

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

January 24, 2020

Memorandum

To: Members, Committee on Financial Services

From: FSC Majority Staff

Subject: January 29, 2020, HCDI hearing entitled “Examining the Availability of Insurance for Nonprofits”

The Subcommittee on Housing, Community Development, and Insurance will hold a hearing entitled, “Examining the Availability of Insurance for Nonprofits” on Wednesday, January 29, 2020 at 2:00 p.m. in room 2128 of the Rayburn House Office Building. This hearing will focus on the availability of commercial liability and property insurance coverage for nonprofit entities and the role of risk retention groups (RRGs) in serving this market. This hearing will have a single panel with the following witnesses:

- **J. Robert “Bob” Hunter**, Director of Insurance, Consumer Federation of America
- **Ivoree Robinson**, Vice President, Property & Casualty, ABD Insurance & Financial Services, Inc.
- **Chlora Lindley-Myers**, Director, Missouri Department of Commerce & Insurance, on behalf of the National Association of Insurance Commissioners
- **Pamela E. Davis**, Founder, President and CEO, Nonprofits Insurance Alliance
- **Jon Bergner**, Assistant Vice President, Public Policy & Federal Affairs, National Association of Mutual Insurance Companies

Background on Risk Retention Groups

Under the McCarran Ferguson Act of 1945, the regulation of insurance markets is left primarily to the states.¹ In limited instances, Congress has acted to narrowly preempt some aspects of state insurance regulation, including to address periods in which insurance coverage becomes unaffordable or unavailable. For example, in response to a period in which the shortage of commercial liability insurance caused many entities to struggle to find and maintain adequate coverage, Congress passed the Product Liability Risk Retention Act of 1981 (PLRRA) to authorize the creation of risk retention groups (RRGs).² RRGs are alternative insurance entities made up of businesses with similar risk exposures that self-insure commercial liability risks on a group basis. Commercial liability insurance generally protects an entity from the risk of being sued or held legally liable for something such as malpractice, injury, or false advertising. Under the PLRRA, RRGs were only allowed to cover product liability insurance, but the Liability Risk Retention Act of 1986 (LRRRA) subsequently amended the PLRRA to allow RRGs to cover any type of commercial liability risks, with the exception of worker’s compensation.³

¹ 15 U.S.C. §§1011 et seq.

² P.L. 97-45; 15 U.S.C. §§3901 et seq.

³ P.L. 99-563.

Under the LRRRA, the primary purpose of an RRG must be to assume and spread the commercial liability of its members. Only commercial enterprises (including nonprofits) and governmental bodies can be members of RRGs. RRGs must be owned by their insured companies, and all the membership of any individual RRG must have similar or related liability exposure. RRGs are limited to writing commercial liability insurance for their members, and reinsurance with respect to the liability of other RRGs. RRGs are not authorized to cover other property/casualty insurance risks.⁴ Though the RRG makeup of the insurance industry has slightly increased in the past few years, they represent a relatively small portion of the commercial liability insurance industry.⁵ The overall premiums for RRGs in 2018 was nearly \$3.3 billion, around 1% of the total for commercial lines of insurance.⁶

In order to allow RRGs to expand the supply of commercial liability insurance the LRRRA largely exempts RRGs from multiple state regulation. Specifically, while traditional insurers are subject to licensing and oversight by regulators in every state in which they operate, RRGs are almost exclusively regulated by their domiciliary state, which is the state in which they are chartered and licensed as an insurance company. Non-domiciliary states where an RRG is operating have limited authority to require RRGs to comply with certain laws, including unfair claim settlement practices laws. RRGs are also required to register in all states in which they operate and provide certain documentation, including the RRG's business plan or feasibility study and annual financial statements. The emphasis on regulation solely by the domiciliary state gives an RRG an arguably greater incentive to establish domicile in states with less rigorous supervision and regulations. In 2018, more than 85 percent of RRGs were domiciled in Vermont, South Carolina, the District of Columbia, Nevada, Hawaii, Arizona and Montana.⁷ The National Association of Insurance Commissioners (NAIC) plays an important role in encouraging minimum standards and greater consistency in the regulation of RRGs across states. For example, through its voluntary accreditation program, NAIC sets minimum standards for solvency regulation of RRGs. To ensure the policyholders are aware of the unique way the RRGs are regulated, the LRRRA requires that all policies issued by an RRG must bear a federally mandated warning that the policy is not regulated or guaranteed in the same way as other insurance policies.

Key Differences between Risk Retention Groups and Traditional Insurers

State Guaranty Funds

All 50 states, D.C, Puerto Rico, and the U.S. Virgin Islands have guaranty funds that traditional insurance companies pay into in the event that an insurance company becomes insolvent,⁸ the proceeds of which are used to cover insurance claims. State guaranty funds were created to protect policyholders by ensuring they receive the full insurance claim due under the terms of their insurance policy even in the event of the company's failure. Unlike traditional insurers, RRGs are specifically prohibited by the LRRRA from participating in state guaranty funds. As such, if an RRG becomes insolvent and is unable to pay out claims to policyholders, its policyholders would not be protected through access to a guaranty fund and RRGs are not responsible for contributing to the guaranty fund to cover failures of other insurers.

⁴ Property/casualty coverage generally includes insurance coverage that is not health or life insurance. For example, property/casualty insurance includes auto, homeowners, and professional liability, among others.

⁵ Guy Carpenter Strategic Advisory, "Insurance Risk Benchmarks Research Report," Oct. 2017.

⁶ RRG premiums from Demotech, "Analysis of Risk Retention Groups—Year-End 2018;" calculations made compared to overall commercial lines premiums from S&P Global.

⁷ Demotech, Inc, "Analysis of Risk Retention Groups: Third Quarter 2018," Dec. 2018.

⁸ NAIC, "Guaranty Associations," Jan. 7, 2019.

Capital and Surplus Requirements⁹

Capital and surplus are key factors in determining an insurer's overall financial strength. Traditional insurers are generally subject to capital and surplus requirements in every state that they operate in. Consistent with their unique regulatory framework, RRGs are only subject to the capital and surplus requirements of their domicile state. Accordingly, non-domiciliary states in which RRGs operate rely on the domiciliary state to set adequate capital and surplus requirements and otherwise to ensure the financial condition of RRGs. Non-domiciliary states may request rate and form approval, in addition to other documentation to determine the financial condition of RRGs, but do not otherwise have any authority to regulate RRGs in this respect. Additionally, many states charter RRGs under regulations intended for "captive" insurers,¹⁰ which typically have lower capital and surplus requirements than traditional insurers. In fact, according to the NAIC, 222 of 228 RRGs are licensed as captive insurers.

According to a 2005 GAO report, some states may have lowered their capital and surplus requirements in order to attract RRGs to domicile in the state.¹¹ However, since that report, the NAIC has taken several actions to address concerns with RRG financial solvency, including revising its accreditation standards to bring RRGs into greater alignment with traditional insurers. For example, NAIC's accreditation standards now require all RRGs to have risk-focused examinations¹² that were already required of traditional insurers as well as the same financial and managerial filing requirements. Partly in response to previous congressional concerns about RRG governance, the NAIC's model law on RRGs now includes corporate governance requirements for RRGs, including a requirement that RRGs have independent directors as well as an audit committee and published governance standards.¹³

Assessing the Financial Condition of RRGs

The key differences between RRGs and traditional insurers described above are important primarily because of the implications they could have for policyholders. Since 1987, there have been 505 RRG formations and 46 RRG insolvencies, an overall insolvency rate of 8.7%.¹⁴ More experienced RRGs, however, have a more stable track record; specifically, among RRGs with at least 10 years of experience, there have only been nine insolvencies since 1987, resulting in an insolvency rate of 1.8% for those RRGs.¹⁵ Among RRGs with at least 10 years of experience *that serve nonprofits*, there has never been a single insolvency.¹⁶ A 2019 AM Best Report noted a rise of RRG impairments over the 2000-2018

⁹ Capital requirements determine the amount of capital, or liquidity an insurance company must have in its reserves to cover its business operating expenses. Surplus requirements determine the excess of funds required to meet a greater than expected losses or lower than projected earnings. These generally reduce the risk of insolvency and protect consumers from unpaid claims.

¹⁰ Captive insurance companies are established by single companies or groups of companies to self-insure risks and are generally offered some regulatory relief compared to traditional insurers under the assumption that the owners of captive companies have sophisticated knowledge about their risks and are incentivized to protect their own interests.

¹¹ GAO, "Risk Retention Groups: Common Regulatory Standards and Greater Member Protections Are Needed," Aug. 2005.

¹² Risk-focused examinations emphasize reviews of higher-risk areas and tend to be more specialized and tailored to individual companies.

¹³ NAIC Model Risk Retention Act, Jan. 2012.

¹⁴ Risk Retention Reporter, "Analysis of Risk Retention Group Insolvencies, A Risk Retention Reporter Special Report," 2019.

¹⁵ *Id.*

¹⁶ *Id.*

review period.¹⁷ The increasing popularity of RRGs is cited as a possible reason for the growth in impairments, but A.M. Best also identifies “unrealistic loss, operating expense, and pricing assumptions” as a significant factor.¹⁸ A 2019 report by the rating agency Demotech, however, found that RRGs remained financially stable, as cash, assets, and liabilities all increased over the past year.¹⁹

Assessing the Availability of Property Insurance Coverage for Nonprofits

In analyzing the availability of commercial liability insurance, it’s important to note the difference between “monoline” coverage and “bundled” coverage. Commercial liability and property insurance are often “bundled” together and sold as one insurance policy by traditional insurance companies whereas “monoline” insurance covers only one type of insurance risk under one insurance policy. RRGs are unable to offer bundled coverage due to their inability to offer coverage beyond commercial liability. The Alliance of Nonprofits for Insurance (ANI) has argued that the unavailability of monoline property coverage acts to limit consumer choice, which could be particularly harmful for nonprofit entities who generally have far fewer choices in the insurance market for the coverage that they need.²⁰ For example, entities that rely on an RRG for their commercial liability insurance would need a monoline commercial property policy from another insurer; however, if the only property coverage available is bundled with liability coverage, that entity may be forced to leave their RRG liability policy in order to obtain adequate property coverage. The National Association of Insurance Commissioners (NAIC), on the other hand, has argued that the availability of monoline property coverage is “narrow and not a true measure” of availability, suggesting that the availability of bundled coverage is a better metric.²¹

Much of the evidence regarding the availability of commercial property insurance coverage for nonprofits is anecdotal. However, a study conducted by Guy Carpenter in 2017 found only a few bundled policies available to small and mid-sized nonprofits and only one company that offered monoline property coverage for nonprofits.²² Further, the increasing cost of property and casualty insurance in recent years may have also made it more difficult for nonprofit entities to find affordable coverage. Beginning in late 2017 and continuing through 2018, the cost of property and casualty insurance began to increase.²³ Natural catastrophe has been cited as a factor of increased premiums and a harder market by the NAIC and the Council of Insurance Agents & Brokers (CIAB).²⁴ According to a November 2019 market report from CIAB, all commercial lines except for workers’ compensation experienced increases in premium pricing for six consecutive quarters.²⁵ The average premium increase for commercial property was 8.8% in Q3 2019, and the average premium increase across all major lines was 5.9%.²⁶ In just a year, the average premium change across accounts of all sizes increased from 1.6% in Q3 2018 to 6.2% in Q3 2019.²⁷

¹⁷ AM Best, “2018 Property/Casualty Impairments Update,” Dec. 9, 2019.

¹⁸ *Id.*

¹⁹ Demotech, Inc, “Analysis of Risk Retention Groups: Third Quarter 2019,” Dec. 2019.

²⁰ Testimony of Pamela E. Davis, Subcommittee on Housing and Insurance hearing entitled “Examining Insurance for Nonprofit Organizations” on Sep. 28, 2017.

²¹ Letter from NAIC to Chairwoman Waters and Ranking Member McHenry dated Oct. 23, 2019.

²² Guy Carpenter Strategic Advisor, “Availability of BOP filings allowing for the provision of property only for 501(c)(3) nonprofits,” Aug. 21, 2017.

²³ NAIC, Property & Casualty Insurance Industry: 2018 Full Year Results, 2018.

²⁴ Council of Insurance Agents & Brokers, “Commercial Property/Casualty Market Index,” 2019.

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.*

Legislation

- **H.R. 4523**, the “Nonprofit Property Protection Act”, introduced by Rep. Al Green, would allow RRGs that meet certain requirements, including at least 10 years of experience, to offer property coverage to nonprofits only in states where there are less than three monoline commercial property policies available.