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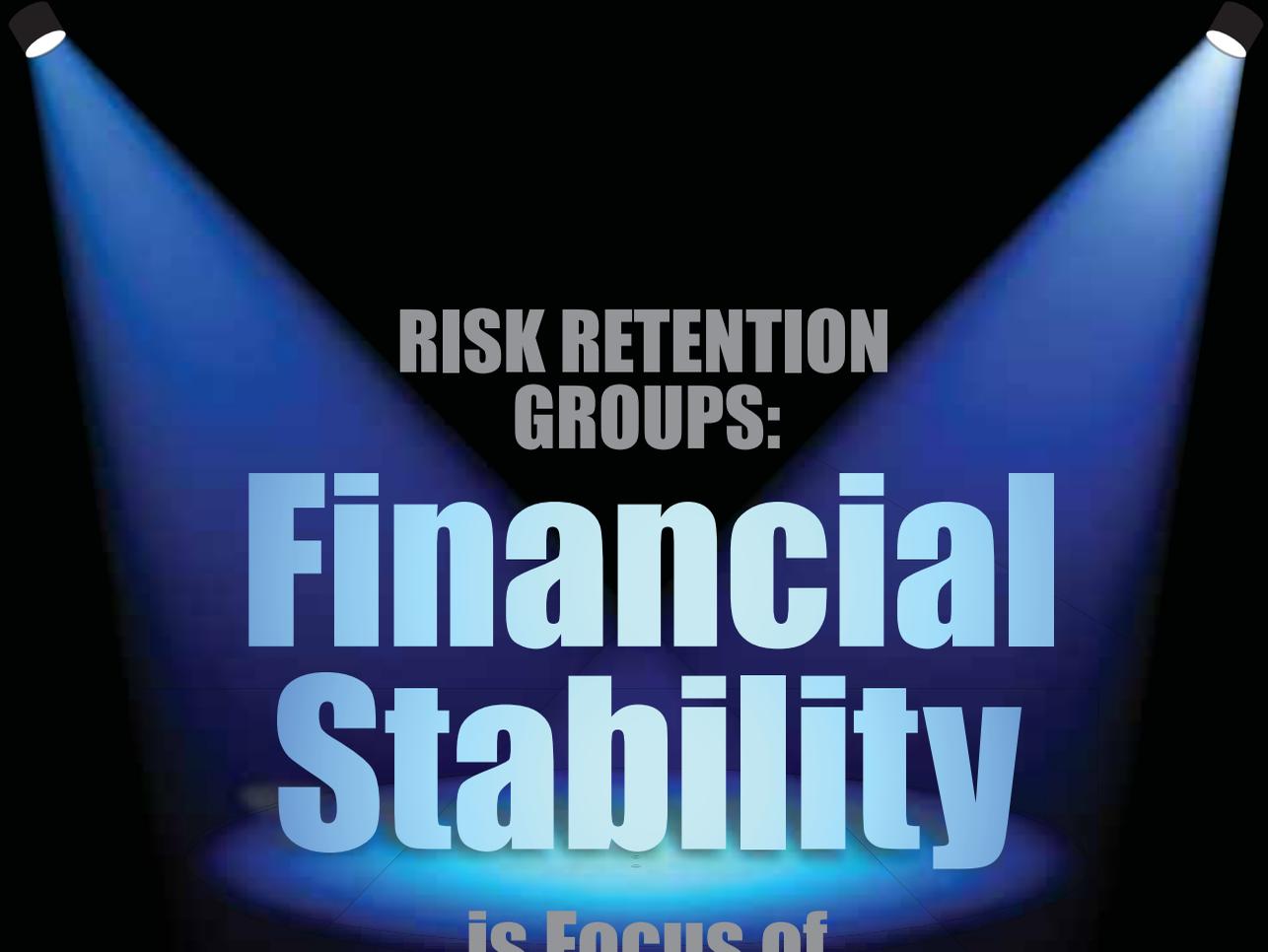
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**RISK RETENTION  
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# **Financial Stability**

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## GAO and NRRA at Odds

Despite current economic uncertainties and the dialogue between the General Accountability Office (GAO) and the National Risk Retention Association (NRRA), Risk Retention Groups (RRGs) in total improved reported results in a number of key areas for the year ending December 31, 2011. The GAO issued its report pertaining to the overall health of RRGs and commented on the extent to which non-domiciliary states were exceeding their authority under current law.

The NRRA issued a statement in response to the latter in February 2012. “We’re pleased that the GAO has recommended Congressional action but disappointed that the agency’s report failed to take a strong position in support of RRGs where certain states have imposed requirements that clearly are in direct conflict with the federal law,” said Sanford Elsass, NRRA Chairman.

In a statement appearing in a report published by Demotech, Inc., Robert Myers, General Counsel of NRRA, added, “Although the GAO accurately presented the financial and regulatory health of the RRG industry, its report and analysis of non-domiciliary state regulatory authority fell short. The GAO report’s conclusions on the scope of non-domiciliary state regulatory authority belie the plain language of the Liability Risk Retention Act (LRRA) and federal courts’ unambiguous interpretation of the LRRA, especially in reference to non-domiciliary registration requirements and fees.”

Although they may disagree on regulatory issues, an issue in which they are not at odds is the financial health and stability of the RRG industry. In its December 2011 report, the GAO concluded that the RRG industry was healthy from a regulatory and financial perspective.

## Balance Sheet Metrics

In reviewing the financial stability of risk retention groups for 2011, one should get the impression that these are a group of insurers with a great deal of financial stability. Assets and policyholders surplus have increased for the 12th consecutive year. During this time, policyholders’ surplus has increased more than 367 percent, from approximately \$686 million in 2000 to more than \$3.2 billion in 2011.

The level of policyholders’ surplus becomes increasingly important in times of difficult economic conditions. The logic being that an insurer can remain solvent while facing uncertain economic conditions and also withstand greater losses.

Liquidity, as measured by liabilities to cash and invested assets, for 2011 was approximately 69 percent. A value less than 100 percent is considered favorable as it indicates that there was more than \$1 of cash and invested assets for each \$1 of total liabilities. This also indicates an improvement for RRGs collectively over 2010 as liquidity was reported at over 72 percent.

Demotech prefers companies report leverage of less than 300 percent. Leverage, as measured by total liabilities to policyholders’ surplus, for 2011 was approximately 136 percent. This also is an improvement for RRGs collectively, as in 2010 leverage was reported at more than 146 percent.

In comparison to the \$7.7 billion in total net admitted assets for 2011, policyholders’ surplus accounted for approximately 43 percent of that reported amount. Losses and loss adjustment expenses accounted for approximately 39 percent of total net admitted assets.

## Underwriting Results and Overall Profitability

RRGs have reported net income since 1996, with profitable underwriting results since 2004 despite the continued difficult economic conditions and direct written premiums decreasing from 2010 to 2011. Thomas Mason, SNL, reported in his February 21, 2012 article, Risk retention group space writing less, spawning fewer companies, that “in aggregate, RRGs recorded a 2.4 percent decline year over year for the 12 months ended September 30, 2011.” By the end of 2011, the decrease in year-over-year direct premiums written was approximately 1.9 percent.

In looking further, it appears that as revenue for RRGs has become stagnant, so have expenses and losses. The GAO reported in December 2011 that the combined ratio, which is calculated by adding the loss ratio and the expense ratio, for RRGs has fluctuated very little during the years 2004 through 2010. The GAO reported that in their analysis of NAIC data, the average combined ratio for RRGs ranged from 92.6

percent in 2005 to 88 percent in 2008. Keep in mind that a combined ratio of less than 100 percent indicates an underwriting profit or gain. A combined ratio of more than 100 percent indicates an underwriting loss.

## 2012 Outlook of RRG Growth

Karrie Hyatt, Managing Editor of the Risk Retention Reporter, recently stated, “The prevailing mood among RRG professionals is one of optimism. Coupling this positive industry sentiment with the more tangible evidence of several RRGs in the pipelines leads to the belief that the RRG marketplace will be growing steadily by year’s end.”

Hyatt bases her comment on the fact that, as of April 19, 2012, five new RRGs have been licensed with two more close to finishing the process. The market for RRG formation leveled off in 2011, reversing the trend of declining RRGs in the market seen over the last several years. She went on to state, “In terms of numbers of [RRGs], there will likely be moderate growth in the upcoming year.”

Joseph Petrelli, President of Demotech, adds, “Even in light of the current environment, opportunities remain for RRGs to bring expertise and focused capacity to the Property and Casualty industry.” In fact, in reviewing the data and in performing analysis, it should be easy to conclude that, in total, these unique insurers will remain financially stable and continue to provide specialized coverage to their insureds. [A]

**\*See Retention Chart on the next page.**

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*Demotech has served P/C insurance companies, Title underwriters and specialty insurance markets, including RRGs, since 1985 and has been assigning Financial Stability Ratings® (FSRs) to these markets since 1989. Visit [www.demotech.com](http://www.demotech.com) for more information.*

# Risk Retention Groups Direct P By Line of

State	RRGs Writing in State	Boiler & Machinery	Commercial Auto Liab No Fault	Other Commercial Auto Liab	Fidelity
Alabama	55	8,602	6,496	819,468	0
Alaska	33	4,690	4,952	44,966	0
Arizona	70	2,776	29,432	2,691,370	73,625
Arkansas	49	12,252	0	6,444,739	0
California	79	76,087	297,436	9,040,765	1,475,425
Colorado	67	6,418	1,131	773,728	167,750
Connecticut	57	4,463	33,848	590,283	102,150
Delaware	51	4,077	10,895	386,911	0
District of Columbia	39	610	0	618,904	5,225
Florida	74	3,163	23,432	1,209,936	2,550
Georgia	67	19,838	1,071	2,095,012	0
Hawaii	31	2,124	0	197,173	0
Idaho	46	1,668	1,770	145,116	0
Illinois	74	43,180	7,165	1,417,548	307,446
Indiana	56	41,426	0	815,074	0
Iowa	47	8,872	0	345,884	60,000
Kansas	48	4,907	0	298,253	297,000
Kentucky	58	6,093	2,059	783,061	0
Louisiana	52	9,002	66,500	2,698,821	0
Maine	39	3,938	67,559	106,828	0
Maryland	67	19,346	35,790	2,302,602	1,038,050
Massachusetts	54	18,580	7,457	195,030	1,217,083
Michigan	58	13,677	1,412	1,220,941	0
Minnesota	45	32,766	110	897,461	6,504
Mississippi	42	14,220	0	652,209	0
Missouri	53	18,548	10,714	1,487,434	160,000
Montana	42	541	0	1,739,189	0
Nebraska	40	2,282	0	522,732	28,820
Nevada	60	6,782	521	826,822	0
New Hampshire	43	8,257	56,284	106,425	0
New Jersey	76	27,328	125,270	12,181,144	570,245
New Mexico	50	1,527	614	205,834	0
New York	78	20,076	18,220	1,674,447	1,881,892
North Carolina	64	40,762	8,016	1,065,074	0
North Dakota	26	757	0	54,595	0
Ohio	71	16,617	1,518	1,983,548	0
Oklahoma	54	17,468	0	870,029	0
Oregon	55	8,903	8,822	1,966,799	0
Pennsylvania	98	58,066	85,396	14,509,379	1,887,836
Rhode Island	37	2,424	4,707	133,929	0
South Carolina	56	5,011	15,503	713,178	4,586
South Dakota	29	707	0	75,798	0
Tennessee	62	30,160	2,491	243,970	0
Texas	84	35,050	209,288	8,542,368	461,730
Utah	45	15,663	0	7,473,777	0
Vermont	43	618	15,760	261,417	0
Virginia	70	22,893	9,022	3,562,168	28,080
Washington	63	21,600	9,008	4,393,469	4,247
West Virginia	50	7,656	0	260,240	0
Wisconsin	39	21,330	7,005	258,443	66,585

# Premium Written - 12/31/2011

## f Business

Medical Prof Liab	Other Liab Claims Made	Other Liab Occurrence	Product Liab	Warranty	Total
11,913,030	11,481,958	4,758,328	39,170	0	29,027,052
386,026	3,794,543	677,657	38,700	0	4,951,534
24,453,629	9,654,458	2,745,184	47,838	0	39,698,312
1,759,864	7,347,086	2,416,491	153,750	0	18,134,182
112,298,728	60,596,382	31,800,357	323,809	1,710	215,910,699
11,285,593	9,995,062	8,335,506	90,915	2,010	30,658,113
46,427,108	9,272,642	7,049,077	59,935	0	63,539,506
3,728,610	3,147,315	16,364,523	0	0	23,642,331
2,261,149	39,504,733	4,689,584	0	0	47,080,205
66,600,972	22,430,804	10,760,426	279,421	17,550	101,328,254
10,735,565	16,792,377	3,561,578	53,928	5,340	33,264,709
1,609,072	1,895,204	2,431,631	0	0	6,135,204
3,172,777	3,609,991	368,317	0	0	7,299,639
31,356,170	34,730,893	12,505,522	88,632	6,510	80,463,066
31,940,271	9,181,299	3,256,645	47,996	10,590	45,293,301
3,227,031	4,032,535	1,568,401	0	0	9,242,723
3,747,929	5,719,061	1,831,928	69,817	0	11,968,895
17,128,614	7,863,728	1,824,443	128,932	0	27,736,930
3,454,580	6,082,098	2,784,502	19,564	0	15,115,067
3,764,552	2,980,315	1,217,359	0	0	8,140,551
53,396,464	17,515,468	5,852,397	2,500	5,580	80,168,197
126,357,346	39,111,890	10,224,573	4,530	0	177,136,489
18,822,975	12,386,318	3,071,018	43,343	0	35,559,684
4,153,540	5,565,398	2,797,941	9,387	5,700	13,468,807
19,050,547	1,969,350	1,560,524	0	0	23,246,850
17,570,266	14,317,397	5,251,122	76,727	0	38,892,208
13,070,747	3,915,489	395,223	12,516	0	19,133,705
2,708,057	1,853,129	5,914,278	0	0	11,029,298
7,455,242	4,599,043	3,718,122	14,386	4,530	16,625,448
2,329,645	1,763,629	2,400,472	8,080	0	6,672,792
28,987,257	16,090,243	9,609,497	0	0	67,590,984
9,062,777	3,439,729	1,878,821	94,984	0	14,684,286
211,672,505	84,707,828	33,766,764	132,354	0	333,874,086
14,308,800	8,374,813	3,616,628	22,539	2,520	27,439,152
132,412	1,243,832	242,182	131,238	0	1,805,016
20,082,864	15,407,208	4,280,912	172,952	0	41,945,619
11,051,705	2,191,900	2,414,787	115,081	0	16,660,970
8,448,913	5,692,826	5,670,454	3,154	0	21,799,871
290,269,154	31,507,349	29,024,278	27,259	0	367,368,717
2,128,199	1,871,758	2,280,129	0	0	6,421,146
3,706,807	5,982,287	-120,381	11,419	7,740	10,326,150
184,435	1,677,692	350,583	0	0	2,289,215
7,118,048	8,130,430	2,038,286	67,349	0	17,630,734
24,353,273	35,398,630	17,849,561	217,263	35,160	87,102,323
3,029,063	5,063,649	1,943,572	9,832	0	17,535,556
875,536	2,865,704	2,666,386	243,891	0	6,929,312
13,843,941	15,315,672	8,783,935	0	4,980	41,570,691
19,055,125	12,223,042	6,239,859	117,421	0	42,063,771
16,397,249	7,002,664	770,304	27,096	0	24,465,209
2,672,352	7,543,382	1,097,454	49,821	0	11,716,372