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Why risk retention groups are critical for a healthy insurance marketplace

Congress is considering new legislation that would authorize RRGs to insure more types of risks. Here's what lawmakers need to know.

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Legislation currently making its way through Congress would authorize risk transfer groups to insure more types of risks. (Photo: iStock)

The insurance marketplace has evolved significantly over the past several decades. Organizations today have access to many forms of risk transfer beyond the purchase of traditional insurance. The Alternative Risk Transfer market (ART), as it has come to be known, is able to tailor solutions previously unavailable and has become an integral part of the insurance landscape.

As part of ART, risk retention groups (RRGs) are a crucial and highly successful form of insurance for many business entities. RRGs pool their similar risk exposures to collectively self-insure — they are effectively owned by their members. RRGs provide an innovative solution for similar entities to insure themselves. For example, a group of hospitals, attorneys, financial institutions, or nonprofits could find specialized insurance from an RRG to meet their specific needs.

The legal framework for RRGs was formed in the early-1980s when the insurance industry found itself in a crisis. Many specialty industries faced skyrocketing rate increases, cancellations, or nonrenewals. To counter this market failure, Congress passed the **Product Liability Risk Retention Act (LRRA) of 1981** to increase the availability of commercial liability insurance across the country. The act was expanded from products liability to a broader definition of liability in 1986.

RRGs can develop highly specialized underwriting and claims handling because they focus on only one type of business. This is why they are so innovative and successful in the marketplace, and they are increasingly important to the way businesses protect themselves.

New legislation impacting RRGs

Legislation currently making its way through Congress would authorize RRGs to insure more types of risks and, thereby, enable market-driven innovation. But despite the significant evidence presented by the success of RRGs, and the presence of strong regulation — which in the opinion of AM Best is already similar to the lead state regulation that commercial companies now have — there has been some conflicting information about how RRGs are regulated.

For example, **testimony** before U.S. House Subcommittee on Housing, Community Development, and Insurance questioned the efficacy of the current regulatory structure: "RRG policyholders in non-domiciliary states do not get the benefits of the full panoply of regulatory protections that the state insurance system normally provides, and the RRG is not subject to the more robust oversight that multiple sets of eyes can offer." This is inconsistent with **the view** of the National Association of Insurance Commissioners (NAIC), which clearly states, "RRGs are treated as multi-state insurance companies and are subject to NAIC accreditation standards, albeit modified to suit the unique nature of RRGs." In addition, the NAIC Model Risk Retention Act, effective January 2012, requires all states to regulate RRGs uniformly.

Furthermore, effective in January 2017, new governance standards adopted by the NAIC require states that regulate RRGs to incorporate uniform standards for governance into their insurance laws.

The Congressional testimony also presented variation in regulation as a problem: "While it is true all states are required to establish a baseline level of regulatory requirements for RRGs in order to obtain NAIC accreditation, those baseline standards are not the same requirements utilized for admitted market regulation." NAIC recognizes that RRGs need different regulation than admitted carriers and is clear on the advantages RRGs provide: "Few RRGs, if any, are required to submit rate and form filings — rates are typically based on an actuarial analysis of the membership, and one of the advantages of captives, as noted with pure captives [of which RRGs are one type], is the ability to manuscript the policy to suit the needs of the membership [emphasis added]."

A third point made in the Congressional testimony is about unfair market participation by RRGs: "Because RRGs are narrowly focused on their members' liability risk, the LRRA allowed them to operate on an unlevel playing field with relaxed treatment relative to traditional commercial insurers."

For these specialty RRGs to operate in 50 states, Congress devised a hybrid regulatory solution: a specialty RRG can be licensed in one state and registered in all others. This different form of regulation allows for state-based regulation of insurance while simultaneously providing specialized insurance to members in 50 states. This hybrid form of regulation does not mean that it is weaker. Proof of the success of the regulatory structure for RRGs is in their track record of nearly 35 years.

All insurers are subject to state requirements for minimum **capital and surplus**. Although statutory minimums for traditional companies vary state by state, they are often irrelevant since nearly all insurers in the U.S., including RRGs, are subject to risk-based capital (RBC) standards. RBC formulae estimate capital needs based on an insurer's operations. Both traditional insurers and RRGs must meet these standards. RBC provides a consistent method of regulation that is used to measure the minimum amount of capital required to support business operations. With RBC standards, RRGs are uniformly regulated in the same way as traditional insurance companies.

In this time of great uncertainty, one thing is clear: Regulators need to enable a competitive and innovative insurance market to meet the needs of our citizens. RRGs are a crucial risk transfer option for specialty professions and sectors across the United States. All types of organizations — health care, public entities, and nonprofits, to name a few — rely on RRGs. In turn, our communities rely on these organizations for a healthy citizenry and strong economy.

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