

State of South Dakota

NINETY-FIRST SESSION
LEGISLATIVE ASSEMBLY, 2016

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HOUSE BILL NO. 1040

Introduced by: The Committee on Commerce and Energy at the request of the Department
of Labor and Regulation

1 FOR AN ACT ENTITLED, An Act to revise and implement certain provisions regarding the
2 regulation of risk retention groups.

3 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF SOUTH DAKOTA:

4 Section 1. That chapter 58-6A be amended by adding a NEW SECTION to read:

5 Any retention group licensed before July 1, 2016, shall be in compliance with sections 2 to
6 15, inclusive, of this Act, by July 1, 2017. Any risk retention group licensed after June 30, 2016,
7 shall be in compliance with sections 2 to 15, inclusive, of this Act, at licensure.

8 Section 2. That § 58-6A-1 be amended to read:

9 58-6A-1. Terms used in this chapter mean:

10 (1) "Board of directors" or "board," the governing body of the risk retention group as
11 elected by the shareholders or members to establish policy, elect or appoint officers
12 and committees, and make other governing decisions;

13 (2) "Completed operations liability," any liability arising out of the installation,
14 maintenance, or repair of any product at a site which is not owned or controlled by:

15 (a) Any person who performs ~~that work~~ installation, maintenance, or repair of any



1 product; or

2 (b) Any person who hires an independent contractor to perform ~~that work~~
3 installation, maintenance, or repair of any product; but includes liability for
4 activities which are completed or abandoned before the date of the occurrence
5 giving rise to the liability;

6 ~~(2)~~(3) "Director," the insurance director of South Dakota or the commissioner, director, or
7 superintendent of insurance in any other state;

8 (4) "Director of the risk retention group," an individual designated in the articles of the
9 risk retention group, or designated, elected, or appointed by any other manner, name,
10 or title to act as a director;

11 ~~(3)~~(5) "Domicile," for purposes of determining the state in which a purchasing group is
12 domiciled:

13 (a) For a corporation, the state in which the purchasing group is incorporated; and

14 (b) For an unincorporated entity, the state of its principal place of business;

15 ~~(4)~~(6) "Hazardous financial condition," based on its present or reasonably anticipated
16 financial condition, a risk retention group, although not yet financially impaired or
17 insolvent, which is unlikely to be able:

18 (a) To meet obligations to policyholders with respect to known claims and
19 reasonably anticipated claims; or

20 (b) To pay other obligations in the normal course of business;

21 ~~(5)~~(7) "Insurance," primary insurance, excess insurance, reinsurance, surplus lines
22 insurance, and any other arrangement for shifting and distributing risk which is
23 determined to be insurance under the laws of this state;

24 ~~(6)~~(8) "Liability," legal liability for damages, including costs of defense, legal costs and

1 fees, and other claims expenses because of ~~injuries to other persons~~ injury to a
2 person, damage to ~~their~~ the person's property, or other damage or loss to ~~such~~ any
3 other ~~persons~~ person resulting from or arising out of any business, whether profit or
4 nonprofit, trade, product, services, including professional services, premises or
5 operations. It does not include personal risk liability and an employer's liability with
6 respect to its employees other than legal liability under the Federal Employers'
7 Liability Act (45 U.S.C. 51 et seq.);

8 ~~(7)~~(9) "Personal risk liability," liability for damages because of injury to any person,
9 damage to property, or other loss or damage resulting from any personal, family or
10 household responsibilities or activities, rather than from responsibilities or activities
11 referred to in subdivision ~~(6)~~ of this section (8);

12 ~~(8)~~(10) "Plan of operation or a feasibility study," an analysis which presents the
13 expected activities and results of a risk retention group including, at a
14 minimum:

15 (a) ~~The~~ For each state in which the risk retention group intends to operate, the
16 coverages, deductibles, coverage limits, rates and rating classification systems
17 for each line of insurance the group intends to offer;

18 (b) Historical and expected loss experience of the proposed members and national
19 experience of similar exposures to the extent that this experience is reasonably
20 available;

21 (c) Pro forma financial statements and projections;

22 (d) Appropriate opinions by a qualified, independent casualty actuary, including
23 a determination of minimum premium or participation levels required to
24 commence operations and to prevent a hazardous financial condition;

- 1 (e) Identification of management, underwriting procedures, managerial oversight
- 2 methods, investment policies, and reinsurance agreements; and
- 3 (f) Information sufficient to verify that the risk retention group's members are
- 4 engaged in businesses or activities similar or related with respect to the
- 5 liability to which the members are exposed by virtue of any related, similar,
- 6 or common business, trade, product, services, premises, or operations;
- 7 (g) Identification of each state in which the risk retention group has obtained, or
- 8 sought to obtain, a charter and license, and a description of its status in each
- 9 state; and
- 10 (h) ~~Such other~~ Other matters as may be prescribed by the director, supervisor, or
- 11 commissioner of the state in which the risk retention group is chartered for
- 12 liability insurance companies authorized by the insurance laws of ~~the~~ that state
- 13 ~~in which the risk retention group is chartered;~~
- 14 ~~(9)~~(11) "Product liability," liability for damages because of any personal injury, death,
- 15 emotional harm, consequential economic damage, or property damage,
- 16 including damages resulting from the loss of use of property, arising out of the
- 17 manufacture, design, importation, distribution, packaging, labeling, lease, or
- 18 sale of a product, but does not include the liability of any person for those
- 19 damages if the product involved was in the possession of such a person when
- 20 the incident giving rise to the claim occurred;
- 21 ~~(10)~~(12) "Purchasing group," any group which:
- 22 (a) Has as one of its purposes the purchase of liability insurance on a group basis;
- 23 (b) Purchases such insurance only for its group members and only to cover their
- 24 similar or related liability exposure, as described in subsection (c) herein;

1 (c) Is composed of members whose businesses or activities are similar or related
2 with respect to the liability to which members are exposed by virtue of any
3 related, similar, or common business, trade, product, services, premises, or
4 operations; and

5 (d) Is domiciled in any state;

6 ~~(11)~~(13) "Risk retention group," any corporation or other limited liability association
7 formed under the laws of any state, Bermuda, or the Cayman Islands:

8 (a) Whose primary activity consists of assuming and spreading all, or any portion,
9 of the liability exposure of its the group members;

10 (b) Which is organized for the primary purpose of conducting the activity
11 described under subsection (a);

12 (c) Which is chartered and licensed as a liability insurance company and
13 authorized to engage in the business of insurance under the laws of any state;
14 or before January 1, 1985, was chartered or licensed and authorized to engage
15 in the business of insurance under the laws of Bermuda or the Cayman Islands
16 and, before such date, had certified to the insurance director of at least one
17 state that it satisfied the capitalization requirements of such state, except that
18 any such group shall be considered to be a risk retention group only if it has
19 been engaged in business continuously since such date and only for the
20 purpose of continuing to provide insurance to cover product liability or
21 completed operations liability;

22 (d) Which does not exclude any person from membership in the group solely to
23 provide for members of such a group a competitive advantage over such a
24 person;

1 (e) Which has as its members only persons who have an ownership interest in the
2 group and which has as its owners only persons who are members who are
3 provided insurance by the risk retention group; or has as its sole member and
4 sole owner an organization which is owned by persons who are provided
5 insurance by the risk retention group;

6 (f) Whose members are engaged in businesses or activities similar or related with
7 respect to the liability of which such members are exposed by virtue of any
8 related, similar, or common business, trade, product, services, premises, or
9 operations;

10 (g) Whose activities do not include the provision of insurance other than liability
11 insurance for assuming and spreading all or any portion of the liability of its
12 group members; and reinsurance with respect to the liability of any other risk
13 retention group or any members of such other group which is engaged in
14 businesses or activities so that such group or member meets the requirement
15 described in subsection (f) from membership in the risk retention group which
16 provides such reinsurance; and

17 (h) The name of which includes the term "risk retention group";

18 (14) "Service provider," any auditor, accountant, actuary, investment advisor, lawyer,
19 managing general underwriter, or any other party responsible for underwriting,
20 determination of rates, collection of premiums, adjusting and settling a claim, or the
21 preparation of a financial statement. The term, lawyer, in this definition does not
22 include defense counsel retained by the risk retention group to defend claims, unless
23 the amount of fees paid to the lawyer is material as referenced in section 4 of this
24 Act;

1 ~~(12)~~(15) "State," any state of the United States or the District of Columbia.

2 Section 3. That chapter 58-6A be amended by adding a NEW SECTION to read:

3 The board of directors of the risk retention group shall have a majority of independent
4 directors. If the risk retention group is a reciprocal, then the attorney-in-fact shall adhere to the
5 same standards regarding independence of operation and governance as imposed on the risk
6 retention group's board of directors or subscriber's advisory committee under these standards.
7 In addition, to the extent permissible under state law, a service provider of a reciprocal risk
8 retention group shall contract with the risk retention group and not the attorney-in-fact.

9 No director of the risk retention group qualifies as independent unless the board of directors
10 affirmatively determines that the director of the risk retention group has no material relationship
11 as described in section 4 of this Act with the risk retention group. Each risk retention group shall
12 disclose these determinations to the group's domestic regulator, at least annually. For the
13 purposes of this section, any person that is a direct or indirect owner of or subscriber in the risk
14 retention group or is an officer, director of the risk retention group, or employee of such an
15 owner and insured, unless some other position of the officer, director of the risk retention group,
16 or an employee constitutes a material relationship, as contemplated by section 3901(a)(4)(E)(ii)
17 of the Liability Risk Retention Act in effect as of January 1, 2016, is considered to be
18 independent.

19 Section 4. That chapter 58-6A be amended by adding a NEW SECTION to read:

20 A material relationship includes:

- 21 (1) The receipt in any one twelve-month period of compensation or payment of any other
22 item of value greater than or equal to five percent of the risk retention group's gross
23 written premium for the twelve-month period or two percent of the risk retention
24 group's surplus, whichever is greater, as measured at the end of any fiscal quarter

1 falling in the twelve-month period by a person with the risk retention group or:

2 (a) The person's immediate family member;

3 (b) A business with which the person is affiliated from the risk retention group;

4 or

5 (c) A consultant or service provider to the risk retention group.

6 A person with the risk retention group or an immediate family member of the person
7 is not independent until one year after the person's compensation from the risk
8 retention group falls below the threshold;

9 (2) A relationship with an auditor where a director of the risk retention group or an
10 immediate family member of a director of the risk retention group who is affiliated
11 with or employed in a professional capacity by a present or former internal or
12 external auditor of the risk retention group is not independent until one year after the
13 end of the affiliation, employment, or auditing relationship; and

14 (3) A relationship with a related entity where a director of the risk retention group or an
15 immediate family member of a director of the risk retention group who is employed
16 as an executive officer of another company where any of the risk retention group's
17 present executives serve on that other company's board of directors is not
18 independent until one year after the end of the service or the employment
19 relationship.

20 Section 5. That chapter 58-6A be amended by adding a NEW SECTION to read:

21 The term of any material service provider contract with the risk retention group may not
22 exceed five years. Any material service provider contract, or its renewal, requires the approval
23 of the majority of the risk retention group's independent directors. The risk retention group's
24 board of directors shall have right to terminate any service provider, audit, or actuarial contracts

1 at any time for cause after providing adequate notice as defined in the contract. The service
2 provider contract is deemed material if the amount to be paid for the contract is greater than or
3 equal to five percent of the risk retention group's annual gross written premium or two percent
4 of its surplus, whichever is greater.

5 Section 6. That chapter 58-6A be amended by adding a NEW SECTION to read:

6 No service provider contract meeting the criteria of material relationship contained in
7 section 4 of this Act may be entered into unless the risk retention group has notified the director
8 in writing of the risk retention group's intention to enter into the contract at least thirty days
9 before entering into the transaction and the director has not disapproved the contract within that
10 period.

11 Section 7. That chapter 58-6A be amended by adding a NEW SECTION to read:

12 The risk retention group's board of directors shall adopt a written policy in the plan of
13 operation as approved by the board that requires the board to:

- 14 (1) Assure that all owners and insureds of the risk retention group receive evidence of
15 ownership interest;
- 16 (2) Develop a set of governance standards applicable to the risk retention group;
- 17 (3) Oversee the evaluation of the risk retention group's management including the
18 performance of the managing general underwriter or any other party responsible for
19 underwriting, determination of rates, collection of premiums, adjusting or settling a
20 claim, or the preparation of a financial statement;
- 21 (4) Review and approve the amount to be paid for each material service provider; and
- 22 (5) Review and approve, at least annually:
 - 23 (a) The risk retention group's goals and objectives relevant to the compensation
24 of officers and service providers;

1 (b) The officers' and service providers' performance in light of those goals and
2 objectives; and

3 (c) The continued engagement of the officers and material service providers.

4 Section 8. That chapter 58-6A be amended by adding a NEW SECTION to read:

5 The risk retention group shall have an audit committee composed of at least three
6 independent board members as defined in sections 3 and 4 of this Act. A nonindependent board
7 member may participate in the activities of the audit committee, if invited by the committee, but
8 cannot be a member of the audit committee.

9 Section 9. That chapter 58-6A be amended by adding a NEW SECTION to read:

10 The audit committee of the risk retention group shall have a written charter that defines the
11 committee's purpose, which, at a minimum, shall:

12 (1) Assist board oversight of the integrity of financial statements, the compliance with
13 legal and regulatory requirements, and the qualifications, independence, and
14 performance of the independent auditor and actuary;

15 (2) Discuss the annual audited financial statements and quarterly financial statements
16 with management;

17 (3) Discuss the annual audited financial statements with the group's independent auditor
18 and, if advisable, discuss the group's quarterly financial statements with the group's
19 independent auditor;

20 (4) Discuss policies with respect to risk assessment and risk management;

21 (5) Meet separately and periodically, either directly or through a designated
22 representative of the committee, with management and the independent auditor;

23 (6) Review with the independent auditor any audit problems or difficulties and
24 management's response;

- 1 (7) Set clear hiring policies of the risk retention group as to the hiring of employees or
2 former employees of the independent auditor;
- 3 (8) Require the external auditor to rotate the lead or coordinating audit partner having
4 primary responsibility for the risk retention group's audit as well as the audit partner
5 responsible for reviewing that audit so that neither individual performs audit services
6 for more than five consecutive fiscal years; and
- 7 (9) Report regularly to the board of directors.

8 Section 10. That chapter 58-6A be amended by adding a NEW SECTION to read:

9 The domestic regulator may waive the requirement to establish an audit committee
10 composed of independent board members if the risk retention group is able to demonstrate to
11 the domestic regulator that it is impracticable to do so and the risk retention group's board of
12 directors itself is otherwise able to accomplish the purposes of an audit committee, as described
13 in section 9 of this Act.

14 Section 11. That chapter 58-6A be amended by adding a NEW SECTION to read:

15 The board of directors shall adopt and disclose governance standards and make the
16 information available electronically through the risk retention group's website or by other
17 means. The risk retention group shall provide the governance standards to members or insureds
18 on request. The adopted governance standards shall include the following:

- 19 (1) Concerning the directors of the risk retention group:
 - 20 (a) A process by which the directors are elected by the owners or insureds;
 - 21 (b) Qualification standards;
 - 22 (c) Responsibilities;
 - 23 (d) Access to management and, as necessary and appropriate, independent
24 advisors;

1 (e) Compensation; and

2 (f) Orientation and continuing education;

3 (2) The policies and procedures that are followed for management succession; and

4 (3) The policies and procedures that are followed for annual performance evaluation of
5 the board.

6 Section 12. That chapter 58-6A be amended by adding a NEW SECTION to read:

7 The board of directors shall adopt and disclose a code of business conduct and ethics for
8 directors, officers, and employees. Each director, officer, and employee shall promptly disclose
9 to the board of directors any waivers of the code. The code of business conduct and ethics shall
10 include the following topics:

11 (1) Conflicts of interest;

12 (2) Matters covered under the corporate opportunities doctrine under the state of
13 domicile;

14 (3) Confidentiality;

15 (4) Fair dealing;

16 (5) Protection and proper use of risk retention group assets;

17 (6) Compliance with all applicable laws, rules, and regulations; and

18 (7) Requiring the reporting of any illegal or unethical behavior which affects the
19 operation of the risk retention group.

20 Section 13. That chapter 58-6A be amended by adding a NEW SECTION to read:

21 If the manager, president, or chief executive officer of the risk retention group becomes
22 aware of any material noncompliance with any standards described in sections 3 to 13, inclusive,
23 of this Act, the manager, president, or officer shall promptly notify the domestic regulator in
24 writing.

1 Section 14. That § 58-6A-2 be amended to read:

2 58-6A-2. Any risk retention group seeking to be chartered in this state shall be chartered and
3 licensed as a liability insurance company authorized by the insurance laws of this state and,
4 except as provided ~~elsewhere~~ in this chapter, shall comply with all of the laws, rules,
5 ~~regulations~~, and requirements applicable to such insurers chartered and licensed in this state.
6 Before it may offer insurance in any state, each risk retention group shall also submit for
7 approval to the director of insurance of this state a plan of operation or a feasibility study and
8 revisions of such plan or study if the group intends to offer any additional lines of liability
9 insurance. ~~Immediately upon receipt of an application for charter, this state~~ If any subsequent
10 material change is made to the plan of operation or feasibility study, the risk retention group
11 shall submit an appropriate revision to the director within ten days of any change. No group may
12 offer any additional lines of liability insurance in this state or any other state until a revision of
13 the plan or study is approved by the director.

14 When filing an application for charter, the risk retention group shall provide to the director
15 a summary of information concerning the filing to the National Association of Insurance
16 Commissioners, including the name of the risk retention group, the identity of the initial
17 members of the group, the identity of those ~~individuals~~ persons who organized the group or who
18 will provide administrative services or otherwise influence or control the activities of the group,
19 the amount and nature of initial capitalization, the coverages to be afforded, and the states in
20 which the group intends to operate. Upon receipt, the director shall forward the information to
21 the National Association of Insurance Commissioners. Providing notification to the National
22 Association of Insurance Commissioners is in addition, and is not sufficient, to satisfy the
23 requirements of this chapter.

24 Section 15. That § 58-6A-3 be amended to read:

1 58-6A-3. Before offering insurance in this state, a risk retention group not chartered in this
2 state shall submit to the director:

3 (1) A statement identifying the states in which the risk retention group is chartered and
4 licensed as a liability insurance company, date of chartering, its principal place of
5 business, and ~~such~~ other information, including information on its membership, as
6 the director of this state may require to verify that the risk retention group is qualified
7 under this chapter;

8 (2) A copy of ~~its~~ the group's plan of operations or a feasibility study and revisions of
9 ~~such~~ the plan or study submitted to its state of domicile. However, the provision
10 relating to the submission of a plan of operation or a feasibility study does not apply
11 with respect to any line or classification of liability insurance which was defined in
12 the Product Liability Risk Retention Act of 1981, before October 27, 1986, and was
13 offered before such date by any risk retention group which had been chartered and
14 operating for not less than three years before such date; ~~and~~

15 (3) A statement of registration which designates the director as ~~its~~ the group's agent for
16 the purpose of receiving service of legal documents or process; and

17 (4) A copy of any material revision to the group's plan of operation or feasibility study
18 within thirty days of the date of the approval of the revision by the director of the
19 group's chartering state, or if no such approval is required, within thirty days of filing.

20 Section 16. That § 58-44-1 be amended to read:

21 58-44-1. Terms used in this chapter mean:

22 (1) "Accredited state," any state in which the insurance department or regulatory agency
23 has qualified as meeting the minimum financial regulatory standards promulgated
24 and established by the National Association of Insurance Commissioners (NAIC);

- 1 (2) "Control" or "controlled," as defined in chapter 58-5A;
- 2 (3) "Controlled insurer," any licensed insurer which is controlled, directly or indirectly,
3 by a broker;
- 4 (4) "Controlling broker," any person who, directly or indirectly, controls an insurer and
5 for any compensation, commission, or other thing of value, acts or aids in any
6 manner in soliciting, negotiating, or procuring the making of any insurance contract
7 on behalf of an insured other than the controlling broker;
- 8 (5) "Licensed insurer" or "insurer," any person duly licensed to transact a property and
9 casualty insurance business in this state. ~~The following are not licensed insurers for~~
10 ~~the purposes of this chapter:~~
 - 11 ~~(a) All risk retention groups as defined in the Superfund Amendments~~
12 ~~Reauthorization Act of 1986, P.L. No. 99-499, 100 Stat. 1613 (1986) and the~~
13 ~~Risk Retention Act, 15 U.S.C. Section 3901 et seq. (1982 & Supp. 1986) and~~
14 ~~chapter 58-6A, and~~
 - 15 ~~(b) All The term does not include any residual market pools and pool or any joint~~
16 ~~underwriting authorities or associations authority or association.~~