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Highlights

Highlights of GAO-12-16, a report to congressional requesters

December 2011

RISK RETENTION GROUPS

Clarifications Could Facilitate States' Implementation of the Liability Risk Retention Act

Why GAO Did This Study

Congress authorized the creation of risk retention groups (RRG)—a group of similar businesses that creates its own insurance company to insure its risk—to increase the affordability and availability of commercial liability insurance. Through the Liability Risk Retention Act (LRRA), Congress partially preempted state insurance laws to allow RRGs licensed in one state (the domiciliary state) to operate in all other states (nondomiciliary states) with minimal additional regulation. In a 2005 report (GAO-05-536), GAO noted concerns with the adequacy of RRG regulation. This report (1) describes changes in the financial condition of the RRG industry from 2004 to 2010;
(2) examines the regulatory treatment of RRGs across domiciliary and nondomiciliary states; and
(3) examines changes to federal and state regulatory practices regarding RRGs since 2004. GAO analyzed RRG financial data, surveyed state insurance regulators (96 percent response rate), and interviewed RRG industry representatives.

What GAO Recommends

To further facilitate states' implementation and help reduce the varying interpretations of LRRA, Congress should consider the merits of clarifying certain LRRA provisions regarding registration requirements, fees, and coverage. NAIC concurred with this matter for congressional consideration.

View GAO-12-16 or key components. To view the e-supplement online, click GAO-12-17SP.
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What GAO Found

Certain indicators suggest that the financial condition of the RRG industry in aggregate generally has remained profitable. In 2003, RRGs wrote about $1.8 billion, or 1.17 percent of commercial liability insurance. In 2010, RRGs continued to comprise a small percentage of the total market, writing about $2.5 billion—or about 3 percent of commercial liability coverage. Other financial indicators, such as ratios of RRG premiums earned compared to claims paid—also suggest profitability. In addition, the number of RRGs has increased since 2004, with the most growth occurring in health care-related lines. In 2010, more than 80 percent of RRGs were domiciled in Vermont, South Carolina, the District of Columbia, Nevada, Hawaii, and Arizona, but RRGs wrote about 95 percent of their premiums outside their state of domicile. Evidence suggests that RRGs may choose to domicile in a particular state, partly due to some financial and regulatory advantages such as lower minimum capitalization requirements. RRG representatives opined that RRGs have expanded the availability of commercial liability insurance—particularly in niche markets—but differed in their opinions of whether RRGs have improved its affordability.

Different interpretations of LRRA have led to varying state regulatory practices and requirements in nondomiciliary states and disputes between state regulators and RRGs in areas such as registration requirements, fees, and types of coverage RRGs may write. For example, while some states have interpreted LRRA to permit RRGs to write contractual liability coverage, others have not, and therefore may not allow RRGs to write this coverage in their state. RRGs have challenged requirements established by nondomiciliary states that RRGs assert are not permitted by LRRA. However courts also have differed in their interpretations of LRRA. Some regulators with whom GAO spoke indicated that their actions toward nondomiciled RRGs reflect an effort to use their limited regulatory authority to protect insureds in their states as well as address concerns about RRG solvency.

Some state regulatory practices for RRGs have changed since 2004, and federal legislation has been proposed. In 2005, GAO recommended implementation of more uniform, baseline state regulatory standards, including corporate governance standards to better protect RRG insureds. The National Association of Insurance Commissioners (NAIC) has since revised its accreditation standards to more closely align with those for traditional insurers which are subject to oversight in each state in which they operate. For example, all financial examinations of RRGs that have commenced during or after 2011 should use the risk-focused examination process. NAIC also has begun developing corporate governance standards that it plans to implement in the next few years. Proposed legislation would amend LRRA to allow RRGs to provide commercial property insurance and also include a federal arbitrator to resolve disputes between RRGs and state insurance regulators. While some RRG representatives and state regulators supported this legislation, others expressed concerns about whether RRGs would be adequately capitalized to write commercial property insurance and about federal involvement in state regulation.