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Statement of the American Insurance Association

Before the House Committee on Financial Services
Subcommittee on Housing and Insurance

United States House of Representatives

"Examining Insurance for Non-profit Organizations"

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INTRODUCTION

Chairman Duffy and Ranking Member Cleaver thank you for the opportunity to testify at today's hearing entitled "Examining Insurance for Nonprofit Organizations." I am Tom Santos, Vice President of Federal Affairs at the American Insurance Association (AIA), and I am pleased to provide AIA's perspective on what we believe is the critical aspect of today's hearing—whether to expand federal preemption contained in the Liability Risk Retention Act of 1986.

AIA represents approximately 330 of the nation's leading insurance companies that provide all lines of property-casualty insurance to consumers and businesses in the United States and around the world. AIA members write more than $117 billion annually in U.S. property-casualty insurance premiums and approximately $225 billion annually in worldwide property-casualty premiums.

Our members have a strong interest in ensuring a competitive marketplace where the regulatory approach focuses on policyholder protection through appropriate financial standards applied in a fair and equitable way.

BACKGROUND

The Product Liability Risk Retention Act of 1981 was enacted in response to the product liability insurance needs of manufacturers. In 1986, the Liability Risk Retention Act (LRRA) was expanded to include all types of commercial liability coverage, again in response to widespread market issues during that time period. Seeking to narrowly address the liability insurance availability problem at hand, Congress wisely chose not to apply the LRRA to commercial property, workers' compensation, private passenger automobile, homeowners' insurance, and other types of insurance unaffected by availability issues.

The preemption authority of the LRRA allows risk retention groups (RRGs)[1] to operate nationally with significantly less oversight than admitted insurers. Unlike admitted, property-casualty companies that must adhere to the regulatory requirements of every state in which they operate, under the LRRA, RRGs are only required to meet the regulatory requirements of the state in which they are chartered/licensed and a limited number of specific regulations in other states in which those RRGs operate. More specifically, under the LRRA, RRGs are subject to less rigorous solvency requirements**.**

[1] An RRG in as insurance company formed pursuant to the federal Risk Retention Act of 1981, which was amended in 1986 to allow insurers underwriting all types of liability risks except workers' compensation to avoid cumbersome multistate licensing laws. An RRG must be owned by its insureds.

SHOULD RRGS BE ALLOWED TO PROVIDE COMMERCIAL PROPERTY COVERAGE

We recognize that RRGs have played a role in the commercial liability insurance market for more than 25 years. We also applaud the important work that many nonprofits do in communities all across the United States. However, since there is no demonstrable national availability problem in property insurance markets, like that experienced with respect to liability insurance in the 1980s, and considering that RRGs operate under a substantially different and less rigorous regulatory regime, AIA opposes further expansion of the LRRA to include commercial property insurance.

Over the years there have been several proposals to expand the LRRA to allow RRGs to offer commercial property coverage. Most recently, such proposals have focused on nonprofit (501(c)(3)) organizations. Proponents of expanding the LRRA suggest that a problem similar to the liability crises of the 1980s exists. But the data does not support that argument.

The proponents of this idea argue that nonprofit organizations are unable to easily acquire property coverage from the traditional insurance marketplace. At the same time, they acknowledge that nonprofits can readily secure property coverage in combination with liability coverage. The fact that nonprofit organizations are able to secure property coverage, even if combined, is evidence that there is no availability or market crisis in commercial property coverage that mirrors the liability crisis of the 1980s. To the contrary, property insurers are looking to expand offerings and enter into new markets, as evidenced by shrinking markets of last resort for property insurance in even the toughest states, such as Texas and Florida. In fact, Florida’s residual property insurance market has shrunk by more than one million policies over the last six years, an unmistakable sign of increasing competition.

Today’s property insurance marketplace is very competitive and insurers offer commercial property and liability insurance products at appropriate and affordable rates. The reality is that there is no market failure or availability crisis that warrants the extreme step of expanding the LRRA into commercial property insurance.

Further, no compelling evidence has been presented to the Committee suggesting an insurance availability problem warranting further federal preemption. In fact, the operators of RRGs have existing options to offer property insurance by using the revenue generated by their groups to form regulated captive, mutual or reciprocal insurers to offer property and other lines of insurance. Accordingly, the real question is, after 30 years of RRG operations, “Why have they not done so?” The answer is regulatory arbitrage.

RRGs want to grow and take on additional risk. But, but only if they can avoid certain state insurance regulations. This should raise very serious public policy questions for the Committee. Should an insurance operation be writing earthquake insurance in California without being subject to any of the rules, regulations and supervision of the California Department of Insurance? Should an insurance operation be writing hurricane coverage in Florida without being subject to any of the rules, regulations and supervision of the Florida Office of Insurance Regulation? If the LRRA is expanded into commercial property insurance, this would allow exactly that type of regulatory arbitrage.

REGULATORY DIFFERENCES AND CONCERNS

As we have already noted, RRG regulation differs significantly from the type and scope of oversight applied to admitted insurance companies, which are subject to licensing and regulation in each state in which they operate. The LRRA's preemption allows RRGs to operate nationally, but without very important oversight, including less rigorous solvency requirements.

AIA has long-argued that the most important consumer protection, when it comes to insurance, is ensuring the ability of the carrier to pay claims when an insured has a loss. This is particularly true when faced with significant losses from a major event (terrorist attack or large natural catastrophe).

Given their relatively small capacity, a RRG could be at greater risk of insolvency following a large loss event or catastrophe. If this occurred, it would leave policyholders without financial support at the very time they need it most. This outcome would be particularly acute for nonprofit organizations at a time when their constituents and communities would need them most. Therefore, concerns about the capital adequacy and financial solvency regulations must be addressed before any expansion of commercial writing by RRGs can be entertained.

AIA is not alone in our concerns about the financial regulation applied to RRGs. A 2011 report by the U.S. Government Accountability Office (GAO) noted that, some RRG representatives and state insurance regulators "… expressed concerns about whether RRGs would be adequately capitalized to write commercial property coverage."[2]

Further, when looking at property casualty insurer impairments, a 2015 A.M. Best Special Report revealed a rise in RRG impairments during the period of 2000-2015. The Best Report noted:

> "One interesting development, however, has been the rise of risk retention group (RRG) impairments during the period. For the period overall, there were 33 RRG impairments, representing 10% of the total. However, looking at the study period in bands showed that RRGs represented 4% of impairments in 2000-2005; 12% of impairments in 2006-2010; and 18% of impairments during 2011-2015. To some extent, the growth in RRG impairments reflects the growth in popularity of this structure. Another significant factor, however, may be unrealistic loss, operating expense, and pricing assumptions being utilized as these self-insurance entities are formed and undertake operations.[3]"

Finally, according to National Association of Insurance Commissioners (NAIC), over the past five years (2012-2016), RRGs have gone into receivership at a much higher rate than admitted property-casualty insurers.

Considering the observations noted in Best's Special Report, the concerns of state regulators, and the record of financial failures highlighted by the NAIC, we respectfully submit that Congress should not expand the LRRA to include commercial property insurance at this time.

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[2] U.S. Government Accountability Office, *Risk Retention Groups; Clarifications Could Facilitate States' Implementation of the Liability Risk Retention Act,* December 2011

[3] Best's Special Report, *2015 Property/Casualty Impairments Update,* October 2016, p. 2-3

CONCLUSION

Again, AIA as seen no demonstrable, national availability crisis that would warrant an expansion of the LRRA. Today, many AIA member companies have dedicated business operations specifically designed to address the needs of nonprofit entities. Non-profits are able to purchase commercial property insurance in the private market and have a wide selection of insurers from which to choose. That being said, if there are situations in which some nonprofit entities are having difficulty acquiring coverage, AIA would be open to helping facilitate a solution between the nonprofit corporations and property-casualty insurers that specialize in providing service to nonprofits.

Allowing RRG's to expand into commercial property under a less rigorous and preferential system of regulatory oversight will likely place policyholders at greater risk. If RRGs want to write property coverage they should become admitted insurance companies and subject themselves to the same capital standards and regulatory oversight as the rest of the insurance industry.

Thank you for the opportunity to present our views this morning, and I'd be pleased to answer any questions.