The
Risk Retention
Reporter

Licensing Quality RRGs Is Aim of Arizona Captive Program

Featuring Stephanie Lefkowski, CPCU, Chief Analyst-Captive Division, Arizona Department of Insurance

Since joining Arizona's Captive Division five years ago, when the program was in its infancy, Stephanie Lefkowski has seen the program grow as the Arizona Department of Insurance learned to license and regulate captives. She believes the secret to the program's success has been stressing quality in the RRGs it attracts and licenses.

RRR: According to your statistics, the number of RRGs domiciled in Arizona went down from 21 in 2008 to 16 now. What trends have you seen during that time, and what factors do you see contributing to the decline?

I believe if you look back to the 21 RRGs, we had more that insured in the construction and trucking industries. With the collapse in the markets, we saw some of those companies withdraw or leave the insurance market for other reasons. Some of it was it was due to business drying up in the construction industry.

We had at least one that went to another state for more flexibility of law, and we had one that merged into a larger captive writing similar coverage.

RRR: What kind of activity have you seen during 2012 in RRG formations, dissolutions, and other notable actions?

We've had a little interest, but nothing that's come to fruition... The formation of RRGs is not as popular in Arizona as it was shortly after we passed our captive legislation. Part of that could be because there are more choices, more domiciles now.

We're seeing a lot more interest in the pure [captive] structure. That could be because each state develops a niche, and perhaps our niche isn't conducive to RRGs.

RRR: Have you discouraged them, or is there anything particular about your program that discourages them from coming there?

We have not tried to discourage them. What we've tried to encourage is quality captives.

RRR: You've lost one RRG this year. Was that a dissolution, or did you have to take them over?

The recent decline has all been voluntary. They redomesticated to Vermont, and the reason was due to interpretation or application of the law. So, more flexibility.

RRR: What factors do you think RRGs consider when choosing a domicile, and how do you think Arizona fares when considering those factors?

I could answer part of that question in terms of what I think RRGs should consider: A collaborative regulatory relationship is an important foundation. Another important consideration is how the domestic regulator interprets the law.

How do we stack up? There are more and more domiciles to choose from, but our laws are competitive and we maintain appropriate regulatory oversight. We have a stable, cohesive, professional team with a very good reputation, and we have a competent regulatory program. It's a pro-business environment that includes a cost-efficient application process, with audit and actuarial exemptions for small companies. We have a flat-rate renewal for the license, so it's easier to budget. We have no premium taxes.

We believe the program has evolved in a positive way from our perspective. We fare well—there's just a lot of competition out there. I rely heavily on the industry and service providers to keep Arizona competitive as well, so we maintain that collaborative regulatory relationship.

RRR: What can you tell us about your staffing?

Our team is very lean, so we have to be very effective and efficient at what we do. Our professional staff is still intact—our legal analyst, the actuarial analyst, and the chief financial analyst. We have experienced some turnover in the financial analysis staff, but they work on the back end. Because we're a state agency, we continue to be lean.

Arizona RRG Regulator
Stephanie Lefkowski

Title: Chief Analyst, Captive Division

Agency: Arizona Department of Insurance

RRGs under supervision: 16 active RRGs in May 2012

Education: B.S., Accounting and Computer Science, Quinnipiac University; Master in Health Care Administration, University of Phoenix; Chartered Property Casualty Underwriter and Associate in Underwriting designations, American Institute for Chartered Property Casualty Underwriters

Experience: Captive insurance analyst, 5 years; insurance and financial services industry analyst and consultant, 19 years, including 16 years with The Hartford Financial Services Group

Biggest challenge: "Meeting internal and external customers' needs is a balancing act because everybody's issue is the most important issue. I embrace the challenge."

RRR: In your May email to the captive community you mentioned that you had experienced tremendous improvement in response time. How did you bring about the improvement?

I was able to delegate some work—relying on staffing resources was a tremendous help.

We've also focused on quality over quantity, so there has been a long-term shift toward higher-quality, higher-caliber captives. Regulating a quality captive requires far less time and energy, and allows us to adequately and appropriately distribute our time among all captives.

For RRGs, we do an annual in-house training and intermittent training on request. The last two years we focused on the Holding Company Act (HCA), which is specifically related to the RRGs.

We've spent time training and developing the community so it makes their job easier, and we've noticed long-term improvement in the quality of the financial filings as well as the submissions for business plan changes. When we have increased quality in those submissions, it's a lot easier for us to review them. We don't have to spend as much time trying to decipher and interpret, and it takes a lot of the guess-work out.

RRR: Do RRGs come under the HCA for the first time in 2012?

It depends on the state's interpretation of the standard. The standard was effective Jan. 1, 2011, and we interpreted it to mean that in 2011 our RRGs had to be in compliance with the HCA, whereas some states may have interpreted it to mean that for the year commencing Jan. 1, 2011, they had to be in compliance, making their first filing March 31, 2012.

RRR: What percentage of your RRGs are coming under the Holding Company Act?

About 50% are covered by the act.

RRR: What changes do you see coming in your RRG regulatory program in the next year? Are the corporate governance standards coming into effect?

We don't require them yet, we just recommend them. I did one hour of training on the NAIC governance standards for risk retention groups, and I recommended that the sooner the RRGs move in the direction of becoming compliant, the better off they will be. We expect that someday it will be an accreditation standard, and they will have less scrambling on the back end if they start now. So, I did provide one hour of training in January.

RRR: How does Arizona work with its RRGs to ensure a healthy relationship and healthy businesses?

Because we're in a regulatory capacity and may sometimes need to make requests that the RRG may not be happy with, we value the relationship.

Accreditation is our gold standard. That standard is the building block for adequate regulation for solvency.

We continue to partner with the industry. We conduct the training sessions because I think the more knowledge [that captives] have, the more understanding they would have for our response and reaction. We train them on critical regulator issues. We continually coach them to make sure we are in compliance with the gold standard.

The relationship is key. Once they understand why we do what we do, it helps them to respond appropriately.

RRR: What challenges do you see for RRGs domiciled in Arizona in the next year or two?

Adapting to change is challenging in general, and while we're in some uncharted territory for many of the RRGs, compliance should not be difficult—it's just that commitment that will be a challenge. You need that commitment to make the change.

RRR: Are you noticing resistance on their part, or do you just think that's where the challenge will come in?

With the Holding Company Act, because it wasn't understood, there may have been fear, and we tried to alleviate that by doing the training sessions. The filings are not difficult, I think just adapting to the change has been difficult.

There are about eight items under the governance standards, and some of the RRGs already have some of the items in place ... Some of the RRGs are already moving in that direction, so it was a little bit easier for them to buy into the corporate governance standards than it was for the Holding Company Act. There's more resistance with the Holding Company Act.

RRR: Is that because they don't think they should be covered by it?

Maybe ... but also the lack of knowledge and understanding. It looks very ominous—it's not written in a user-friendly format. ... Having done the training, I understand first-hand the difficulties with both the HCA and the governance standard. To put on the presentation I did earlier this year on the governance standard, I had to actually do the work.

You have to actually develop your corporate governance standards, and you need a written charter. You have to sit down and formulate that. There are some things they don't say in the by-laws that they should document in the charter—I think that would just be a business best practice.

RRR: So you've encouraged RRGs to look at the corporate governance standards as a best practices document?

Yes, for example, when you create your governance standards, they say you should have a process where the directors are elected by the owner-insureds. The board needs to decide how they are going to go about doing that. What are the terms, responsibilities, nomination qualifications? They need to come up with the content under those items.

A lot of times, for example, director qualification standards or director responsibilities—they probably never put any thought into that.

RRR: Personally, what have been your biggest challenges in this job over the last five years?

It depends on the day. Currently [in May], I am actively recruiting for a financial analyst, so today staffing resources are a big challenge, and I worry about making the best possible decision for the department.

June 30 is a significant accreditation deadline, and it's also the state's fiscal year end. If we were having this conversation a few weeks out I would be telling you that balancing accreditation deadlines and bureaucratic deadlines while training new staff and being responsive to the industry at the same time is my biggest challenge. It just depends on the day.

Meeting internal and external customers' needs is a balancing act because everybody's issue is the most important issue. I embrace the challenge.

RRR: What's your biggest success? What are you proudest of?

I'm extremely proud of the quality of our captive program. When I joined the department five years ago, the Captive Division was in its infancy. It was experiencing tremendous growth, and we were learning on the job how to effectively license and regulate captives... At the same time the financial market collapsed and some insurance companies required a higher degree of regulatory oversight.

Our regulators are among the best in the country, and we have helped our companies weather the economic storm. We mitigated the impacts of the financial crisis by promoting quality over quantity. We've increased our efforts to try to train and educate the captive community and improve communication with the captive community, to try to help the industry understand the regulatory process and their role in it.

In the past few years we have experienced conservative growth. We licensed quality captives with sound business plans, good corporate governance, and we're now a thriving mid-size domicile based on the number of captives that we regulate, but our captives are subsidiaries of some very significant industry leaders and are generating very significant premium volume. So I believe in our own way we have experienced success here.

RRR: Is there anything else you want to talk about?

We're still committed to maintaining high standards in the captive community nationwide. We're focusing on quality rather than quantity. I think the reputation of Arizona and our service providers is exemplary and it keeps us on the competitive edge on a global stage.

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