

CAPITALISM, COMPETITION AND INNOVATION ABOUND IN SOUTH CAROLINA INSURANCE MARKET

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(Author's note: Prior to 1995, South Carolina's reputation was one of being decidedly "...tilted toward consumerism..." as observed that year in this publication.¹ However, I also wrote in that same article, which dealt with major restructuring of state government in general and the South Carolina Department of Insurance ("SCDOI") specifically, that the new Director of Insurance, operating for the first time from cabinet level, was "...seeking to further develop a pro-business, free enterprise climate in which positive competition drives products, rates and service."² First under then-Director Lee P. Jedziniak, and now under Director Ernst N. Csiszar, mammoth strides forward have been achieved at SCDOI such that it might arguably be considered the most "user friendly"³ state regulatory authority in the nation.

This article will trace a series of events creating in South Carolina an environment in which insurers like to do business, with the ultimate beneficiary being the insuring public.)

Background

Prior to 1974, South Carolina's assigned risk plan ("ARP") for private passenger auto insurance was a source of considerable public consternation in that no physical damage coverage was offered, agents had no binding authority, liability rates were substantially above those in the voluntary market and insureds relegated by the ARP considered themselves "stigmatized," just to name some of the more prominent criticisms.

The ARP became a major issue in the 1969 gubernatorial campaign, and, after his election that year, Governor John C. West spearheaded legislation during his term which, in 1974, replaced the ARP with a reinsurance facility/take-all-comers concept ("SC Reinsurance Facility" or "SCRF").⁴ This system endured for two and a half decades with only relatively minor changes.

(Author's comment: Had the insurer segment of the industry not presented such an inflexible front and not remained steadfastly resistant to *any* meaningful change, a less radical departure from the ARP would likely have resulted.)

Perhaps due in part to a decision not to promulgate a uniform SCRF rate or at least pure loss component, the number of insureds ceded to SCRF steadily climbed and, in part because of an out-of-balance merit rating plan, so did losses, totaling as much as \$200 million a year at one point and \$40 million per quarter toward the end.⁵ Across-the-board recoupment of losses from all insureds became a central focus of attack by insurers and others seeking change.

A New System

Pressures for a more competitive market mounted during the time frame following passage of the 1974 legislation ("Act 1177"), and in 1997 the SC General Assembly, with concurrence from the Director of Insurance and the Governor, passed landmark legislation scrapping SCRF, first in favor of a joint underwriting association (JUA), with this, ironically, to be converted into, you probably guessed it, an ARP (actually termed "Associated Auto Insurers Plan" or "AAIP").⁶

The statutory schedule called for the JUA to be implemented March 1, 1999, with that mechanism phasing into the new AAIP March 1, 2003. Meanwhile, the SCRF runoff timetable calls for it to renew its last policy February 28, 2002, with all remaining policies in force eliminated by March 1, 2003. However, a somewhat protracted schedule notwithstanding, voluntary agents and companies with business ceded to SCRF, as

well as designated agents (“DAs”) writing solely for SCRF servicing carriers, began moving business to a rapidly revitalizing voluntary market immediately upon the 1997 legislation’s (“Act 154”) initial stage implementation, with the JUA as residual market backup. Newfound competition spurred the escalating momentum.

The transition, which involved a whopping 42 percent⁷ of South Carolina’s private passenger (and small commercial by definition) insurance coverage in SCRF, was sparked by other key provisions in Act 154 such as an indexed up-to-seven-percent file and use section, the freedom to promulgate individual class and territorial plans, and repeal of compulsory insurance in favor of a “first bite” financial responsibility law.⁸

Passage and early implementation occurred on Jedziniak’s watch, but the bulk of making the new system work fell on the able shoulders of Csiszar, appointed Director of Insurance by newly-elected Governor James H. Hodges in 1999.

Supporters of the legislation predicted positive results, but even they were admittedly astounded by the influx of companies into South Carolina and the literal wholesale depopulation of the state’s residual market mechanism. More specifically:

- Since passage of Act 154, at least 103 additional companies have come into South Carolina to write private passenger auto, more than doubling the number prior to the legislation’s enactment.⁹ (This number could enjoy another sharp increase by early next year since a special forum for the insurance industry, coordinated by SCDOI and particularly highlighting opportunities in the South Carolina coastal area, is planned for Charleston, SC, in late November. The forum will also include some recognition of the vastly improved auto insurance climate in South Carolina.)¹⁰
- Compared to a staggering 42 per cent of the marketplace in SCRF prior to enactment of Act 154, the JUA now contains less than 300 policies.¹¹
- Generally, rates have dropped, including an average 12 percent decrease the first year after implementation, the largest reduction in the nation.¹²

Incidentally, a significant difference in the pre-1974 ARP system and the JUA (soon-to-be-AAIP) system of today is that companies now may not refuse to write coverage or base rates on race, color, creed, religion, national origin, ancestry, economic status or income level.¹³ (Credit scoring is not prohibited, but negative rumblings in that regard are beginning to surface.)

Indeed, participating in a nationally-attended 1998 Property and Casualty Forum in Columbia, SC, which highlighted law and regulatory climate changes in the Palmetto State, one senior regional company official, echoing sentiments generally, described South Carolina’s climate as being “as good as it gets.”¹⁴ The forum was Jedziniak’s idea, but all segments of the industry in South Carolina participated in its success. During his four-year term as Director, Jedziniak also successfully pressed for more expeditious handling of form and rate filings, as well as of the Department’s licensing responsibilities.

Enter Csiszar

By no means to be outdone, enter “Ernie” Csiszar, the affable, articulate, knowledgeable, charmingly-accented, newly-appointed Director with a background as insurance company president, university business professor, merchant banker and attorney, and with an unswerving belief in capitalism, free enterprise and competition as the ultimate regulator. A little more about his rather diverse background:

Born in Jimbolia, Romania, and emigrating to Canada in 1966, he later obtained a law degree from the University of Windsor in Ontario. For nine years, Csiszar served as Managing Co-Director of Holborn Holdings of Geneva, an investment banking firm. From 1993 to 1995, he was a Visiting Professor at the

School of Business, University of South Carolina. Then, in 1995, Csiszar teamed with former SC Governor West (see discussion of Act 1177 of 1974, *supra*) to breathe new life into the Seibels Bruce Group of Columbia, SC, an old line property and casualty operation and SCRF servicing carrier, which was teetering on the brink of insolvency. He was appointed SC Director of Insurance in 1999. Currently, Csiszar serves as Chairman of the International Insurance Relations Committee of the National Association of Insurance Commissioners (“NAIC”), Chairman of the Subcommittee on Securitization of the International Association of Insurance Supervisors (“IAIS”) and is a member of the IAIS Reinsurance Committee.

If there is a shorthand description of Csiszar’s insurance regulatory philosophy, it is that free enterprise and competition are the most effective and efficient regulators of all, which is consistent with his background and experience.

Oh, incidentally, he’s fluent in several foreign languages.

Csiszar’s Initiatives

After quickly settling into his new cabinet-level position, Csiszar unleashed a mind-boggling, innovative legislative agenda for 2000, in reality a coordinated, multi-dimensional package of new insurance initiatives. The results were, not one, not two, but *three* immensely significant enactments that year (two passing within the space of 24 legislative days), all a part of an unabashed agenda to create a climate attractive to the insurance, and other, industry.

(Author’s note: Csiszar views his responsibility as far greater than just regulating insurance and has assumed a leadership role in the Administration’s overall economic development efforts. For example, he has created within SCDOI the position of Director of Business Development – thought to be the only such position within an insurance department in the nation – along with the Alternative Risk Transfer Services Division, currently with a staff of four.)

Commercial Lines Deregulation

The first 2000 enactment, and the one with the greatest initial impact on the insurance industry, was commercial lines deregulation.¹⁵ Under its provisions, a package of commercial coverages with a combined total premium greater than \$50,000 become “exempt commercial policies” and fall outside the scope of SCDOI regulation, even to the extent of manuscripting individual policies. The theory, of course, is that large business operations possess their own insurance expertise and sophistication equivalent to that of regulators, and their size permits them to negotiate coverages tailored for their needs. Commercial lines deregulation was the first step toward developing a competition-oriented environment in South Carolina second to none.

Captives Legislation

The second, which could have the greatest long-range impact of all, was enactment of an exceedingly favorable framework of laws for captive insurers, placing South Carolina right up there with – or ahead of – Bermuda, the Cayman Islands, and Vermont.¹⁶ The legislation, combined with diligent efforts by the Director and two senior SCDOI staff members, is already paying off as a boon to the state with 10 captives approved to date, five applications pending and 15 more in various stages of completion. Using experience in Vermont as a barometer, captives could boost South Carolina’s treasury by upwards of a billion dollars, fully a sixth of the state’s entire current budget.

Of the 19 US jurisdictions with captive legislation on their books, Vermont and Hawaii are South Carolina’s most significant competitors. South Carolina’s almost instant success can be attributed to establishment of the necessary office and administrative framework immediately upon passage of the legislation. (See discussion of new position and new division, *supra*.)

Answering a question posed from time to time, current law does not permit a captive to write workers' compensation coverage on a direct basis, *but* it may do so with a fronting arrangement. At the risk of skipping ahead to the conclusion of this piece, look for legislation permitting captives to write direct workers comp in the future.¹⁷

(For a more detailed, erudite discussion of the 2000 captives legislation and its impact on South Carolina as well as the captive market, please see an article in the March 24, 2001, issue of this publication authored by my esteemed colleague from Charleston, SC, Michael A. Malony.)¹⁸

Protected Cell Legislation

The third major successful legislative effort in 2000, which can somewhat tie in with the captive concept, was passage of "protected cell" legislation.¹⁹ Specifically, this legislation permits a domestic insurer to establish protected cells of coverage areas and sell bonds to finance insurance operations within those cells. A Protected Cell Company ("PCC") can create distinct cells, which have their own assets and liabilities, effectively initiating captives operating within a single company. This is similar to the "rent-a-captive" concept in that the entity desiring the captive "rents" the company structure from the PCC, which usually supplies the capital. In any event, the protected cells are created within the capital structure of the company in order to segregate and protect the assets within that cell from claims which are unrelated to that cell. This legislation is partially aimed at encouraging coverage for hurricane-susceptible coastal areas by permitting an insurer to segregate insurance operations there, but its principles could apply anywhere. (CNA is the first company to take advantage of the protected cell legislation, forming CNA Lakeside as a South Carolina domestic.)

New Dimensions

Each of the three acts passed in 2000 add yet another dimension to South Carolina's rapidly growing reputation as a state interested in promoting a reasonably unfettered insurance industry and offering innovative, attractive laws to encourage and facilitate the state's business activities. Overall purposes of the 2000 legislative blitz and South Carolina's continuing efforts, are to "(1) encourage economic development, (2) preserve and improve the SC insurance environment, and (3) modernize the overall insurance market (particularly in the wake of the federal Financial Services Modernization Act)." (parens mine)²⁰

More Legislative Efforts

But the story doesn't end there. The 2001 legislative year brought successful legislation expanding captives' authority into the area of reinsurance. This new legislation, just now beginning to gain a foothold, permits reinsurance companies to form captives in South Carolina which must be capitalized to a minimum tune of \$300 million, with at least 35 percent of the assets to be managed in South Carolina. Such will provide an unprecedented stream of capital for financial institutions and service providers in the Palmetto State.²¹ And, as part of a comprehensive "clean-up" bill recommended by Csiszar, a file and use provision, really more of a 30-day "deemer" concept, relating to forms only, was enacted this year.²²

The Future?

Next year is an election year, with Csiszar and SCDOI planning to offer a less ambitious legislative agenda than in the past. One area of particular interest to insurers, however, will probably be recommendations to revamp Title 38, Chapter 11, of the SC Insurance Code dealing with investments. And, looking long-range, perhaps beyond 2002, more comprehensive file and use legislation is likely for legislative consideration. It will probably be across the board and further encompass rates.²³

As South Carolina continues its steady, positive march in the area of "user friendliness," one must smile

when recalling the 1998 “as good as it gets” statement and, at the same time, other than the couple of items mentioned immediately *supra*, wonder just what else is on the horizon for a deep-south state bent on achieving excellence in meeting the insurance needs of its citizens through a capitalistic, competition-dominated environment.

Endnotes

1. H. Kelley Jones, Esq., “Major Restructuring for South Carolina’s Regulatory System,” FORC Quarterly Journal of Insurance Law and Regulation, Vol. VII, Edition 4, December 1, 1995), p. 1, 12 *et seq.*
2. *Id.*
3. A term often used by regulators and the regulated in describing South Carolina’s regulatory environment today.
4. Act 1177 of 1974.
5. Source: Automobile Insurance Plans Services Office.
6. Act 154 of 1997.
7. Source: Automobile Insurance Plans Services Office.
8. *See* generally Act 154 of 1997.
9. Source: SC Department of Insurance.
10. Source: SC Department of Insurance, particularly Senior Advisor to the Director (James Byrd).
11. Source: Automobile Insurance Plans Services Office.
12. Sources: SC Department of Insurance, SC Insurance News Service, National Association of Insurance Commissioners.
13. Sections 38-77-122 and 38-77-123, SC Code of Laws as Amended.
14. Palmetto Professional (Newsletter of the SC Association of Professional Insurance Agents), Vol. 1, Issue 4, April 1998, p. 1.
15. Act 235 of 2000.
16. Act 331 of 2000.
17. SCDOI website, www.state.sc.us/doi.
18. Michael A. Molony, Esq., “The Palmetto State: ‘Let It Captivate You,’” FORC Quarterly Journal of Insurance Law and Regulation, Vol. XIII, Edition I, March 24, 2001, p. 14.
19. Act 238 of 2000.
20. Source: SC Department of Insurance, particularly Director of Business.
21. Act 58 of 2001.

22. Act 82 of 2001.

23. Source: SC Department of Insurance, particularly Legislative Liaison (Melanie Joseph).