requirements required by the licensing state. **CIT**

Tony Weller
CEO
Citadel Risk Group

Dennis Silvia
President
Cedar Consulting