

# RRG BOARDS' BEST PRACTICES

## Creating Empowered Boards

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Creating an empowered board is critical to the success of a risk retention group. An empowered board is one that is fully informed on company operations, knows enough about the business in which the company is engaged to exercise independent judgment, and is not controlled by management.

Creating an empowered board is especially important for RRGs because board members often know little about liability insurance. This can lead to faulty judgments influenced by management or competition — judgments that could lead to financial impairment or even bankruptcy.

RRGs tend to be made up of executives or professional practitioners in the business that is insured. Our company, Uni-Ter Underwriting Management Corporation, based in Atlanta, Georgia, builds and manages RRGs that insure long-term care facilities, physicians and surgeons, and nurses. Each of the RRGs we manage is organized as a stock company, which makes it easier to understand their valuation. Boards of the RRGs we manage are composed largely of facility owners/operators, medical doctors, and nurses. As policyholders and shareholders, board members want stable, reliable insurance at affordable rates and, they expect to see their stock grow in value. To achieve these objectives in a soft market — where the lure of lower prices may tempt management to engage in cutthroat competition — requires an informed board empowered to make tough decisions in the long-term interest of the shareholders. Our boards also include independent members from other financial businesses and academe.

### Best Practices for RRG Boards

To my knowledge, there is no "Best Practices Manual" on how to create an empowered board. RRGs may differ in their approach but based on our experience in launching five RRGs in the last six years, there are certain guidelines that we believe every RRG should follow:

- *Educate board members on insurance practices and issues so they can make informed policy decisions and monitor management's performance.*
- *Offer new board members training in insurance accounting (GAAP/Statutory), Incurred But Not Reported (IBNR) reserving, investment strategy, and the various components of the insurance premium.*

- *Appoint some independent directors from other businesses who bring outside perspectives to bear on policy deliberations.*
- *Create an Audit Committee authorized to meet with outside auditors without management present and directed to provide its comments to the board in a letter.*
- *Hold board meetings at least quarterly.*
- *Pay board members an annual retainer plus meeting fees and expenses.*
- *Expect board members to attend all board meetings and committee members to attend all committee meetings.*
- *Let board members know they can contact any management staff member directly to ask questions or request information on company operations.*
- *Set regular meeting dates on an annual basis so board and committee members can plan their schedules.*
- *Provide board members at least a week in advance of meetings with a three-ring binder containing the board agenda, committee reports, and background information on each agenda item.*
- *Allow plenty of time in board meetings for thorough discussion of each agenda item and any new business.*
- *Document governance standards to meet regulatory requirements of the domiciliary state and for prospective board members to review before they join the board.*
- *Communicate to the board and periodically review the corporate policy on full disclosure of any potential conflicts of interest.*

With these basic guidelines in place, an RRG board should be well positioned to fulfill its fiduciary responsibility to oversee management, evaluate corporate performance, meet regulatory requirements, and establish policy in the best interest of the shareholders.

### NAIC Corporate Governance Standards

The National Association of Insurance Commissioners (NAIC) has proposed corporate governance standards for RRGs. These standards are under review and would be enforced by the state in which the RRG is domiciled. The proposed standards may seem unduly restrictive and time consuming to some RRGs. However, an RRG that follows the guidelines listed here should be able to comply. In fact, working in concert with the Nevada Department of Insurance, where most of our RRGs are domiciled, we adopted at the outset

governance standards that comply fully with the NAIC proposals.

Beyond specific guidelines, there are some other important initiatives that management and board members should take together in order to assure responsible and effective corporate governance. The most important, in my judgment, is to establish a climate of trust. Each manager or CEO will have his or her own style, but the basic commitment should apply to all — open communication between management and the board on all matters, respect for the opinions of each board member, and encouragement of dialogue where board members feel free to debate issues. This includes having the senior management team available to participate in board meetings and generally accessible to the directors.

Given the trust factor's primacy in empowering boards, what is the best way to achieve this positive, understanding relationship between board members and management? Again, there is no established formula for the chemistry of trust. It all depends on the human dynamics of managers and board members. However, it is worth repeating that there are two essential ingredients: open communication on all matters affecting the corporation and mutual respect.

In the course of creating and managing five RRGs, we have found that trust is built also through creating a rapport with board members. Our boards are independent and tough minded, but we have achieved friendly relationships that contribute to open dialogue. Outside the formal environment of board meetings, we dine together, play golf, and share a cocktail or a glass of wine. In this collegial climate, we can disagree occasionally without being disagreeable. If management proposes something the board disagrees with, then we have done a poor job of explaining or it is a bad idea.

### Quarterly Board Meetings

Here is how we program quarterly board meetings. Two meetings are held by conference call. Two are held in person, one of them in the state where the RRG is domiciled. For these meetings, members arrive late in the afternoon before the meeting. We devote two hours to discussion of agenda items for the next day's meeting and any matters board members may want to bring up. The management team advises them on financials, claims, risk management, marketing, regulatory, and administrative issues. Then we have drinks and dinner.

The board meets the next morning for about three hours to hear reports from staff members and act on agenda items — well informed by background information provided in advance (three-ring binder) and discussion the night before — then lunch and a game of golf. When important issues arise between meetings, we hold conference calls. This approach to board meetings may not work for every RRG, but it has worked for us.

As CEO of the management company, I do not sit on the boards. Meetings are conducted by the Chair. The senior management team prepares the agendas, compiles background information, and joins actively in dialogue, but the board decides. Unlike most RRGs, our company performs all the management services — administration, underwriting, claims, risk management, marketing, and regulatory. The Company also oversees auditing, actuarial, investment, legal, and reinsurance placement on behalf of the RRG boards.

Our RRGs are virtual companies with no employees. We have found that providing one-stop, bundled services is efficient and productive. The boards of RRGs we manage average between five and seven members each with at least two directors from outside the business and no directors from the management company.

What are some of the critical issues we address at board meetings? Corporate performance, of course, is the key agenda item. We present all the financial information with comparisons to the previous quarter, the previous year, and actual vs. budget. We review underwriting results and any proposed changes in underwriting guidelines. We report on claims activity including any unusual claims that may lead to serious disputes. We discuss risk management and loss control.

These are the standard items but, most important, we examine the state of the industry, competitive challenges, growth opportunities, and demographic changes that will have long-term impact on our insured shareholders. As an example, Ponce de Leon, which operates exclusively in Florida, recently commissioned a study by the eminent research and consulting firm, LarsonAllen, to evaluate and analyze factors that will impact long-term care facilities over the next 20 years.

Our board members ask penetrating questions. They share experience based on their own operations — experience that contributes to formation of enlightened board policy. The concept of "best practices" is implicit in everything we do including corporate governance and board procedures. We participate actively in industry associations to learn from our peers.

One of our most fundamental commitments in terms of "best practices" is to create boards that are empowered to exercise informed judgment in determining corporate policy and charting the future course of the companies we manage. It works for us. It can work for you.

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