

EXAMINING INSURANCE FOR NONPROFIT ORGANIZATIONS

HEARING BEFORE THE SUBCOMMITTEE ON HOUSING AND INSURANCE OF THE COMMITTEE ON FINANCIAL SERVICES U.S. HOUSE OF REPRESENTATIVES ONE HUNDRED FIFTEENTH CONGRESS FIRST SESSION

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EXAMINING INSURANCE FOR NONPROFIT ORGANIZATIONS

Thursday, September 28, 2017

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING
AND INSURANCE,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:38 a.m., in room 2128, Rayburn House Office Building, Hon. Sean P. Duffy [chairman of the subcommittee] presiding.

Members present: Representatives Duffy, Ross, Royce, Posey, Luetkemeyer, Rothfus, Zeldin, MacArthur, Budd; Cleaver, Beatty, Kildee, Kihuen, and Gonzalez.

Chairman DUFFY. The Subcommittee on Housing and Insurance will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Also, without objection, members of the full Financial Services Committee who are not members of this subcommittee may participate in today's hearing for the purposes of making an opening statement and asking our witnesses questions.

Today's hearing is entitled, "Examining Insurance for Nonprofit Organizations."

The Chair now recognizes himself for 3 minutes for an opening statement.

I want to welcome our witnesses. Thank you for being here today. And I would just note that Mr. Cleaver is on his way. He is going to participate, and I am sure he is going to want to ask questions and make an opening statement as well, but welcome.

Risk retention groups, or RRGs, are liability insurance companies owned by their members that allow businesses with similar needs to pool their risk together. They were originally created to address a distortion in the marketplace when product liability insurance was largely unavailable.

In the 1980s, Congress expanded the types of liability insurance RRGs could offer to commercial liability as companies faced similar issues obtaining commercial liability insurance.

From a regulatory standpoint, RRGs operate under a different regime than a traditional property and casualty insurance company. Whereas an insurance company is regulated in each State they offer an insurance product, RRGs' regulation is largely handled at the State in which the company is domiciled, a pretty significant difference.

In the RRG regime, that company can ultimately sell products in other States without being under the same solvency regulation requirements as an admitted carrier.

Now, we have had several nonprofit organizations claim that there is, once again, an availability issue in regard to property coverage. And so I think we are going to have a vigorous and lively conversation today about, should we now change the rules, expanding from liability to property coverage for nonprofits?

And I know we have a lot of different opinions. The industry is probably somewhat split. I am sure that this body is split as well, but this is truly an opportunity for us to hear from you on your thoughts and opinions and provide advice and counsel to the Congress on what action, if any, you think we should take.

So I am looking forward to your testimony and insight. And again, I want to welcome you to our hearing.

With that, I want to recognize the Vice Chair of the subcommittee, the gentleman from Florida, Mr. Ross, for 2 minutes.

Mr. ROSS. Thank you, Mr. Chairman.

And I thank the witnesses for being here today as well, and for their testimony.

This subcommittee will discuss an issue that has been of deep importance to me for some time, and that is the insurance needs and options available for nonprofit organizations.

I first started working on this subject after hearing stories from my local Boys and Girls Clubs back in central Florida who were worried about the lack of commercial insurance policies that offered the coverage they needed at an affordable price.

As I dug deeper into the issue, I discovered that it was not uncommon for many of our community nonprofit organizations to be underinsured, specifically with regard to property coverage.

These groups are the lifeblood of their communities. Many of them dedicate themselves to serving others in the time of need, organizing volunteers to support a good cause or helping the most vulnerable members of our society work for a better future.

Unfortunately, their commitment to charity in their community comes with a cost. Nonprofits, by the nature of their very mission, have a unique set of risks, different than almost any other commercial enterprise. And that unique risk makes them difficult to insure.

In addition, many nonprofits operate on extremely thin margins, giving back all they take in and looking to maximize returns to the people they serve. That, too, contributes to the nonprofit sector's relative undesirability in the insurance market.

Today, a significant number of nonprofit organizations have insurance in the form of liability coverage from a risk retention group, also known as an RRG. In the mid-1980s, Congress passed the 1986 amendments to the Liability Risk Retention Act, which expanded the lines of liability insurance that RRGs could offer to their member owners.

And today, we will have a chance to discuss my draft proposal to further expand the lines of insurance an RRG may offer to include standalone property coverage. I believe that my proposal is appropriately tailored to address the issue at hand.

Importantly, it includes strong consumer protections that mitigate some traditional concerns surrounding RRG expansion. I think it is a good compromise that will help fix this very real problem.

I am glad to have each witness here today to share with us their experience and expertise and to help this subcommittee get a better understanding on the issue of the merits and demerits of the proposal like the Nonprofit Property Protection Act. We have a great group of witnesses, and I thank them for being here.

I yield back.

Chairman DUFFY. The gentleman yields back.

I now want to take this opportunity to welcome our witnesses. We have Mr. Baird Webel, a specialist in financial economics from the Congressional Research Service; Ms. Pamela Davis, the founder, president, and chief executive officer of Alliance for Nonprofits for Insurance; and Mr. Santos, the vice president of Federal Affairs for the American Insurance Association (AIA).

And for the introduction for Mr. Cothron, I want to recognize Mr. Ross, who knows Mr. Cothron well.

Mr. ROSS. Thank you, Mr. Chairman. It is my distinct honor to introduce Mr. Kevin Cothron, who has been a longtime friend of mine. He is the president of Southeast Nonprofit Insurance Programs. He has over 25 years in the insurance industry.

He created and manages an insurance placement program that specializes in niche insurance markets of 501(c)(3) nonprofits throughout the United States. The company performs no direct sales and works entirely through independent brokers and agents.

He has been a leader in the nonprofit insurance sector for many years, and we are very fortunate to have him here today. Thank you for being here.

Chairman DUFFY. Wonderful.

And welcome, Mr. Cothron.

In a moment, the witnesses are all going to be recognized individually for 5 minutes to give an oral presentation of their testimony. And without objection, the witnesses' written statements will be made a part of the record.

Once the witnesses have finished presenting their testimony, each member of the subcommittee will have 5 minutes within which to ask each of you questions.

And with that, Mr. Webel, I recognize you now for 5 minutes.

STATEMENT OF BAIRD WEBEL, SPECIALIST IN FINANCIAL ECONOMICS, CONGRESSIONAL RESEARCH SERVICE

Mr. WEBEL. Thank you. Mr. Chairman, Ranking Member Cleaver, and members of the subcommittee, I would like to thank you for the opportunity to testify today. As the chairman said, my name is Baird Webel. I am a specialist in financial economics at the Congressional Research Service.

And just for anybody who is watching and doesn't know this, CRS' role is to provide objective nonpartisan research and analysis to Congress. We take no position on the desirability of any specific policy. Any arguments presented in my written and oral testimony are for the purposes of informing Congress, not to advocate for a particular policy outcome.

As the chairman mentioned, risk retention groups were created by Congress in the 1980s in response to problems in the liability market. And there are obviously a lot of different policy options one could have when you have insurance market problems.

Congress sought to address the supply problems by essentially simplifying the regulatory structure of the liability insurance. And in doing so, they put particular limitations on the risk retention groups that resulted from this legislation.

Particularly, they can only supply commercial liability insurance, and I think the “commercial” is important because what the presumption is to some degree is that businesses purchasing commercial insurance are going to have some measure of sophistication in the purchase of the insurance.

The risk retention groups have to be owned by the policyholders. And this, I think, was an attempt to basically give the owners and the policyholders some skin in the game and some control over how the risk retention groups were going to operate, and the policyholders facing similar risks essentially should at least make the management and the judgment about the risks of these groups a little easier to manage and to face.

Importantly, the Federal law prevents risk retention groups from participating in the State guaranty funds, which do provide some protection in the case of an insolvency, which means that the RRG policyholders, again by the statute, do not have this protection.

A number of State laws do still apply to risk retention groups, notably relating to unfair claims practices, nondiscrimination, and State premium taxes still apply to these companies.

In the 30 years since, I think that the experience in general in the risk retention market has largely followed to some degree the ups and downs of the rest of the commercial liability market.

Property casualty insurance tends to move in cycles of hard markets where insurance gets expensive and difficult to obtain, frequently followed by softer markets where the insurance gets a little cheaper and a little easier.

And as you might expect for a sort of niche product like risk retention groups, they tend to improve during hard markets when people are looking for these types of insurance.

They grew a lot after they were first created and then sort of plateaued in the 1990s and grew a little more in the early 2000s, as we saw another hard market. Then for the last 10 years overall, you have seen pretty soft market conditions and, again, a sort of plateauing of the numbers of risk retention groups.

They are a reasonably niche product. The overall premium of risk retention groups compared to property casualty insurance in general is pretty small, about \$3 billion versus compared to somewhere in the realm of \$600 billion for property casualty overall.

But I think it is important to know that within the niches where a company can serve, they can still be important, even if the overall market may be soft. The worldwide capital markets have seen a lot of liquidity in the last 10 years.

But that doesn't mean that the individual niches where property casualty insurance is sold necessarily experience the same market conditions. It is a local product that is sold under local conditions.

And in order to really judge what is going on you have to look at those particular local conditions.

The people who have looked into the market in general, the Commerce Department in the 1980s and GAO more recently, have generally found that risk retention groups have served a positive role in these sorts of niche markets.

And so that basically concludes what I wanted to say, and I look forward to answering any questions you may have.

[The prepared statement of Mr. Webel can be found on page 47 of the appendix.]

Chairman DUFFY. Thank you, Mr. Webel.

Ms. Davis, you are now recognized for 5 minutes.

**STATEMENT OF PAMELA E. DAVIS, FOUNDER, PRESIDENT,
AND CHIEF EXECUTIVE OFFICER, ALLIANCE OF NON-
PROFITS FOR INSURANCE**

Ms. DAVIS. Thank you. Mr. Chairman, Ranking Member Cleaver, and members of the subcommittee, thank you for the opportunity to testify in favor of the Nonprofit Property Protection Act, which will permit a very small subsection of established risk retention groups to provide property and auto physical damage insurance to their members. We have submitted a written statement for the record.

I am the president, CEO, and founder of Alliance of Nonprofits for Insurance (ANI), a nonprofit risk retention group on whose behalf I am testifying today. ANI insures small and mid-sized community-based nonprofit organizations across the country, those in our neighborhoods who work with the most vulnerable among us.

They are homeless shelters and programs for those with Alzheimer's, victims of abuse, and the developmentally disabled. They are animal rescue organizations, elder care services, drug and alcohol rehabilitation centers, school arts programs. They are foundations raising money for diabetes, heart disease, and cancer research, among many others.

80 percent of our member insureds have annual budgets of \$1 million or less. These little nonprofits got into the business of insurance because commercial insurance carriers walked away from them. They never wanted to be in the insurance business but were forced into it to be able to serve our communities.

We are successfully insuring these organizations for difficult risks, such as auto liability and sexual abuse and employment practices liability. We offer a vast array of free consulting and educational services, such as employment risk management and driver training to our members whose small budgets do not allow them to purchase or provide these services.

But our future ability to continue to offer assistance to these organizations is now in danger. Commercial insurers, when they are willing to offer coverage for these unusual risks represented by nonprofits, will provide it only as a bundled package. That is, these small nonprofits must purchase the liability insurance and the property insurance together as a package, somewhat like a cable triple play package.

However, by Federal law, as an RRG, ANI is only allowed to offer liability insurance to our member insureds. Since ANI's incep-

tion, only one insurance company has offered the standalone property and auto physical damage policies that small and mid-sized members of ANI need.

Several years ago, that company told us that the program is too small to be viable in the long term because of the requirements of filing and reporting in 50 States. And they advised us to look for other options.

We asked our insurance brokers and agents who work with nonprofits to find other commercial insurance companies to provide the standalone property and auto physical damage that their clients need. They told us in no uncertain terms that there were no markets available.

Every insurance carrier required that to purchase the property, the nonprofit would also have to purchase liability from them at the same time. Hearing that, we engaged Guy Carpenter to conduct an independent study to see whether there were insurance department filings that we had overlooked, because surely there was some other carrier that would provide this coverage.

Guy Carpenter's research demonstrated that only one other company has filed the property form that our members need. But that filing requires that the commercial insurance company sell the property and liability together as a bundled package. The property cannot be sold on a standalone basis.

We had exhausted all of our options for market-based solutions and our future viability without the Nonprofit Property Protection Act is now in danger.

To address consumer protections, there are provisions included in the bill that require any RRG authorized to offer property insurance to: one, have a minimum of \$10 million in threshold capital, although the domicile regulator may require more; and two, to have a minimum of 10 years' experience offering liability insurance.

And to make sure the bill will correct only this market failure and not interfere with an otherwise well-functioning commercial property market, the bill allows RRGs to offer these coverages only to their members that are 501(c)(3) nonprofits.

And any single nonprofit may be insured for only up to \$50 million in total insured value because it is presumed that larger nonprofits will have the market clout to be able to purchase this in the standard marketplace.

In closing, ANI offers important specialized coverages and risk management services for community-based organizations serving some of the most vulnerable in our communities. We help those organizations provide their services safely and efficiently as possible to make sure that scarce resources are directed back into our communities.

Standalone property and auto physical damage insurance is essential for these RRG members, but it is not available from the commercial marketplace. This bill would allow nonprofits to solve that problem for themselves without requiring any government resources so they may continue to do their important work in our communities. Thank you.

[The prepared statement of Ms. Davis can be found on page 29 of the appendix.]

Chairman DUFFY. Thank you, Ms. Davis.
Mr. Santos, you are now recognized for 5 minutes.

**STATEMENT OF TOM SANTOS, VICE PRESIDENT, FEDERAL
AFFAIRS, AMERICAN INSURANCE ASSOCIATION**

Mr. SANTOS. Thank you, Mr. Chairman. Chairman Duffy, Ranking Member Cleaver, members of the subcommittee, thank you for inviting me to testify at today's hearing.

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.

AIA represents approximately 330 of the Nation's leading insurance companies that provide all lines of property and 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 and casualty premiums and approximately \$225 billion annually in worldwide 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 equitably.

We recognize that risk retention groups have played a role in the commercial liability insurance market for more than 25 years, and we applaud the important work that many nonprofits do in communities all across the United States.

However, there is no demonstrable national availability problem in commercial property insurance markets. And considering that RRGs operate under a substantially different and less rigorous regulatory regime, AIA opposes further expansion of the Risk Retention Act to include commercial property insurance.

Over the years, there have been several proposals to expand the Risk Retention Act to allow RRGs to offer commercial property. Most recently, these proposals have focused on not-for-profit 501(c)(3) organizations.

Proponents that argue for expanding the LRA suggest an insurance availability problem exists. They also argue that nonprofit organizations are unable to easily acquire property coverage from the traditional insurance markets. That is not the case.

Proponents themselves acknowledge that nonprofits can secure property coverage in the marketplace. 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 the commercial market for property insurance.

Today's property insurance marketplace is extremely competitive, with insurers offering commercial property and liability products at affordable and appropriate rates. In fact, property insurers are looking to expand offerings and enter into new markets, as evidenced by shrinking markets of last resort for property insurance in some of the toughest markets in the country.

With regard to insurance for nonprofits, many AIA member companies have dedicated business operations specifically designed to meet the needs and address those of nonprofit entities, giving non-

profits the ability to purchase commercial property insurance in the private market from a wide selection of insurers.

Again, simply put, there is no market failure that warrants the extreme step of expanding the Risk Retention Act's Federal preemption into commercial property insurance.

AIA has long argued that the most important consumer protection when it comes to insurance is the ability of the insurer to pay claims when an insured has a loss.

This is particularly true when faced with a significant loss from a major event such as a terrorist attack or a large natural catastrophe. A risk retention group insolvency would leave policyholders and its impacted community without the financial support at the very time they need it most. This impact would be particularly acute for nonprofit organizations serving the most vulnerable in our communities.

We are not alone in our concerns about RRG insolvency. A 2011 report by the Government Accountability Office noted that some RRG representatives and State regulators, "expressed concerns about whether RRGs would be adequately capitalized to write commercial property coverage."

Further, in looking at property and casualty impairments, a 2015 A.M. Best special report revealed a rise in risk retention group impairments during the period from 2000 to 2015.

In addition, the National Association of Insurance Commissioners have noted that RRGs have gone into receivership at a much higher rate than admitted property and casualty insurers.

Thus, concerns about capital adequacy and solvency regulation must be addressed before any expansion of commercial writing by risk retention groups is even considered.

Again, we see no demonstrable national availability crisis that would warrant such a significant expansion of the Risk Retention Act and there are options for risk retention groups if they wanted to get into the commercial property space. They could become licensed admitted carriers. There are other corporate structures of which they could avail themselves.

Thank you for the opportunity to present our views this morning. We look forward to your questions.

[The prepared statement of Mr. Santos can be found on page 39 of the appendix.]

Chairman DUFFY. Thank you, Mr. Santos.

Mr. Cothron, you are now recognized for 5 minutes.

STATEMENT OF M. KEVIN COTHRON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, SOUTHEAST NONPROFIT INSURANCE PROGRAMS

Mr. COTHRON. Mr. Chairman, Ranking Member Cleaver, Congressman Ross, and members of the subcommittee, I would like to thank you for the opportunity to testify today in support of the Nonprofit Property Protection Act.

The majority of nonprofits that I work with are small to mid-sized social service organizations. These nonprofits have limited funding, but provide invaluable services within their communities.

I have been in the insurance industry for 25 years and have worked with 501(c)(3) nonprofits throughout the southeast. The

type of nonprofits that we work with are senior care centers, foster care and adoption agencies, mental health services, homeless shelters, and animal rescue groups, among many others.

In my experience we have had an ongoing crisis in trying to secure property coverage for small to mid-sized 501(c)(3) nonprofits. The challenge these small to mid-sized nonprofits have in securing property insurance is they have to rely on commercial insurance companies, and there are few of these companies that will insure this type of risk.

And insurance companies that will insure nonprofits typically only provide the property insurance if they are also getting the liability insurance, thereby creating what is called a package program.

The package programs are offered on an all-or-nothing basis, meaning the nonprofit cannot purchase the property insurance from the insurance company unless the liability insurance is also purchased from the same company.

When the insurance carrier offers a package program to a nonprofit they typically charge more for liability insurance than what the nonprofit would pay if they were getting the liability insurance from a risk retention group.

I work extensively with a risk retention group for nonprofits, but unfortunately, the risk retention group is prohibited from being able to provide property insurance. In most States, an insurance company, an insurance mutual captive or even an insurance trust can provide all lines of commercial insurance coverage, including property.

Only a risk retention group is restricted to providing only liability coverage to nonprofits. This is unfair to nonprofits who prefer to have their coverage and services with a risk retention group. It also creates an unfair market advantage for the insurance companies.

It has been my practice in my business to work with insurance companies, including risk retention groups. I believe in offering the best possible coverage to clients at a reasonable cost. I think insurance is more than just a piece of paper with coverage terms, and that the industry should provide risk management services to the nonprofits.

It has been my experience with risk retention groups that they provide insurance with broader, specialized coverages and services that are tailored to a nonprofit's actual needs.

For example, I know that my clients really appreciate the risk retention group's loss control services, that will help them train their employees and volunteer drivers, as well as providing them with advice on how to navigate complex employment law and help them avoid claims and litigation.

While I never worked with an RRG or a commercial insurance company that claims to always offer the lowest price, I have done many comparisons that demonstrate when a nonprofit is forced to purchase a package policy on an all-or-nothing basis from a commercial insurance company, the nonprofit is typically paying a higher price in annual liability premium in order to get the property coverage.

Most nonprofits I work with have limited operating funds and are receiving all or some of their funding from State, Federal, or local governments. The nonprofit has been entrusted with the taxpayers' money and should not have to spend an unnecessary high amount on insurance.

This added undue expense in turn negatively impacts the amount of services that they can provide to their communities. By allowing a risk retention group the ability to provide property insurance, the nonprofit will receive more competitive pricing from all the insurance options that are available and still be able to benefit from the specialized coverages and services they value.

I work with over 100 brokers, and I can state without hesitation that we need risk retention groups for nonprofits to be able to provide property to serve the small to mid-sized nonprofits that choose to be a member of a risk retention group and benefit from their strong niche focus and loss control resources.

These RRGs are already providing coverage for the difficult liability exposures and are presently able to provide multi-million limits for a van full of children, but they are prohibited from insuring a dent on the van.

There is no reason risk retention groups should not be able to provide property and auto physical damage, particularly with the strong consumer protections that are included in the bill.

I strongly support the Nonprofit Property Protection Act, and ask that you please pass this bill as soon as possible. Thank you.

[The prepared statement of Mr. Cothron can be found on page 24 of the appendix.]

Chairman DUFFY. I want to thank the witnesses for their opening statements.

The Chair now recognizes himself for 5 minutes for questions.

Let us drill into the problem, if there is a problem. So maybe if I can have everyone answer this question, is there an agreement that nonprofits cannot exclusively buy property insurance?

Ms. Davis, what do you think?

Ms. DAVIS. The qualifier really needs to be the standalone property and auto physical damage coverage. If a nonprofit wants to purchase the property, they have to buy it from a commercial market. And they have to buy it as a bundled package with the liability together with the property.

But we sell only liability and so the nonprofits can't get the standalone property.

Chairman DUFFY. Mr. Santos, do you agree with that?

Mr. SANTOS. I don't. I think there are products available in the marketplace. In fact, previously the proponents have done a comparison where they have suggested they could purchase a monoline property coverage and when paired up with the monoline liability product combined or standalone products, they were more expensive.

But a combined package produced a product that was both more economical for the insurer to produce and cheaper for the insured to purchase.

Chairman DUFFY. And quickly, Mr. Cothron and Mr. Webel, do you want to weigh in on this? Because I think we have to identify whether there really is a problem.

Mr. COTHRON. Yes, there is a problem. The commercial insurance carriers will only offer it as a package. I have worked with independent brokers. I don't do direct sales.

I work with independent brokers throughout the southeast, and there is not a week that goes by that I am not contacted by a broker searching for a property market that will write a nonprofit on a monoline basis, and that product is just not there.

Chairman DUFFY. Mr. Webel?

Mr. WEBEL. I would say from what I have seen that there is probably not a problem at a national level, but that it is entirely possible that you might see some individual niche problems.

Chairman DUFFY. Did you also want an expansion to auto, too, Ms. Davis?

Ms. DAVIS. The answer is yes. This is auto physical damage. We actually—

Chairman DUFFY. So is it fair to say that you can actually buy auto insurance that is unbundled?

Ms. DAVIS. We write auto liability insurance and other carriers write the liability. It is the auto physical damage that we are not allowed to write as a risk retention group. So just to clarify, we presently now insure plenty of vans that carry kids and insure that up to \$10 million. But if that van is in an accident, we are not allowed to fix a dent in the bumper.

Chairman DUFFY. Okay.

Mr. Santos, do you agree with that?

Mr. SANTOS. Again, there may be individual instances in particular communities, but it is not a national problem. I think one of the questions is, if they are covering the liability, is that vehicle not insured for property damage or are they purchasing it from someplace else?

Chairman DUFFY. Okay. So we are not going to get an agreement on whether or not we have a problem. I expected that.

But if we want to have an expansion, why don't we just have the risk retention groups become insurance companies and become licensed in each of our States that they want to do business? What is the problem with walking down that path instead of expanding this exclusion?

Mr. Santos, do you see a problem with that?

Mr. SANTOS. In fact, that is what we think companies should do. I would highlight also they may not need to go as far as to become an admitted licensed carrier in every State in which they operate, although that would certainly provide the most rigorous consumer protection and the most rigorous solvency oversight.

There are other avenues that they could do without this sort of broad Federal preemption that the Risk Retention Act provides.

Chairman DUFFY. Mr. Cothron?

Mr. COTHRON. There is no practical purpose to becoming an insurance company. The purpose behind that would be if they want to insure numerous types of businesses. But a risk retention group specializes in a unique niche market.

So if you only want to do 501(c)(3)s, which is all a risk—this bill pertains to nonprofits, and an insurance company won't do just nonprofits.

Chairman DUFFY. But this is just—it is pretty fair to say that when in the business of insurance, all kinds of insurers can come in and say, I have a really specific niche market, therefore, I shouldn't be subject to State laws, and I shouldn't be licensed in a certain State because I am a certain niche market. Everyone could make that argument, right?

Mr. COTHRON. The risk retention groups are subject to laws. They are regulated.

Chairman DUFFY. In each State?

Mr. COTHRON. Ms. Davis would be better able to answer that question, but there are State laws that apply in each and every State.

Chairman DUFFY. I know that, but not all the laws in regard to insurance. Some of the laws I believe do. Let me just—my time is almost up. If I can quickly just ask, a risk retention group doesn't have access to the State guaranty fund, is that correct, if that risk retention group becomes insolvent?

Mr. Webel?

Mr. WEBEL. Yes, that is correct, by Federal statute.

Chairman DUFFY. Ms. Davis?

Ms. DAVIS. I would just—

Chairman DUFFY. Do you agree?

Ms. DAVIS. I would just like to add that there are lots of different forms of insurance providers, and we really need that innovation. There are many types of insurance that are not subject to guaranty funds. It is certainly not just risk retention groups.

So this is really an innovative solution that Congress has put forward because we have member nonprofits in 50 States, so we have to cover the whole country with very, very small premiums.

And there is very little difference now in the regulation of risk retention groups and traditional insurance companies because the NAIC has done wonderful work to make sure there is uniformity in that.

Chairman DUFFY. Thank you, Ms. Davis. My time has expired.

I now recognize the gentleman from Missouri, Mr. Cleaver, the ranking member of the subcommittee, for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

In my real life I am a United Methodist Pastor, and we have to deal with this issue all over the country with the United Methodist Church. In fact, I live in the United Methodist building across the street. And this is something that is not some issue that there is not a lot of interest in. We are interested.

I have been on this committee for 13 years. A few months before the economic collapse in 2008, the insurance rating companies sat at that same table and told us that the economy was essentially healthy, that the corporate community, based on their investigations and surveys, showed that everything was solid just a few months before the collapse.

And I am always skeptical of them now, but as it relates to the RRGs, there is no rating. There is no examination of solvency, no financial ratings from the rating agencies. Does that disturb you? Anybody?

Ms. DAVIS. I would like to address that. Actually, there are many regulations that apply to risk retention groups, and they are very,

very significant regulations that are very much like the traditional insurance companies.

And the NAIC has done a tremendous amount of work over 30 years to make sure that the regulation of risk retention groups is very, very similar now to traditional.

Mr. CLEAVER. Financial rating agencies?

Ms. DAVIS. Let me speak to that. We actually are rated as an A.M. Best A-rated insurance company. So yes, the premier rating service for insurance companies rates us as A-rated excellent. So that is very important to us and we are very proud of that.

Mr. CLEAVER. Who does the rating?

Ms. DAVIS. It is A.M. Best. It is the most prominent rating agency for insurance companies, and our financial rating with them is an "A."

Mr. CLEAVER. Yours, then?

Ms. DAVIS. Yes.

Mr. CLEAVER. Anyone else? Everybody embraces the—

Mr. COTHRON. In the bill itself there is a lot of structure in there regarding capital, financial security of an RRG itself. And again, this is pertaining just to 501(c)(3)s. It is not making it available to all risk retention groups within the marketplace, but those that specifically deal with 501(c)(3) nonprofits.

Mr. SANTOS. Mr. Cleaver, just an additional comment? I think the A.M. Best ratings are important, but I think it is important to remember that we are trying to determine what the right public policy solution here is.

So any number of companies may have a good rating from A.M. Best, either a risk retention group or a traditional property company. The fundamental question is, should we be expanding the Risk Retention Act?

One point I would want to clarify is while the NAIC does have some solvency regulation in the State of domicile for the risk retention group, they are not subject to those capital solvency requirements in every State in which they operate.

Mr. CLEAVER. Do you agree that the RRGs are subject to less stringent State regulatory schemes?

Ms. DAVIS. May I comment on that?

Mr. CLEAVER. Would you? Go ahead.

Ms. DAVIS. I would like to say that statement was true 30 years ago, but the NAIC has done a tremendous amount, as I say, of work. And now, for example, we must submit our financials to all States in which we operate every year, the annual statement.

We are subject to the same examinations, the risk focus examinations that every other insurance company is. We are required to comply with the same investment regulations, the same annual annual audit requirements, the same actuarial opinion.

And I do want to point out that we have quite a bit of control by the other States that we are not domiciled in. For example, if a State in which we are not domiciled does not think that we are doing a good job, they have the ability to ask our State regulator to do an examination.

And if our State regulator does not do that, then the other State has the opportunity to do the financial examination themselves.

And if they don't like what they find in that examination, they can actually go to court and have us shut down.

So there are a lot of protections that are offered to the non-domicile States through the Risk Retention Act. And it has been very well-thought out and I think it is quite strong regulation for the type of entity we are where we can insure only one type of organization, and we can only do one sort of coverage.

It is a very, very limited ability to write this just for 501(c)(3) nonprofits. So we are very, very different than a traditional insurance company.

And I think the way we are regulated reflects that different sort of company. It allows innovation to have a different sort of regulation. Not less strict, just different.

Mr. CLEAVER. I am out of time, so thank you very much.

Mr. ROSS [presiding]. Thank you.

I will now recognize myself for 5 minutes.

Ms. Davis, it has been well over 30 years since the Risk Retention Act was amended to allow for liability. Obviously, this is not a new concept. Obviously, there was a need 30 years ago.

Today, we are here because we are seeing a market need that is stressing the resources of our nonprofits. Could you further explain under the proposed Nonprofit Property Protection Act, the additional consumer protections?

Because I think what we are trying to do—look, we are not trying to take over a market. We believe in them. There is probably nobody more in favor of free market insurance than I am in this Congress.

And yet, I also do have a compassionate side of me that realizes that nonprofits use their resources, that are so limited, to serve their clients.

For example, let us take Goodwill. Their risk is a very homogeneous risk. It is a greater risk because of the clientele they serve.

We have seen this in workers' compensation in the State of Florida where we had to go after and being able to allow legislatively for the creation of groups to sell workers' compensation because the commercial market didn't want to take that risk.

And now we are saying, okay, but we are going to let you take the liability risk in the open market if you take the property risk. Where do your resources go?

So my question to you is, to make sure that we are not looking at trying to expand the markets or that we put RRGs into the insurance business, which they are not, what protections are we offering that would make sure not only for consumers but also for the market so that we could alleviate—as you pointed out, Guy Carpenter has shown you can't find a monoline product out there?

That is evidence. That is pretty strong. Guy Carpenter is a pretty well-known organization that brokers insurance. So how can you alleviate some of the concerns of my colleagues that this is just not an expansion into an insurance market for the sake of profit?

Ms. DAVIS. Thank you very much. Those are really good comments. I will remind you that, again, we are a nonprofit-owned company so there is no one gaining from this bill except for the thousands of nonprofits that are our members. So there is no individual to gain any profit from this.

Also, we can only insure this very narrow niche, and I would remind you also—

Mr. ROSS. And you have to have solvency.

Ms. DAVIS. Yes.

Mr. ROSS. You have to have—

Ms. DAVIS. Yes. And that is in the protections in the bill—\$10 million of minimum capital that is required before you can write property—10 years of writing the more difficult liability insurance, which before you can write property, and then it is still limited to only 501(c)(3) nonprofits that have demonstrated that there is a market need.

And we don't want to disrupt the otherwise functioning market where there is coverage. And so again, you have rightly limited this to \$50 million total insured value so that only nonprofits that are small and mid-sized can benefit from this bill.

So there are a lot of really well-thought-out restrictions in this bill that you have put in, I think, because you have listened.

Mr. ROSS. Mr. Cothron, we, being Floridians, have just seen another devastating storm season that is not yet over in our State. We saw in 2004 what happened to the property market.

We saw that there was an expansion of a State-run property insurer that private markets ran. They did rate filings for increases in rates, and it had an adverse effect, not only on commercial insurance but also on nonprofits.

What do you anticipate is going to be the state of the property market in the State of Florida following this storm season? And would it not be in the best interest of these nonprofits, again, who have very stressed resources, to be able to have an opportunity to find property insurance through an RRG?

Mr. COTHRON. First of all, the market had been pretty soft for years because we hadn't had that many—

Mr. ROSS. That is why I asked that, yes.

Mr. COTHRON. —natural catastrophes. Correct. On the heels of two hurricanes this year, the market is going to get very what we call a hard market. The insurance companies are going to draw a much stricter line on who they won't insure and what type of business they won't insure.

Mr. ROSS. Why don't they want to insure nonprofits?

Mr. COTHRON. Because they will insure a nonprofit if they have large enough insured values. I have met with a lot of property carriers. I cannot find one on a monoline basis who will insure a nonprofit unless their total insured value is \$100 million or more. Now, these small nonprofits in a community that is working out of a donated house, provide a—

Mr. ROSS. So my Alliance for Independence nonprofit back home that has 70-some clientele that they serve doesn't have that type. So what do they do?

Mr. COTHRON. They either end up underinsured in the marketplace or they are forced into these package policies where they are paying a lot more for insurance than they would have to if the availability was there with a risk retention group.

Mr. ROSS. Thank you. I see my time has expired.

I recognize the gentlelady from Ohio, Mrs. Beatty.

Mrs. BEATTY. Thank you very much, Mr. Chairman and to our ranking member.

First, let me thank the panel for being here today. My question centers around one of the biggest concerns with expanding the Liability Risk Retention Act is that the risk retention groups do not have access to State guaranty funds.

And we have been hearing a lot this morning about floods and hurricanes and so with the rising frequency of the wildfires in the northwest, the earthquakes, the flash floods and the hurricanes, coupled with the fact that any one of these storms has the ability to force insurance companies into solvency, what happens to the consumers if their risk retention group goes insolvent and they do not have access to the State guaranty funds?

Mr. WEBEL. Basically in that kind of situation the assets that are left in the risk retention group would be used to pay off policies to the extent that there are assets in the risk retention group. And if there are insufficient assets to pay off the policies, then some of the policies would end up being unpaid.

Mrs. BEATTY. Is this a valid concern and would limiting the ability of the risk retention groups with at least \$10 million in capital or surplus to be allowed to offer property insurance be enough to mitigate these concerns?

Mr. WEBEL. Again, I think it certainly is a concern. It is real that they do not participate in the guaranty funds. The thing is, in one sense commercial policies—the guaranty funds limits are compared to some commercial policies relatively low.

So it is entirely possible that in the higher level commercial insurance the guaranty fund protection isn't going to do that much in the end. If you have a \$1 million or a \$2 million claim and the limit is \$300,000, you are looking at possible losses on that anyway.

Any solvency regulation that is going to stop a company from going insolvent is certainly going to help. But no solvency regulation is going to completely stop the possibility of a company going insolvent.

Ms. DAVIS. Could I comment on that?

Mrs. BEATTY. Yes, please.

Ms. DAVIS. Thank you. I would like to point out that we already are authorized to insure and we insure organizations for their own liability up to \$10 million.

So we don't have a guaranty fund at this point, but we certainly have much higher limits already on the liability side that we have done it very responsibly and we will continue to do so through reinsurance and other risk spreading.

But also I would like to point out that many types of insurance companies are not part of the guaranty fund, that we are not unusual in that way.

In fact, we have offered to be part of the guaranty fund with this bill, and we would be happy to do so, but it has been the insurance companies that have opposed our being part of the guaranty fund. But we would like to have that privilege if we could.

And I will also point out that adding property to the liability that we now insure will actually lower our risk because it allows us to hold different types of risk and actually brings us a lower cost of

risk and will make us less risky rather than more risky by being able to add the property to the liability.

Mrs. BEATTY. Does anyone else want to comment before my time runs out?

Mr. COTHRON. One quick comment? Also, when we look at risk that, whether it is an insurance company or a risk retention group retains, none of them that I am aware of bear 100 percent of the risk. They all insure risk to a certain level and then they purchase reinsurance behind that.

So once a claim expense gets to a certain level, the cost is then borne by the reinsurance carrier that is behind it. So all of the companies out there and all of the RRGs that I am aware of lay off their risk to reinsurance carriers for that sole purpose.

Mrs. BEATTY. Okay. We are not going to leave you out, so—

Mr. SANTOS. Yes, thank you. I think there is an important distinction here. One is admitted carriers are subject to the solvency and capital requirements of every State in which they operate. So in the example you gave of a large catastrophe or an event, you may have concentration of risk there.

And State regulatory agencies, they weigh the capital requirements of that insurer in the State in which those properties are insured. And then the capital requirements are set based on their risk profile.

So putting a number in the Federal statute and then allowing that entity to write risks all across the country, we think presents a considerable problem and puts policyholders at risk in the type of events that you just outlined.

Mrs. BEATTY. Okay.

Thank you, Mr. Chairman, and I yield back.

Mr. ROSS. Thank you.

The Chair now recognizes the gentleman from Missouri, Mr. Luetkemeyer, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman, and I also ask for unanimous consent that the statement from the National Association of Mutual Insurance Companies be entered into the record.

Mr. ROSS. Without objection, it is so ordered.

Mr. LUETKEMEYER. Thank you.

This is kind of an interesting hearing this morning. I am always willing to listen to situations where we can improve the situation and allow more private sector competition, more choices for consumers, but along the way we need to find and make sure we have a problem.

The NAMIC letter that I have here this morning indicates that they don't feel that there is a problem. So, if we have insurance companies that want to expand, that is fine, but I guess it goes back to the structure of the RRGs.

They can become insurance companies, can you not, Ms. Davis? Can't you become an insurance company and then fall underneath all of the other things so that you can expand services?

Ms. DAVIS. We would not be able to do that. It is not financially possible because recall we are very different in our structure because we—

Mr. LUETKEMEYER. Yes, I understand that, but that is like it is the same situation we have with a lot of other entities, whether

banks and credit unions and you wind up with the farm credit services versus banks.

You have a lot of entities that started out with a very narrow purview, a narrow band of where they are supposed to be operating and suddenly they want to get beyond that, which is fine.

But once they get beyond that, they need to become the entity that they are competing against. And so my concern is that if you want to become an insurance company, become an insurance company and fall under the rules and regulations to be capitalized in the same way. Do you have reinsurance?

Ms. DAVIS. Yes, of course we have reinsurance. And in fact, if we were able to insure the property, we would reinsure it as well. We insure property in California. We are authorized in a risk pool in California, and we have been doing the property risk there. And we actually—

Mr. LUETKEMEYER. So in California, you sell liability and property already?

Ms. DAVIS. Yes, we do. And through a different entity, not through the risk retention group. But my point there was that we actually reinsure this risk in excess of \$100,000. We are just trying to make this efficient for nonprofits. We are not trying to take on all this risk ourselves.

We only take on risk on the property up to \$100,000, and all the rest of the risk is back in the commercial insurance market. So we are really just trying to make an efficient solution, something that our nonprofit members need.

We are not trying to do more than we can. We are very well-capitalized. We are very aware our work is that we need to protect these nonprofits.

Mr. LUETKEMEYER. I am not against you, but I am also concerned that when you start getting into a different area, you have to behave differently. Your company has to be structured differently. That is just the way it works.

Life insurance companies are completely different than property and casualty companies. They are structured differently. They are capitalized differently. They are reinsured differently.

What you are asking us to do today is to allow you to retain your RRG status and expand to become something completely different and still be that same entity. Nobody else does that.

It is very difficult to get past this and I am trying to get my head wrapped around this, but when you have the ability to change your structure so that you can do this, which you don't want to do apparently, but yet you can do it, I am a little on the reluctant side to go along with this. So—

Ms. DAVIS. Sir, I think—

Mr. LUETKEMEYER. —educate me.

Ms. DAVIS. Excuse me. I think we are just trying to get the right regulation, keeping in mind that we are—

Mr. LUETKEMEYER. And the regulation is a whole other part of this, but structure is what I am concerned about. You have to be structured differently.

Now, Mr. Santos, you have stated a number of times that there are plenty of companies out there that will allow or that will do what the RRGs are wanting to expand and get into.

Can you name two or three? I am not trying to promote their names, but they act like there is nobody out there. Can you give me two or three names of folks who can do this?

Mr. SANTOS. I am reluctant to identify any particular company, but, as you well know, Mr. Luetkemeyer, there are approximately 2,500 companies, property insurance companies across the country.

I do know that there are some who offer a wide range of products for not-for-profit entities, providing all forms of nonprofit services, whether it be teen shelters or diabetes or cancer associations and the like, so they go from large to small.

Mr. LUETKEMEYER. Okay.

Mr. SANTOS. They do that. We can get you a list—

Mr. LUETKEMEYER. I guess I would go back to my original point. I am not against what you are trying to do, but there is a difference in the coverages you are trying to offer compared to what you are offering now.

And that means the structure of your entity has to change to be able to accommodate that. You can't be the same thing you are today if you are going to change what you do tomorrow.

With that, Mr. Chairman, I yield back.

Mr. ROSS. The gentleman yields back. We are having votes. What we are going to do is we are going to take one more round of questions from the gentleman from Pennsylvania, and then we are going to recess.

We probably will not be back after votes, so I will ask that those Members who do have questions, if you would submit them for the record and we will see to it that our panel gets them.

And with that, I will recognize the gentleman from Pennsylvania, Mr. Rothfus, for 5 minutes.

Mr. ROTHFUS. Thank you, Mr. Chairman.

Mr. Webel, you wrote in your testimony that the total premium volume for the 236 RRGs currently operating is about \$3 billion. How does this compare to the overall market for liability insurance?

Mr. WEBEL. I don't know that I have the figure for liability in front of me. As I said, it is relatively small compared to the overall property casualty, but I—

Mr. ROTHFUS. We will follow up with you and see if you can get that data for us.

Mr. WEBEL. Absolutely.

Mr. ROTHFUS. Do you know whether there is a significant difference in the premiums that nonprofits are paying for liability insurance from RRGs versus the admitted property casualty insurers?

Mr. WEBEL. I haven't seen the figures, but just from regulation, the costs of regulation for an RRG are going to be less because it is a single State regulation. And that essentially is the whole point of the RRG structure.

If you didn't have lower costs because of this regulation, essentially the entire RRG construct from the Congress there wouldn't be any point.

Mr. ROTHFUS. Is the RRG market share growing or shrinking right now?

Mr. WEBEL. I think that it has been—the numbers have been shrinking of individual RRGs. The premium has been relatively flat, growing a little bit for the past 5 to 10 years.

Mr. ROTHFUS. You framed this issue in your testimony as a question of availability versus reliability. You also referenced the same A.M. Best report as Mr. Santos, which highlights a significant trend of RRG impairments over the years.

Clearly, expanding the scope of business that RRGs can engage in would broaden availability. Do you have any research on whether it would harm the reliability of these firms?

Mr. WEBEL. I think that the reliability to some degree can go either way because I think it is true that as you broaden a risk pool, you can make an insurance company more stable because they are covering differential risks that are unlikely to both sort of come due at the same time. So in that way, expanding it might improve your liability because you are no longer a monoline structure.

But a lot of it does come down to the regulation of the individual States that are overseeing the RRGs and each of those individual States making sure that as an RRG entered the property market, they are adequately capitalized to do so.

Mr. ROTHFUS. This conversation we have been having this morning—by the way, all of you did really well with the testimony, so thank you for giving us some good background on this issue.

But Ms. Davis, do many RRGs convert to admitted insurance companies?

Ms. DAVIS. I am not aware that this happens very often. They have to be very, very large to make that even a financial possibility as the other individual, Mr. Webel, said. This is why the Risk Retention Act was created, because if you have members, a very small number of members in all 50 States, you need to have the structure that risk retention groups make available.

I would like to point out that I believe the receiverships increasing with risk retention groups, a lot of those are voluntary where they just don't see the need for the particular risk retention group anymore.

I didn't want that to be implied to be because they are in financial trouble. I believe in many cases they have just put themselves into liquidation.

Mr. ROTHFUS. Thank you.

Mr. Chairman, I yield the balance of my time to the gentleman from New Jersey.

Mr. MACARTHUR. I thank the gentleman.

Mr. Webel, if a State wanted to do what the nonprofits are asking, and that is retain the risk on auto physical damage and property, could States allow that or does Federal law currently preempt?

Mr. WEBEL. Federal law preempts in the sense of a risk retention group may only under the Federal law write liability insurance. If a State—there is nothing stopping a State from recognizing another insurance company coming into their State without requiring a license.

So if a State sort of wanted to create what would be a similar structure as an RRG in terms of a recognition of another State's regulation without requiring a license, a State could do that.

Mr. MACARTHUR. Yes. I would just like to point out from my perspective that when risk retention groups were created, there was a public policy interest in the Federal Government being involved. Liability claims involve other people who are damaged if there are not adequate resources, adequate capital to pay those claims.

This is fundamentally different. These are organizations who are talking about their own losses. They are the only ones who lose if they are not adequately insured. That is true. There is no real public policy interest.

I get why Congress is sort of forced to consider this, but it is really odd to me that the United States Congress is trying to figure out how nonprofits retain or transfer risk. And it seems to me we would do well to find a way to put this back to the States.

If States want to allow it, I am fine with it. If States want to impose capital requirements, I am fine with that, too. But this to me is fundamentally different than liability claims, and I just think that we need to find a way to put this back where it belongs.

States adequately govern insurance matters, and I just think this is—I get why we are here. But this is an odd place for us to have to be to tell nonprofits whether to retain risk or transfer it or how to transfer it. If you lose your property, you have lost your own property, nobody else's.

And with that, I yield back. Thank you.

Mr. ROSS. Thank you. The gentleman yields back.

Before we adjourn, I have been asked to ask Ms. Davis to clarify a statement in her opening that, "the best rating of A excellent and see that we have thrived, even though we have been handed the most difficult of these risks, such as sexual abuse and professional liability with no ability to balance these long-tail lines with short-tail property." Could you clarify that just a little bit?

Ms. DAVIS. Yes, absolutely. Risk retention groups have been put in the position of holding a whole portfolio of stocks and not being allowed to hold bonds. We have been forced to do the most difficult of these risks.

Sexual abuse and auto risks are extremely difficult to do. We took it on because the insurance industry wouldn't do it. And I can tell you that actually being able to offer the property would actually lower our risk because then we would have a balanced portfolio, and nonprofits would be able to benefit from having the property and the liability together.

Mr. ROSS. Balanced against the long tail, I guess, is the—

Ms. DAVIS. Absolutely, very much. It's unlikely that both things are going to have difficulty at the same time, and this would greatly help us to balance that risk.

Mr. ROSS. Thank you.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And with that, this hearing stands adjourned. Thank you all for being here.

[Whereupon, at 10:38 a.m., the hearing was adjourned.]

A P P E N D I X

September 28, 2017

Testimony of M. Kevin Cothron

President and CEO
Southeast Nonprofit Insurance Programs
Lake Mary, Florida

The Subcommittee on Housing and Insurance
The Committee on Financial Services
United States House of Representatives

Hearing:
"Examining Insurance for Nonprofit Organizations"

September 28, 2017

Mr. Chairman, Ranking Member Cleaver, and Members of the Subcommittee:

Thank you for the opportunity to testify as part of the Subcommittee's Hearing on "Examining Insurance for Nonprofit Organizations" in favor of the Nonprofit Property Protection Act which would permit a certain subsection of established Risk Retention Groups to offer property and auto physical damage insurance to their members. I am the President/CEO of The Cothron Group, Inc. (TCG) dba Southeast Nonprofit Insurance Programs.

Southeast Nonprofit Insurance Programs is an Insurance Placement service that specializes in coverages for 501(c)(3) Nonprofits in North Carolina, Georgia and Florida. We perform no direct sales, but work through independent insurance brokers. We currently have over 200 nonprofits insured but have had difficulty in finding property insurance. I appreciated this hearing on the Nonprofit Property Protection Act as passing this would provide more insurance options for nonprofits who are members of Risk Retention Groups.

I have been in the insurance industry for over twenty years and have worked with 501(c)(3) nonprofits throughout the Southeast for over ten years. We have had a crisis in trying to secure property coverage for 501(c)(3) nonprofits and with the recent Hurricanes of Harvey and Irma, this will only become more difficult. I work extensively with a Risk Retention Group (RRG) for liability insurance for nonprofits but unfortunately the RRG is prohibited from being able to provide property insurance.

At this time in most states, a commercial insurance company, insurance mutual, a captive or even an insurance trust can provide all lines of commercial insurance coverage to customers. Only an RRG is prohibited from providing property coverage.

The challenge 501(c)(3) nonprofits that are members of an RRG have in securing property insurance is that they have to rely on commercial insurance companies to provide that coverage. These insurance companies typically will only provide the property insurance along with the liability insurance creating a package policy. A package policy means that overages are bundled together on an all or nothing basis, meaning that the property cannot be purchased from the insurance company unless the liability is also purchased from the same insurance company.

While, I never work with RRGs or commercial insurance companies that claim to always offer the lowest price, I have done many comparisons that demonstrate that when a nonprofit is forced to purchase a package policy on an all or nothing basis from a commercial insurance company, the nonprofit is typically paying a higher price in annual liability premium in order to get the property coverage.

Over the years, I have collected various data regarding the difficulties 501(c)(3) nonprofits member of RRGs have had obtaining standalone property coverage and in turn, the need for this legislation. Listed below are several examples in which a nonprofit was put in a position of purchasing a more expensive liability insurance policy in order to be able to purchase the property insurance they needed.

Ronald McDonald House: The RRG provided a very affordable liability insurance quote, but an insurance carrier provided a package quote including the property on an all or nothing basis. The nonprofit had to have property and had to take the more expensive liability coverage as part of the package.

Boys & Girls Club: The RRG provided a less expensive liability insurance option, however, the carrier only offered to provide the property if the liability was also purchased at the same time. The nonprofit was not able to take advantage of the pricing and services offered by the RRG.

Heartland for Children: Once again the RRG liability quotes were actually lower than the insurance carrier's, but the carrier's quote was on an all or nothing basis.

Alzheimer's Association and Related Disorders: Once again, a package quote from a commercial insurance carrier was offered only as a package policy. Although the liability quote from RRG was better. They went with an insurance carrier on a package program, which required combining the property and the liability.

Center for Drug Free Living: This multi-location nonprofit was anxious to be able to utilize the services and competitive pricing that the RRG offered. However, they had to go with a commercial insurance carrier that offered Property with their package program.

Seminole County Victims' Rights Coalition: The property values represented over 50% of the insurance premiums this nonprofit was paying. The RRG provided a very cost effective liability quote. However the insurance carrier refused to offer the property coverage on a stand-alone basis. Since the RRG could not provide property, the nonprofit had to go with the more expensive package quote from the commercial insurance carrier.

Goodwill of the Gulf Coast: In this bid process the RRG delivered the best liability quotes of all submissions. However the best property quote was delivered by an Insurance Trust who refused to provide the property on a standalone basis. The RRG could not offer a property quote. The nonprofit had to select the higher premium liability quote from the Insurance Trust in order to obtain the property coverage.

The combined increase in annual liability premium paid by these nonprofits listed above exceeds \$150,000. Because they had to purchase a package policy that required purchasing the liability and property together rather than being able to select the best pricing on each of the coverages from different companies. Most of these nonprofits are small to midsized. The additional expense they incur with their insurance premiums will negatively impact the services they provide in their communities. These nonprofits were put in the position of paying the higher premiums on the liability because the insurance carrier gave them an all or nothing option with their policy program.

Most nonprofits I work with have limited operating funds and are receiving some or all of their funding from state, federal or local government. A nonprofit entrusted with the tax-payer's money should not have to spend an unnecessary high amount on insurance. That undue expense in turn negatively impacts the amount of services they can provide to their communities. By allowing an RRG the ability to provide property insurance, the nonprofit will receive more competitive pricing from all of the insurance options that are available and still be able to benefit from the specialized coverages and services they value.

I have worked with nonprofits for over a decade. I believe that insurance is more than just a piece of paper with coverage terms on it. I believe that insurance is a service industry and working with RRGs it has been my experience that:

- RRGs specialize and know their markets exceedingly well. The one I am most familiar with insures the 501(c)(3) nonprofit marketplace.
- RRGs provide liability insurance with broader and specific coverages tailored to the specialized needs of their limited market segment.
- RRGs provide a host of safety, risk management and loss control services for their member-owners.
- RRGs tend to be specialized value driven service based companies sensitive to the needs of their members-owners, whereas the typical insurance company is more likely to offer a basic one size fits all policy with added services that are more generic and not aspecifically tailored to that market segment.
- RRGs in many cases offer better coverage, service and pricing, however they cannot provide a "package program" as they are prohibited from providing property coverage. In nonprofits' case, this is a significant disadvantage because of the requirement in the commercial market that nonprofits purchase package policies. Insurance companies are aware of this and utilize this unfair competitive advantage to make the nonprofits who would like to benefit from coverage from their own RRG, instead forgo the additional services offered by the RRG so they can get property coverage, even if it means paying more for liability coverage.

I work with dozens of brokers and I can state without hesitation that we need RRGs for nonprofits to be able to provide property to serve the small to mid-sized nonprofits that choose to be members of an RRG and benefit from their strong niche focus and loss control resources. These RRGs are already providing coverage for the difficult liability exposures. RRGs are presently able to provide multi-million dollar limits for a van full of children, but are prohibited by federal law from providing coverage for a dent in that van. There is no reason RRGs should not be able to provide property and auto physical damage coverage, particularly with the strong consumer protections that are included in the Nonprofit Property Protection Act.

I strongly support the Nonprofit Property Protection Act and ask that you please pass this bill as soon as possible.

Thank you.



Testimony of Pamela E. Davis

*Founder, President and CEO
Alliance of Nonprofits for Insurance, Risk Retention Group
Santa Cruz, CA*

The Subcommittee on Housing and Insurance
The Committee on Financial Services
United States House of Representatives

Hearing:
"Examining Insurance for Nonprofit Organizations"

September 28, 2017

Mr. Chairman, Ranking Member Cleaver, and Members of the Subcommittee:

Thank you for the opportunity to testify as part of the Subcommittee's Hearing on "Examining Insurance for Nonprofit Organizations" in favor of the Nonprofit Property Protection Act which would permit a certain subsection of established risk retention groups to offer property and auto physical damage insurance to their members. I am the President/CEO and founder of the Nonprofits Insurance Alliance Group, which includes Alliance of Nonprofits for Insurance, Risk Retention Group (ANI) on whose behalf I am testifying today.

ANI is part of the Nonprofits Insurance Alliance Group which currently insures more than 17,000 nonprofit organizations across the country. ANI is a 501(c)(3) tax-exempt nonprofit insurance company governed by its 501(c)(3) federally tax-exempt nonprofits, including animal rescues and shelters, volunteer centers, group homes for children, teens and the disabled, art programs, library associations, foster family agencies, Meals on Wheels, United Way, Goodwill, Boys and Girls Clubs, charter schools and others. Member-insureds of ANI include community-based nonprofit organizations such as Southeast Missouri Food Bank, Garden State German Shepherd Rescue, Community-Based Care of Brevard County, Center for the Arts Evergreen, Companion Animal Advocates, AIDS Foundation of Chicago, Education Alternatives, Domestic Abuse Services, National Alliance for the Mentally Ill, Animal Care & Control of New York, Sunnyside Home Care Project, and Riverton Community Housing. It has grown from initial capital grants of \$10 million from the David and Lucile Packard Foundation and the Bill &



Melinda Gates Foundation to an insurance company rated A (Excellent) by A.M. Best, insuring more than 7,500 nonprofits in 30 states and the District of Columbia.

My written statement provides a brief description of the problem the Nonprofit Property Protection Act would solve for small and mid-sized nonprofits and explains why there is a particular insurance market failure affecting this group. It describes the research that has been conducted to discover whether there are other sources of standalone property, auto physical damage, and business interruption insurance available in a form applicable for small and mid-sized nonprofits who are members of an RRG. Without any cost to government, the Nonprofit Property Protection Act will:

- Increase capacity, choice, and market options for property and casualty insurance for small and mid-sized 501(c)(3) nonprofit organizations;
- Create a lasting solution for RRG members who are small and mid-sized nonprofits who are presently not able to find market-based solutions for their property and auto physical damage needs;
- Lower the cost of risk for RRGs owned and governed by nonprofits, by allowing them to have a broader spread of risk across different types of coverage; and
- Enable these RRGs to provide stable coverage and pricing for both liability and other lines of coverage, such as property, to insulate these small community-serving organizations from the cyclical nature of the larger commercial insurance market.

A. **Liability Risk Retention Act of 1986**

ANI owes its existence to the Liability Risk Retention Act (LRRA) of 1986. In the mid-1980s, the insurance industry found itself in financial difficulty and dramatically reduced its capacity for providing insurance. Nonprofits were particularly hard hit by the capacity crisis as they faced huge rate increases, mass cancellations of coverage, and the unavailability at any price of entire lines of insurance, as commercial insurers abandoned these markets. To end this crisis, Congress passed the 1986 Amendments to the LRRA, which expanded the lines of liability insurance that RRGs could offer to their member-owners in order to protect these consumers that proved the most difficult to insure in hard markets.



B. History of ANI's Service to Nonprofits

ANI is an unlikely success story whose future is now in jeopardy without the Nonprofit Property Protection Act. ANI's story is about how 17,000 small organizations, the vast majority of which have annual budgets of less than \$1 million, have come together to jointly insure each other and develop specialized risk management tools through ANI and its California affiliate, so that they may serve our communities more safely and efficiently. All of the companies in the Nonprofits Insurance Alliance Group, including ANI, are themselves 501(c)(3) nonprofits.

When I speak of small and mid-sized nonprofits, I mean community-based organizations in our neighborhoods that work with the most vulnerable among us. They are homeless shelters and programs for those with Alzheimer's, victims of sexual abuse and the developmentally disabled. They are animal shelters, adoption agencies, foster family agencies, elder care services, alcohol abuse clinics and after-school art programs. They are foundations raising money for diabetes, heart disease and cancer research, and many others. These little nonprofits got into the business of insurance because the commercial carriers walked away from them. Nonprofits never wanted to be in the insurance business, but were forced into it to be able to continue to serve our communities. In fact, when I was in the process of raising money from the Ford Foundation to capitalize the first organization in our Group, the Ford Foundation told me that they really didn't want nonprofits to get into the "insurance business." They commissioned a third-party to conduct a study and told me that I was not going to get a dime unless the study showed that because of the specialized nature of the risk, and the limited appetite for this sector for most insurance companies, the only way for nonprofits to gain long-term stability and protection was to get into the insurance business ourselves. The study was conclusive and we got the money.

Why would thousands of nonprofits choose an RRG over a commercial insurance company? Why would 95% of them stay with us year after year? Why would hundreds of brokers recommend an RRG for their nonprofit clients? I can tell you, it is not for higher commission or contingent commission! And, if you are familiar with our financials and our A rating from A.M. Best, you know it is not because of prices that are unsustainably low. It is our laser focus on meeting the specialized insurance needs of these organizations, providing stability, and supporting their risk management needs. Virtually none of these organizations have a line item for "risk management" in their budgets. Virtually no foundation or



government is going to fund that. So, we have found a way to efficiently be the collective "risk management" department for thousands of nonprofits by imbedding that cost in the price of insurance.

The mission of nonprofits is to enhance their communities, not hurt them. We help them to conduct their work more safely and efficiently and in the process, fewer people get injured. We offer unlimited and free driver training, both in person and online, for our member-insureds. We have three staff employment attorneys, whose only role is to provide help and advice for these nonprofits who have, on average, 15 employees. Organizations that small have no one on staff to advise them on complex employment laws. We do that for them on an unlimited basis and completely free of charge. It is simply not efficient for commercial carriers, which insure many types of risks, to focus like we do on this special group.

We have heard concerns that an RRG cannot be sufficiently strong or well-regulated to provide property insurance. Let me remind you of our history. ANI has an affiliate charitable risk pool in California which I started in 1989 with a \$1 million loan for capital, and began offering \$1 million liability policies. We had 300 small member-insureds and \$1 million in premium at the end of our first year. We were the first to offer an affirmative sexual abuse policy, in contrast to the "silent" policies being offered by commercial carriers that allowed them to decline many claims, leaving nonprofits completely exposed. The only infusion of additional capital we have received in our history is \$10 million in grants from the David & Lucile Packard Foundation and the Bill & Melinda Gates Foundation to allow us to create ANI in 2000. Insuring organizations deemed "uninsurable" by the commercial industry, these two affiliates have generated as a Group \$180 million in earnings from operations that is now our surplus and we have given an additional \$35 million back to nonprofits in the form of dividends. If commercial insurers had been serving this market well, we would never have been able to succeed as we have.

During the insurance crisis, most commercial insurers did not believe that they could profitably insure the complex risks of things like vans full of kids driven by volunteers and the professional risk of caring for kids who had been sexually abused; but, most commercial insurers didn't stop there. They banned all 501(c)(3) nonprofits from their underwriting appetite completely. A large number of commercial carriers specifically exclude 501(c)(3) nonprofits from their underwriting appetites even today; and, because of the specialized risks presented by these organizations, that position may actually be a prudent thing for many, if not most commercial insurers. However, the result is that many brokers and agents, especially



small agents in rural areas, may have only one or two carriers who will entertain a 501(c)(3) nonprofit risk—and that only on a package and surplus lines basis.

ANI adds another option, primarily for the small to mid-sized organizations whose agents frequently have limited markets. ANI is governed by nonprofits themselves through an elected board of directors representing the members. Because ANI is an RRG, we have been limited to writing only liability lines, which are typically long tail lines. Nonetheless, you can check out our financials and our A.M. Best rating of A (Excellent) and see that we have thrived, even though we have been handed the most difficult of these risks, such as sexual abuse and professional liability, with no ability to balance these long-tail lines with short-tail property.

C. RRG Regulation

When it passed the Risk Retention Act, Congress recognized that, because of their very narrow class of business and overall market size, RRGs would not have adequate resources to be licensed and admitted in all states. These RRGs typically have a relatively small amount of premium in any one state because they can only insure liability and only for a very small subset—their members-- which are all part of a narrow group of related businesses. This narrow focus and small premium potential makes it inefficient and not feasible to support a regulatory compliance function for their members across 50 states for these specialty RRGs. The ingenious solution devised by Congress was a hybrid form of regulation – licensing in one state and registration in all others.

This hybrid approach respects the state-based regulation of insurance while introducing efficiencies to make it possible for industry-specific associations to create insurance companies to provide virtually the same specialized liability insurance and loss control to their members in all 50 states.

Over the past 30 years, it has become clear that different regulation, as it relates to RRGs, does not mean inferior regulation. Congress provided different regulation for RRGs because of the nature of the risks they are insuring and the limited market available to them in any one state. RRGs insure only commercial business. They write no personal lines and insure only their member-owners. They offer essentially the same specialty insurance products in all 50 states. They focus on only one type of business and develop



highly-specialized underwriting, claims handling and loss control products specifically for that one business group.

The 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 National Association of Insurance Commissioners (NAIC) require states that regulate RRGs to comply with uniform standards for governance. The proof of the success of the regulatory structure for RRGs is in their track record of nearly 30 years.

D. Nonprofit RRG Members Need Standalone Property

Present law prohibits RRGs from offering their member-owners property insurance. If a nonprofit wishes to purchase property insurance or auto physical damage insurance, it must purchase it from a commercial insurance company in a “package” policy. For small and mid-sized nonprofits, commercial insurance companies do not sell the needed standalone property and auto physical damage coverage without simultaneously requiring the purchase of liability insurance.

Commercial insurers, when they are willing to offer coverage for the unusual risks nonprofits represent, will offer coverage to them only as a bundled package. That is, these small nonprofits must purchase the liability insurance and the property insurance together as a package, somewhat like a cable triple play package. However, by federal law, as an RRG, ANI is allowed only to offer liability insurance to our member-insureds. When insurance brokers and agents attempt to help nonprofit members of ANI purchase property insurance to go along with the liability insurance provided by us, they are told that the property is only sold if the liability is sold with it by that same commercial insurance company.

The unavailability of standalone property insurance for nonprofits is not related to a general shortage in property insurance capacity. Instead the Nonprofit Property Protection Act is about a specific type of coverage—standalone property policies for small 501(c)(3) nonprofits—that is simply not available from commercial insurers. This is because the standard practice of commercial insurance companies is to only offer property insurance combined with liability insurance as a bundled package for 501(c)(3) nonprofit clients. This prevents 501(c)(3) nonprofits, that obtain specialized liability insurance and loss prevention



services from their Risk Retention Groups (RRGs), from finding satisfactory standalone property policies in the commercial market.

Thousands of nonprofits purchase specialized liability insurance, including tailored risk management services, from RRGs they own and govern. These small nonprofits are unable to purchase from the commercial market the insurance coverages they need, yet their RRG is not permitted by law to provide those coverages for them. In the absence of commercial standalone policies, many small 501(c)(3) community-based nonprofit organizations, such as programs for the disabled, homeless shelters, drug and alcohol rehabilitation facilities, day care centers for children and seniors, animal shelters and rescues, counseling centers, arts organizations and others must forgo altogether the tailored risk management of their RRGs.

E. Other Proposed Solutions Inadequate

RRGs serving nonprofit organizations have tried many solutions to this problem prior to asking for help from Congress. Nonprofit RRGs have developed group programs and used fronting companies to provide the property insurance their nonprofits need, but these solutions have proven unworkable because these standalone property policies tend to be very small in premium with minimum premiums as low as \$250 per year. Even in the aggregate, with thousands of nonprofits purchasing together, the premium across 50 states is just too small to support regulatory compliance obligations making these solutions not economically viable over the long-term.

F. Third-Party Research Confirms This Market Failure

In response to requests for additional detail from Congress, several third-parties have gathered and analyzed data to confirm whether standalone property and auto physical insurance policies are available from the commercial admitted insurance market in a form needed by small and mid-sized 501(c)(3) nonprofit organizations. Summaries of those analyses are provided below.

Date of Research: Spring 2015

Party Conducting Research: Independent insurance agents and brokers representing 2,000 nonprofit clients.

Nature of Research: Email survey of 47 insurance carriers.



Findings: Only 4 carriers indicated any interest in offering standalone property, but only for larger accounts, not in all states, and with significant restrictions on habitational exposures such as domestic violence shelters, group homes, homeless shelters, and drug and alcohol rehabilitation facilities. No insurer was interested in providing standalone auto physical damage insurance.

Date of Research: May 2017

Party Conducting Research: Guy Carpenter, a Marsh & McLennan Company

Nature of Research: Determine whether the American Association of Insurance Services (AAIS) has produced for use, by its more than 700 insurance company members, a standalone property form or standalone auto physical damage form of the type needed by small and mid-sized 501(c)(3) nonprofits.

Findings: AAIS confirmed that a search of their database revealed they have not produced such a form for either property or auto physical damage. They further advised they were not aware of any independent filings of this nature made by an admitted insurance carrier.

Date of Research: May 2017

Party Conducting Research: Guy Carpenter, a Marsh & McLennan Company

Nature of Research: Determine whether the Insurance Services Office (ISO) has produced a standalone property form or standalone auto physical damage form for use by commercial insurance companies of the type needed by small and mid-sized 501(c)(3) nonprofits.

Findings: ISO confirmed that a search of their database revealed they do not presently have such a form for either property or auto physical damage. They advised they had such a property form prior to 2002; however, it was still mandatory that the insurance carrier offered the property policy and the liability policy together. They concluded, that it was more efficient to offer the property and liability on one policy and discontinued offering the standalone property form. They have never had a standalone auto physical damage offering.

Date of Research: June 2017

Party Conducting Research: Perr & Knight is an independent, leading provider of insurance support services, including Actuarial Consulting, Competitive Intelligence, Data Services, Regulatory Compliance and Insurance Technology.



Nature of Research: Perform targeted research in the states of Florida and New York looking for admitted insurance companies having filed Business Owner's Policy (BOP) programs for organizations falling under IRS Section 501(c)(3) tax-exempt nonprofits which offer standalone property insurance as well as commercial auto coverage providing standalone auto physical damage coverage.

Findings: In New York and Florida, Perr & Knight found a filing made by North American Elite Insurance Company, part of the Swiss Re Group of Cos. offering a BOP policy for 501(c)(3) tax exempt nonprofits which offers standalone property insurance at the request of the Alliance of Nonprofits for Insurance, RRG (ANI). In addition, Perr & Knight found a New York filing by Mount Vernon Fire Insurance Company, part of Berkshire Hathaway, in which a BOP policy was designed for 501(c)(3) tax-exempt nonprofits. The Mount Vernon Fire Insurance Company filing **requires both property and general liability coverage to be purchased at the same time.** They found no filings for standalone auto physical damage coverage.

G. Consumer Protections Included in Nonprofit Property Protection Act

The Nonprofit Property Protection Act would permit only well-established RRGs to provide property insurance. It would apply only to a very narrow subsector of RRGs. Specifically, only RRG members that are small and mid-sized 501(c)(3) nonprofit organizations—organizations that qualify for donations that may be deducted from personal income taxes—qualify under this bill. Additionally, the bill requires RRGs to meet the three following minimum criteria to provide property insurance to their members:

1. Have provided liability insurance for at least ten years;
2. Have at least \$10 million in capital, although the domicile regulator may require more; and
3. Insure any one member for a maximum Total Insured Value (TIV) of \$50 million.

RRGs are owned and governed by their members and since RRGs may only offer this benefit to 501(c)(3) nonprofit member-insureds, the only beneficiaries of this bill are the 501(c)(3) nonprofits themselves.

H. Benefits of the Nonprofit Property Protection Act

The Nonprofit Property Protection Act would allow Risk Retention Groups (RRGs) to insure the property of their small and mid-sized 501(c)(3) nonprofit members, in addition to the liability insurance they already provide. This is necessary because the standalone property insurance policies and standalone auto physical damage insurance policies that small and mid-sized nonprofits need is not available from



commercial insurers. This would allow these nonprofit members of RRGs to purchase necessary coverages and make it easier and more efficient for these small nonprofits to satisfy their property and casualty insurance needs. This is more practical and well-suited regulation for a very small and specific segment of the market. The types of nonprofits for which this bill will provide relief are those providing direct services to some of the most vulnerable members of our communities. Organizations that oversee tens of thousands of foster family agencies, provide enrichment and afterschool programs for young people, create affordable housing, rescue and find homes for abandoned cats and dogs, provide daycare and enrichment for children and fragile seniors, offer enrichment through art in underserved communities, serve meals to veterans, provide foodbanks and more will directly benefit from the Nonprofit Property Protection Act, at no cost to government.

I. Conclusion

This narrow bill solves a problem limited to small and mid-sized 501(c)(3) nonprofit organizations. The only RRGs that may qualify under the Nonprofit Property Protection Act are those serving 501(c)(3) nonprofit organizations, such as Boys & Girls Clubs, domestic violence shelters, afterschool programs, animal rescues, and programs for those with disabilities. Furthermore, these RRGs may not insure any individual nonprofit for more than \$50 million in real property—a cap which limits the scope of this bill to a very small part of the commercial property market. This bill specifically prohibits qualifying RRGs from providing health, life, disability or workers' compensation insurance.

The Nonprofit Property Protection Act is narrowly drafted to solve a problem for an often overlooked, but vital segment of our economy--small and mid-sized 501(c)(3) nonprofits--without in any way impacting the larger insurance industry, and the markets already being adequately served. This bill would give immediate relief to many thousands of nonprofits across the country. Eighty percent of these nonprofits have annual budgets of \$1 million or less. Nonprofits are not asking for a handout. They are simply asking for the ability to solve a problem themselves.



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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”

September 28, 2017

Statement of the American Insurance Association
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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 (LRRRA) 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 LRRRA to commercial property, workers' compensation, private passenger automobile, homeowners' insurance, and other types of insurance unaffected by availability issues.

The preemption authority of the LRRRA 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 LRRRA, 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 LRRRA, RRGs are subject to less rigorous solvency requirements.

¹ An RRG is an 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 LRRRA to include commercial property insurance.

Over the years there have been several proposals to expand the LRRRA to allow RRGs to offer commercial property coverage. Most recently, such proposals have focused on nonprofit (501(c)(3)) organizations. Proponents of expanding the LRRRA 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 LRRRA 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 LRRRA 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 LRRRA'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 LRRRA to include commercial property insurance at this time.

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 LRRRA. 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.



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TESTIMONY

Statement of

Baird Webel

Specialist in Financial Economics

Before

Committee on Financial Services
Subcommittee on Housing and Insurance
U.S. House of Representatives

Hearing on

“Examining Insurance for Nonprofit Organizations”

September 28, 2017

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Mr. Chairman, Ranking Member, and Members of the Subcommittee, thank you for the opportunity to testify before you today. My name is Baird Webel, specialist in Financial Economics at the Congressional Research Service (CRS). CRS's role is to provide objective, nonpartisan research and analysis to Congress. CRS takes no position on the desirability of any specific policy. Any arguments presented in my written and oral testimony are for the purposes of informing Congress, not to advocate for a particular policy outcome.

The subject of today's hearing is insurance for nonprofit organizations. As the most recent legislative proposal on the issue (H.R. 3794 in the 114th Congress) focused on risk retention groups (RRGs), my testimony today does so as well. It begins with general background on insurance regulation and markets, followed by specific details on RRG regulation, the RRG market experience and possible RRG-related policy considerations. Finally, an appendix presents a brief legislative history of the RRG statutes.

Background on Insurance Regulation and Markets

Regulation of insurance markets was left to the states in the 1945 McCarran-Ferguson Act.¹ This was a specific policy choice made by Congress, and Congress has continued to use its underlying authority to regulate insurance in various ways since 1945. This has occurred both in broad financial regulatory laws, such as the Gramm-Leach-Bliley Act (GLBA)² and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank),³ and in narrower laws aimed specifically at insurance, such as the Terrorism Risk Insurance Act (TRIA).⁴ Both GLBA and Dodd-Frank generally confirmed the state regulatory system while nonetheless introducing new federal authority over insurers.⁵ A more recent example of a law narrowly preempting some aspect of state insurance regulation was the National Association of Registered Agents and Brokers Reform Act enacted in 2015.⁶

The insurance industry, particularly property/casualty insurance, is known for alternating periods of "hard" and "soft" markets. Turns in this cycle are typically traced to unexpected changes in the investment climate, or unexpected changes in insurance payouts, or both. During a typical hard market, the supply of insurance goes down, insurance prices go up, and underwriting standards become more stringent. This often leads to consumers encountering difficulty in finding and affording insurance. During a soft market, prices are typically flat, and insurers are more willing to underwrite greater risks, so consumers typically do not face such difficulties in obtaining insurance. In general, insurance markets have been soft for the last decade or so with large amounts of capital available worldwide. However, although the capital sources for insurance may be worldwide, the insurance policies themselves are very particular and specific products. Thus, specific lines of insurance or certain states may face market conditions that are quite different than the general market conditions seen by most market participants.

¹ P.L. 79-15, 15 U.S.C. §§1011 *et seq.* This act did not differentiate between different types of insurance, such as health, life, and property/casualty. While health insurance and life insurance are relatively straightforward as they are named, property/casualty is a more diverse group, including auto, homeowners, professional liability, and many others. Property/casualty essentially refers to everything that is not life or health insurance. Because the jurisdiction of this committee covers primarily life insurance and property/casualty insurance, this testimony focuses on these types of insurance as well.

² P.L. 106-102.

³ P.L. 111-203; see also CRS Report R41372, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Insurance Provisions*, by Baird Webel.

⁴ P.L. 107-297, §105 which preempted any state approvals of insurance policy language excluding coverage of a terrorist attack.

⁵ For example, GLBA implemented federal oversight of financial holding companies including insurers if the holding company included a bank or a savings and loan. Dodd-Frank created a Federal Insurance Office which has the power to preempt state laws regulating insurance under certain circumstances.

⁶ P.L. 114-1, Title II. For more information, see CRS Report R43095, *Insurance Agent Licensing: Overview and Background on Federal NARAB Legislation*, by Baird Webel.

Legislative attention often tends to focus on insurance matters during hard markets as constituents relate complaints about finding or affording insurance to their legislators, although the legislature in question is most often a state legislature. Among the solutions offered at the state level has been the creation of, or allowance for, “alternative” market entities to increase the amount of insurance available to consumers. The alternative market is made up of entities or arrangements that spread and finance risk similar to an insurance company, but that operate outside the normal regulations governing the world of “regular” insurance companies. Such alternatives include nonadmitted or “surplus lines” insurers⁷ and captive insurance companies.⁸

In the 1970s and 1980s, liability insurance became difficult to find for a wide variety of entities. In response, Congress authorized the creation of alternative market entities known as risk retention groups (RRGs) in an attempt to expand insurance supply by simplifying insurance regulation. In the 1981 Product Liability Risk Retention Act, subsequently amended in 1986 and known now as the Liability Risk Retention Act (LRRRA),⁹ Congress crafted a narrow exception to the usual state insurance regulations for these groups, largely exempting the groups from regulation except by the RRG’s home state.¹⁰

Risk Retention Groups: Structure and Regulation

By current federal law,¹¹ risk retention groups are required to be state-chartered insurance companies; RRGs are allowed to insure commercial liability risks, such as the risk that a physician will be found liable for medical malpractice, but not property risks, such as the risk that a physician’s office might burn down. All policies issued by a risk retention group must bear a federally mandated warning that the policy is not regulated or guaranteed in the same way as other insurance. These insurance companies also must be owned by the members of the group. Group members are required to be businesses, including individual professionals such as physicians and attorneys, or government entities, such as public universities, school districts, and town or city administrations, that are engaged in a similar business or face similar risks. The exact corporate structure of an RRG can vary. Many are licensed as captive insurers, which may have lower capital requirements, but some are licensed as regular insurers.

If risk retention groups must be licensed as an insurer under the existing laws of an individual state, two questions arise: (1) what advantages do they possess? and (2) why go to the trouble and expense of creating such a group? The answers are in the different regulatory treatment of these groups as they operate outside of the state in which they are chartered (or “domiciled”). Under normal circumstances, an insurer that wishes to operate outside of its domiciliary state must receive a license and submit to regulation from every state in which it wishes to do business. This means complying with up to 51 different sets of state or district laws and regulations in order to do business across the country. The impact of this multiplicity of regulation is particularly high in insurance, as compared with other businesses, because both the prices and the content of insurance policies are highly regulated in most states.

⁷ Nonadmitted or surplus lines insurers are not licensed by the state in which they are selling insurance, but are permitted to do so under a narrow range of conditions, particularly when a specific type of insurance is not available from a licensed insurer in that state.

⁸ Captive insurers are: “Insurers that are created and wholly owned by one or more non-insurers, to provide owners with coverage. A form of self-insurance.” From the Insurance Information Institute’s online glossary available at <https://www.iii.org/services/glossary/c>. See also <http://www.captive.com>.

⁹ 15 U.S.C. §§3901-3906, created by P.L. 97-45 and P.L. 99-563; for more detail on these laws, please see the Appendix.

¹⁰ The LRRRA also provided for risk purchasing groups which allow for group purchasing of liability insurance.

¹¹ 15 U.S.C. §§3901 *et seq.*

Risk retention groups are exempted by federal law from the requirement to be licensed in all states in which they operate as well as from some other state laws regulating the business of insurance. RRGs must register and file documentation with a state's insurance regulator, but after this filing, they are essentially free to do business in that state. Although this exemption from state law extends to most laws on the business of insurance, laws such as those on fraudulent trade practices, nondiscrimination, and unfair claim settlement practices still apply. RRGs must also pay state premium taxes as regular insurers do. In addition, a non-domiciliary state's insurance regulator is empowered to monitor the financial solvency of a group, including requiring that a group submit to a financial condition examination if the chartering state regulator refuses to do such an exam, and seeking an injunction to force it to cease doing business if the group is in hazardous financial condition. This regulatory oversight is less than that accorded regular insurance companies, however, and some observers fear that this might lead to an increased danger of such groups becoming insolvent.

The treatment of RRG policyholders in the unlikely event of an insolvency is one of the major differences that an RRG policyholder might experience compared with a policyholder of an insurer specifically licensed to operate in a state. In the case of most insurer insolvencies, the state-run guaranty funds step in to pay outstanding claims up to a certain limit even when the failed insurer's assets are insufficient to pay these claims.¹² Financial assessments are then made on the remaining insurers in order to provide the funding necessary to do this.¹³ RRGs by federal statute, however, are prohibited from participating in the guaranty fund system. Thus, RRG policyholders would only be able to collect on claims to the extent that company assets existed to pay these claims and may face a more lengthy court process in order to receive payments.

Role of the National Association of Insurance Commissioners

Although the regulation of insurance is left up to each state, the states act in common through the National Association of Insurance Commissioners (NAIC) to set standards and develop model laws and regulations. While the states may in many cases choose which NAIC models to adopt, and sometimes change them in the process, there is a core *accreditation* program to promote financial solvency standards. Maintaining accreditation allows for recognition of one state's solvency oversight by other states, and states generally adopt the standards necessary to maintain accreditation. Thus, to the extent that RRG-related standards are included in the accreditation process, it is possible for non-domiciliary states to influence the regulation of RRGs even though by statute this regulation is solely up to the domicile state.

The NAIC accreditation standards have specific standards for RRGs including the application of a variety of NAIC models to RRGs that are organized as captives and operate in multiple states.¹⁴ These standards were supplemented at the beginning of 2017 with the requirement that the NAIC Model Risk Retention Act¹⁵ be applied, particularly relatively new language relating to corporate governance. The question of

¹² Limits vary by state, typically \$300,000, but can be higher depending on state law. For more information see National Conference of Insurance Guaranty Funds, *Frequently Asked Questions About Guaranty Funds*, at http://ncigf.org/media_faqs.

¹³ This is similar in concept to the deposit insurance provided to bank depositors by the Federal Deposit Insurance Corporation (FDIC). The FDIC is, however, largely pre-funded partly because of the speed at which bank failures can occur. In contrast, the liabilities in insurer failures typically occur over a longer period of time, thus allowing the post-event funding model of insurance guaranty funds to operate.

¹⁴ For more information on of the standards, see National Association of Insurance Commissioners (NAIC), *Financial Regulation Standards and Accreditation Program*, August 2017, pp. 11-12, at http://www.naic.org/documents/cmt_e_f_rsa_pamphlet.pdf. Also, the U.S. Government Accountability Office (GAO), summarized the new NAIC standards in *Risk Retention Groups: Clarifications Could Facilitate States' Implementation of the Liability Risk Retention Act*, GAO-12-16, December 2011, pp. 34-40, at <http://www.gao.gov/assets/590/587531.pdf>.

¹⁵ NAIC, *Model Risk Retention Act*, #705, January 2012, at <http://www.naic.org/store/free/MDL-705.pdf>.

corporate governance standards was specifically identified by the Government Accountability Office (GAO) in 2005¹⁶ and also was the subject of previous legislation in Congress.¹⁷

Growth in the Risk Retention Market¹⁸

Market reaction to the expansion of the LRRRA in 1986 was relatively swift. By 1988, 52 risk retention groups had been created with more than 24,000 insureds and a total premium amount of \$250 million. The number climbed to 79 in 1991 and then largely plateaued for the next 10 years, declining to 72 by 2001. The number of insureds and the total premium amount, however, continued to increase, reaching more than 172,000 insureds and \$944 million in premiums in 2001. Within the aggregate statistics, there was significant churning, as individual groups were formed and retired based on the business decisions made by those seeking insurance. In the period from 1987 to 2001, a total of 142 RRGs were formed and 73 retired. Reasons for a group retirement vary greatly. Some became insolvent, some changed status to become a regular insurer or were absorbed by a regular insurer, and some simply ceased operation when insurance on the regular market became more affordable.¹⁹

The relative calm in the marketplace that prevailed through the 1990s ended quickly with the hardening of the insurance market in 2001. This hard market has been ascribed to the downturn in both interest rates and the stock market as well as to unexpected losses, particularly the approximately \$35 billion in insured losses due to the terrorist attacks on September 11, 2001. Interest in RRGs increased along with the prices of insurance and reinsurance. The number of RRGs and premiums increased fairly steadily from 72 groups and \$994 million in premiums in 2001 to 245 groups and \$2.6 billion in premiums in 2006. The number of RRG insureds, however, did not follow the same pattern. The insureds numbered 172,713 in 2001, declined to 139,837 in 2002, before increasing to nearly 218,000 in 2006.

Risk retention group growth during the hard market of the early 2000s occurred particularly in the health care arena. In a 2004 *Risk Retention Reporter* survey, for example, 28 of the 41 new groups were insuring some form of health care liability. In a 2007 *Risk Retention Reporter* study, the comparable number was 34 of 52 new RRGs. Within health care, nursing homes showed the largest growth, going from zero nursing home RRGs in 2002 to 20 at the end of 2005.²⁰ The growth in health care RRGs seemed largely due to widely reported difficulties that health care providers were encountering in obtaining medical malpractice insurance.

The liability insurance market generally has softened since 2005 or so and the years since the financial crisis of 2007-2009 have been marked by low interest rates and a relatively large supply of capital for most types of insurers. Medical malpractice insurance, which was the source of much RRG growth, has also seen a significant change in financial results, with relative claim amounts dropping and significantly improved profitability. As might be expected in softer market conditions, RRGs have not grown in the past decade as they had before. According to the 2008 *Risk Retention Reporter* survey, the total number of RRGs peaked in 2008 at 272. By 2016, however, there was a net drop of nearly 40 RRGs. Most of this drop occurred in 2013-2014 among relatively new or small RRGs. Of the 40 RRGs that retired from January 2013 to November 2014, “five never became operational, 18 voluntarily dissolved and entered

¹⁶ See GAO, *Risk Retention Groups: Common Regulatory Standards and Greater Member Protections Are Needed*, GAO-05-536, August 2005.

¹⁷ For example, H.R. 2126 in the 112th Congress.

¹⁸ Except where noted, statistics in this section are taken from successive annual surveys done by the *Risk Retention Reporter* (Pasadena, CA; <http://rrr.com/>).

¹⁹ See “Soft Market Fueled Risk Retention Group Retirements During 1990s,” *Risk Retention Reporter*, February 2002.

²⁰ “Premium Generated By Healthcare RRGs More Than Triples Since 2001,” *Risk Retention Reporter*, December 2002.

run-off, six merged into another captive or insurer, three merged into another RRG, one converted into a traditional insurer, and seven became insolvent.”²¹ Although the reported number of RRGs has dropped, the premium volumes and numbers of insureds have continued to increase somewhat over time, suggesting that larger RRGs have been more successful through the soft market. For 2016 total premium volume for 236 operating RRGs is estimated to be slightly over \$3 billion, with more than 500,000 insureds.

Some Difficulties Have Come Along with Growth

The growth of risk retention groups has not been without problems. Perhaps the most notable RRG failure was that of the National Warranty Insurance Risk Retention Group (hereinafter “National Warranty”). Although physically headquartered in Lincoln, Nebraska, National Warranty was incorporated in the Cayman Islands. It was one of a handful of RRGs that were incorporated outside of the United States before 1985 and was thus grandfathered out of regulation by any of the individual states in the 1986 amendment. Prior to its being declared insolvent in August 2003, it acted as an insurer of the obligations taken on by its members, mainly marketing companies and auto dealerships that sold vehicle service contracts. Although the actual group was made up of only approximately 580 members, the effect of the insolvency was more widespread, as these members sold contracts to or through more than 5,000 auto dealerships in 49 states.²²

The LRRRA requires insureds to be members and part owners of an RRG; however, this line was apparently somewhat blurred in the National Warranty case. National Warranty acted both as an administrator, adjusting claims on behalf of its members, and as the insurer of these members.²³ This dual role apparently gave the impression that the final consumers were purchasing service contracts directly from National Warranty rather than from the individual group members.

In the aggregate, the total number of RRG failures is not particularly large, but the recent trend may provide reason for concern. The insurance rating service A.M. Best identified 33 RRG “impairments” from 2000 to 2015.²⁴ The number of RRG impairments increased over this time period, with 6 in 2000-2005, 9 in 2006-2010, and 18 in 2011-2015. This contrasts to the experience in other types of insurers, whose impairments peaked at a total of 156 in 2000-2005, fell to 68 in 2006-2010, and rose to 80 in 2011-2015. 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.²⁵

Policy Issues and Considerations

The fundamental questions surrounding potential LRRRA expansion are essentially the same as those addressed by Congress when the first act was passed in 1981, and when it was expanded in 1986. Stripping away jargon, this question can be phrased as an issue of availability versus reliability.

²¹ “2014 Risk Retention Reporter Survey of Risk Retention Group Premium, Policyholders, and Insureds,” *Risk Retention Reporter*, vol. 28, no. 11, November 2014.

²² Figures from John Taylor, “Irate Consumers File Class-Action Suit against Lincoln, Neb., Firm,” *Omaha World-Herald*, September 23, 2003.

²³ Caroline McDonald, “Lessons from National Warranty,” *National Underwriter, Property & Casualty/Risk & Benefits Management Edition*, October 24, 2003.

²⁴ An impairment is defined as “situations in which a company has been placed, via court order, into conservation, rehabilitation, and/or insolvent liquidation.” See A.M. Best, *2015 Property/Casualty Impairments Update*, October 13, 2016, p. 1.

²⁵ A.M. Best, *2015 Property/Casualty Impairments Update*, October 13, 2016, p. 3.

Arguments in support of expansion often focus on a failure of the insurance market, and the regulatory system, to make a sufficient supply of insurance available so that consumers who need insurance can find it at a reasonable price. The question posed is essentially: “What happens to a community when a business, a school, or a doctor cannot find or afford insurance?” A change in regulatory structure may not be the only way to answer this question; however, this is the path Congress chose in passing the LRRRA.

Arguments opposing expansion often focus on the dangers in allowing insurance to be sold that is not subject to the same regulatory standards as “normal” insurance. The question posed is essentially: “What happens to a community if the insurer from which this business, school, or doctor purchases insurance ends up bankrupt or if the policy does not cover what needs to be covered?” The requirements of the LRRRA that RRG policyholders also be owners of the RRG provides somewhat of an answer to this as, presumably, the RRG policyholders/owners would not desire to purchase unreliable insurance. The same statute, however, prohibits RRG guaranty fund participation, thus ensuring that RRG policyholders will not have the same benefits in an insolvency compared with an insurer licensed in that state.

Assessing the arguments on either side may be a challenge for Congress. The broad question of availability versus reliability can be framed by some as a basic philosophical question about the degree of regulation needed by insurance markets and may not have an absolute empirical answer. Some see insurance philosophically as a public good, akin to a basic utility, and one that must be highly regulated in price and content to protect consumers. Others do not share this philosophy and feel insurance should be lightly regulated, with the market determining prices and content. In general, the states, which have faced such basic insurance regulatory questions for many years, have attempted to suit the amount of regulation to the perceived sophistication of the consumer. Thus, the market for commercial insurance is usually left relatively less regulated on the theory that the businesses purchasing in the commercial market have the knowledge and experience to discern the intricacies of insurance policies and companies, or at least hire professionals to make these “reliability” judgments for them. Individual consumers are often presumed to be less well placed to make these judgments; thus, the market for such insurance, particularly homeowners and auto, tends to be more regulated.

Risk retention groups occupy a small part of the insurance market. The approximately \$560 billion²⁶ of direct premium written in the property/casualty market in 2016 far exceeded the approximately \$3 billion in RRG premium. Economic theory suggests, however, that it is not necessary for a competitor to have a large market share in order to have an impact on prices or availability. Anecdotal cases also suggest that the LRRRA is expanding the availability of insurance, especially in local situations with severe supply difficulties. The Department of Commerce came to the conclusion in 1989 that the 1986 act had been successful in addressing supply problems,²⁷ and the GAO reported similar findings in the previously mentioned 2005 report²⁸ and a 2011 report.²⁹

²⁶ A.M. Best, *4Qtr 2016 U.S. Property Casualty Financial Results*, March 15, 2017, p. 3.

²⁷ See U.S. Department of Commerce, *Liability Risk Retention Act of 1986: Operations Report 1989*, NTIS PB 90-123134.

²⁸ “RRGs have had a small but important effect in increasing the availability and affordability of commercial liability insurance for certain groups.” GAO, *Risk Retention Groups: Common Regulatory Standards and Greater Member Protections Are Needed*, GAO-05-536, August 2005, p. 5, at <http://www.gao.gov/new.items/d05536.pdf>.

²⁹ “RRG representatives opined that RRGs have expanded the availability of commercial liability insurance—particularly in niche market—but differed in their opinions of whether RRGs have improved its affordability.” GAO, *Risk Retention Groups: Clarifications Could Facilitate States’ Implementation of the Liability Risk Retention Act*, GAO-12-16, December 2011, in “What GAO Found,” at <http://www.gao.gov/assets/590/587531.pdf>.

Appendix. Risk Retention Act Legislative History

The 1981 Product Liability Risk Retention Act

The first “Product Liability Risk Retention Act” was introduced in 1979, and an amended version became P.L. 97-45 in 1981. Its origin can be traced to an interagency task force created by the White House in 1975³⁰ to examine difficulties in the availability of product liability insurance. Among the proposals discussed by the task force’s report was the possible creation of alternatives to the traditional insurance market. The 1981 act was relatively narrow, limiting risk retention groups and risk purchasing groups to insurance covering product liability³¹ as well as completed operations liability.³² The 1981 act also limited members of these groups to “product manufacturers, wholesalers, distributors and retailers.”³³ Risk retention groups had to be chartered, and thus regulated, as an insurer in one of the United States or U.S. jurisdictions, or in Bermuda or the Cayman Islands.³⁴ The act specifically exempted risk retention groups from most regulation by any state in which they operate, aside from the chartering state. This federal exemption, however, did not cover laws that were not specific to the business of insurance, such as fraud or deceptive practice laws. The act also preempted any state laws preventing risk purchasing groups from purchasing the same narrow range of insurance as that allowed to be offered by risk retention groups.

By the time the act became law in September 1981, the liability market difficulties that prompted so much attention had largely passed. With regular commercial insurance available and relatively inexpensive, there was little incentive for companies to undertake the expense of forming risk retention or purchasing groups, and only three of the former and four of the latter were formed in the first four years of the act’s operation.

Despite the lack of market action, congressional interest in the issue continued. In 1983, a Clarification of the Risk Retention Act (S. 1046, eventually P.L. 98-193) was passed by voice votes of both the House and the Senate. This act was a response to a model state law promulgated by the NAIC. This model law referenced the various state tort laws in its definition of “product liability” rather than following the definition passed by Congress in the 1981 act. The state tort laws tended to have a more narrow definition than that desired by Congress. P.L. 98-193 specified clearly that the definitions in the federal statute would be the controlling definitions for purposes of the Risk Retention Act.³⁵

³⁰ Interagency Task Force on Product Liability. Its final report was published by the Department of Commerce in 1977 (NTIS PB-273-320).

³¹ “Products liability refers to the liability of a manufacturer or seller for injury caused by his product to the person or property of a buyer or third party.” See CRS Report R40148, *Products Liability: A Legal Overview*, by Vivian S. Chu for additional discussion.

³² Completed operations liability insurance generally covers claims arising after the completion of a project (for example, if a contractor finished a house, but a defect was found some time later).

³³ U.S. Congress, Senate Committee on Commerce, Science, and Transportation, *Product Liability Risk Retention Act of 1981*, report to accompany S. 1096, 97th Cong., 1st sess., S.Rept. 97-102 (Washington, GPO, 1981), p. 1; and U.S. Congress, House Committee on Energy and Commerce, *Product Liability Risk Retention Act of 1981*, report to accompany H.R. 2120, 97th Cong., 1st sess., H.Rept. 97-190 (Washington, GPO, 1981), p. 7.

³⁴ The authority to form risk retention groups outside of the United States was limited in time, expiring on January 1, 1985.

³⁵ For more discussion, see U.S. Congress, Senate Committee on Commerce, Science, and Technology, *Clarification of the Risk Retention Act*, report to accompany S. 1046, 98th Cong., 1st sess., S.Rept. 98-172 (Washington, GPO, 1983).

The 1986 Liability Risk Retention Act

In the mid-1980s, insurance markets began to harden again and Congress heard of many problems faced by businesses and individuals in finding and affording insurance. One of the congressional responses was to reconsider the 1981 act. Numerous bills were introduced to expand the provisions so that more consumers might avail themselves of the additional insurance supply mechanism that Congress had created.

Congress ultimately passed S. 2129 (eventually P.L. 99-563), which renamed the 1981 act the “Liability Risk Retention Act” and brought the law to its present form. P.L. 99-563 expanded the scope of the insurance to include most types of commercial liability insurance and expanded the organizations that could form such groups to include any business as well as state or local governments or governmental entities as long as all the members of a single group were engaged in similar business activities or were exposed to similar risks. This expansion, however, did not retroactively include the small number of foreign-based risk retention groups. These groups, formed under the temporary authority described above, were allowed to continue in the area of product liability insurance but were not permitted to expand into other kinds of commercial liability insurance. P.L. 99-563 also included changes designed to allow some increased oversight of risk retention and purchasing groups, including the requirement to file documentation in non-chartering states, and the right of non-chartering commissioners to conduct examinations if the chartering state fails to do so and to seek injunctions against groups in a hazardous financial situation. In general, however, the perceived intent of Congress remained to allow these groups to operate throughout the country while being regulated largely, if not solely, by a single state regulator, rather than facing 51 jurisdictions with different laws and regulatory styles.



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September 26, 2017

The Honorable Sean P. Duffy
 Chairman
 Subcommittee on Housing and Insurance
 2129 Rayburn House Office Building
 Washington, D.C. 20515

Dear Chairman Duffy:

We applaud the Housing and Insurance Subcommittee for holding a hearing to examine insurance for nonprofit organizations. The Council of Insurance Agents and Brokers (CIAB) supports the legislation, the Nonprofit Property Protection Act, sponsored by Congressman Dennis Ross (R-FL) and Congressman Ed Perlmutter (D-CO) in the previous Congress. The legislation allows certain Risk Retention Groups (RRGs) to insure property of their small and mid-sized 501(c)(3) nonprofit members, in addition to the liability insurance they already provide.

Historically, the CIAB has supported legislation that expands the insurance market. During periods of hard commercial markets, insureds –particularly sophisticated commercial clients – are increasingly drawn to the appeal of alternatives to the traditional, regulated marketplace to expand their coverage and hold down costs. One such mechanism that offers an alternative is Risk Retention Groups, created under the provisions of the federal Liability Risk Retention Act. While we have supported broader risk retention legislation in the past, the current proposal is narrowly tailored to address the market inadequacies for nonprofits.

One of our members, Guy Carpenter, a Marsh & McLennan Company and a global leader in providing risk and reinsurance intermediary services, recently completed a study on the market for standalone property insurance. During the months of May, June, and July of 2017, Guy Carpenter undertook a series of steps to determine the existence of insurance company filings for standalone auto physical damage or standalone property on a Businessowners Policy (BOP) for 501(c)(3) nonprofits. In particular, the research was conducted to determine the availability of a BOP property form that would allow an admitted insurance carrier to provide property coverage only to 501(c)(3) nonprofits, without requiring liability coverage to be purchased simultaneously. Guy Carpenter performed some of this research internally and also engaged the services of Perr & Knight, a leading provider of insurance support services.

Despite extensive research over several months, Guy Carpenter was not successful in locating standalone auto physical damage or standalone property coverage filings that could be used to provide appropriate monoline coverage for 501(c)(3) nonprofits wishing to purchase a property or auto physical damage policy without simultaneously purchasing liability coverage. The few filings applicable to small and mid-sized nonprofit organizations required the simultaneous



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purchase of property and liability insurance. This study highlights the market failure that the bill is trying to solve for nonprofits.

We also want to commend the sponsors for including additional consumer protections in the legislation, particularly the minimum capital standard, the "seasoning requirements" (i.e. a Risk Retention Group must be licensed and operating as a liability Risk Retention Group for 10 years before being able to offer property coverage), and a total insured value (TIV) cap to ensure that the bill primarily addresses small and community-based nonprofits. Larger nonprofits should have no difficulty finding standalone coverage in the marketplace.

Risk Retention Groups have served the market well in the last 30 years by providing liability coverages for their members. The bill offered by Congressman Ross and Congressman Perlmutter is narrowly tailored to address the unique niche market failure limited to small- and mid-sized 501(c)(3) nonprofit organizations without impacting the traditional insurance market. This narrow bill would provide relief to thousands of nonprofits across the country. By giving certain Risk Retention Groups that primarily serve nonprofits the ability to provide standalone auto physical damage or standalone property insurance to go along with the liability coverage they currently provide, it will create efficiencies in the marketplace that will benefit nonprofits and the populations they serve.

For these reasons, the CIAB supports the Nonprofit Property Protection.

Sincerely,

Ken A. Crerar
 President
 Treasurer, CouncilPAC

Joel Wood
 Senior Vice President
 Government Affairs

Joel Kopperud
 Vice President
 Government Affairs

cc: House and Insurance Subcommittee Members

Statement for the Record
By The Cincinnati Insurance Companies
for the House Financial Services Committee
Subcommittee on Housing and Insurance
Hearing on "Examining Insurance for Nonprofit Organizations"
September 28, 2017

On Thursday, September 28, 2017, at 9:30 a.m. in Room 2128 of the Rayburn House Office Building, the Housing and Insurance Subcommittee will hold a hearing entitled "Examining Insurance for Non-profit Organizations." Given the witness lineup announced by the Subcommittee, we expect one or more of the hearing witnesses to argue for expansion of the Liability Risk Retention Act of 1986 (the "LRRRA") for the purpose of allowing thinly regulated risk retention groups (RRGs) to provide all forms of commercial insurance to 501(c)(3) nonprofit institutions.

The Cincinnati Insurance Companies would oppose any such effort to expand the LRRRA. The LRRRA was enacted to ensure the availability of insurance coverage when coverage is not widely available for a certain segment of the insurance marketplace. Such was the case in 1986 when the LRRRA was enacted to address availability issues in the product liability insurance marketplace.

That is not the case with 501(c)(3) nonprofit institutions in 2017. There is no crisis of availability in this very competitive segment of the admitted commercial insurance marketplace. As such, there is no reason to put nonprofit insurance consumers at risk by allowing RRGs, which are generally exempt from the consumer protection and financial surveillance requirements of the state insurance regulatory system, to provide full commercial insurance coverage in this segment of the marketplace.

In considering this expansion, Congress should also keep in mind that RRGs are not eligible for assistance under the state insurance guaranty fund system. This would put nonprofits at greater risk of loss from insurer insolvencies since nonprofits insured by RRGs would have little recourse against a failed RRG. It should also be noted that RRGs are generally at greater risk of insolvency since they are not subject to the same level of stringent financial oversight as admitted insurers in the commercial marketplace.

For these reasons, we urge Congress to oppose expansion of the LRRRA to allow thinly regulated RRGs to market all lines of commercial insurance to 501(c)(3) nonprofit institution.

Submitted by:

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STATEMENT BEFORE
THE UNITED STATES HOUSE OF REPRESENTATIVES
FINANCIAL SERVICES COMMITTEE
HOUSING AND INSURANCE SUBCOMMITTEE
HEARING ENTITLED “EXAMINING INSURANCE FOR NONPROFIT ORGANIZATIONS”

September 28, 2017

I. Introduction

The Independent Insurance Agents and Brokers of America (Big “I” or IIBA) respectfully submits the following statement outlining insurance options for nonprofit organizations and to express the Association’s opposition to expanding the Liability Risk Retention Act of 1986 (LRRRA). Specifically, IIBA is concerned about recent proposals to enable Risk Retention Groups (RRGs) to provide commercial property and auto insurance coverage to nonprofit organizations and others.¹ IIBA believes that expanding the types of insurance that RRGs can provide to include commercial property and auto insurance would needlessly undermine state insurance regulation, distort insurance markets by creating a parallel insurance marketplace that is essentially unregulated, and ultimately harm consumers, including the nonprofit organizations that are the subject of today’s hearing.

The Big “I” is the nation’s oldest and largest trade association of independent insurance agencies, representing a nationwide network of approximately a quarter of a million agents, brokers and employees. Big “I” members sell all lines of insurance—property/casualty, life, health, employee benefit plans and retirement products to business, individuals and non-profit clients. The Big “I” supports

¹ See, e.g. H.R. 3794, the “Nonprofit Property Protection Act of 2015” by Reps. Dennis Ross (R-FL) and Ed Perlmutter (D-CO). (This legislation would have widely expanded the LRRRA and broadly preempted state insurance laws to allow a certain subset of large RRGs to offer commercial property insurance to millions of nonprofit and educational institutions, while abiding to lower regulatory standards than traditional insurance companies.)

competitive state insurance marketplaces and for decades has been a leading supporter of a modernized state regulatory system. The association strongly opposes the federal regulation of insurance.

II. Congress authorized the use of RRGs in the 1980s for a limited purpose in response to a specific economic crisis and did not intend for RRGs to be used broadly to insure multiple types of risks.

When Congress enacted the Product Liability Risk Retention Act in 1981 and amended the statute by passing the LRRRA in 1986, it was responding to a specific and serious national crisis. In the 1980s, liability coverage was often unavailable at any price, and businesses were confronted by policy cancellations, dramatic reductions in coverage, significant increases in deductibles, and exponential premium increases. The magnitude of the crisis is difficult to overstate, and it dominated news headlines at the time.

Congress took notice and held multiple hearings (including nine hearings alone in the House Commerce Committee during the 99th Congress) and after much research and debate found “entire lines of insurance virtually unavailable at any price.”² Congress responded to these extreme and exigent circumstances by taking the radical and unusual step of creating a new limited type of insurance company: the RRG. In doing this, Congress preempted state insurance laws to allow RRGs licensed in one state to operate in all other states with minimal additional regulation.

While the crisis was overwhelming, the solution was targeted. The changes made to federal law in the 1980s were intended to increase the supply of commercial liability insurance available in the market; not to broadly confer special rights on to certain insurers in a way that could distort insurance markets that were not impacted by the availability crisis. One important and appropriate limitation on RRGs is that they can only offer commercial liability insurance and cannot write commercial property coverages. RRGs were created in response to the specific problems that existed in the commercial liability insurance markets in the 1980s, so Congress naturally restricted the reach of RRGs. RRGs were not authorized to offer commercial property coverages because those coverages were – and continue to be – widely available in traditional insurance markets. In fact today, unlike the 1980s, commercial liability coverage is also widely available in the traditional market.

III. There is no compelling reason to expand the types of insurance that RRGs can provide because commercial liability and property insurance is widely available and there is no crisis in the insurance markets like the one that precipitated the creation of RRGs in the 1980s.

Some RRG proponents now suggest that there is a property insurance need similar to the liability insurance crisis of the 1980s and that some groups, including nonprofits, are unable to obtain affordable commercial property coverage in the traditional marketplace. Yet, there is no valid data to support this assertion. According to the Urban Institute there are approximately 1.5 million nonprofits registered with the Internal Revenue Service. However, the Big “I” is only aware of one organization (with approximately 16,000 nonprofit members) that has been pursuing a specific expansion of federal law that would essentially allow an RRG operated by that organization the ability to expand to offer commercial property insurance to millions of organizations under less stringent regulatory standards than traditional insurers.³

² See, H. Rep. 99-865 (1986), reprinted in 1986 U.S.C.A.N. 5303

³ See, the Nonprofits Insurance Alliance Group 2016 Annual Report at page 1, available at: <https://insurancefornonprofits.org/pubs/AnnualReport/files/assets/common/downloads/publication.pdf>.

Commercial property insurance for nonprofit groups is broadly available in the traditional insurance market. According to the National Association of Insurance Commissioner (NAIC) there are approximately 250 RRGs in operation today and there are over 2,500 insurance companies that offer a wide variety of property and casualty insurance products across the U.S.⁴ Many of these 2,500 carriers including major national and regional insurance companies, not only offer general products and services to nonprofit organizations, but have developed products specifically tailored to address the unique needs of nonprofits.

Today's insurance markets can provide multiple products for nonprofits, including both commercial liability and commercial property and auto coverages which can be purchased together or separately at reasonable prices depending on the specific needs of the nonprofit organization. For example:

- Liberty Mutual offers numerous types of insurance coverages specifically for nonprofit organizations, such as community health clinics, counseling centers, homeless shelters, and special needs schools in 48 states.⁵
- Travelers Insurance offers both standalone and bundled insurance coverages crafted expressly for nonprofit organizations.⁶
- GuideOne™ Mutual Insurance Company insures more than 51,000 commercial policyholders and offers a variety of property and liability coverages on a standalone or bundled basis to nonprofits. GuideOne™ operates in all 50 states and specializes in churches, educational institutions, senior living and healthcare centers, and nonprofit organizations.⁷
- Philadelphia Insurance Companies offers insurance products “uniquely designed to provide a wide range of special insurance needs for the nonprofit, social services, and human services sector as defined under IRS code 501 (C)(3).”⁸
- Farmers Insurance offers “personalized coverages” specifically for the education and nonprofit sectors.⁹

In fact even a limited survey conducted by an entity that supports expansion of RRGs for the sole purpose of determining that no insurers offer standalone property and auto insurance coverage found that four of 46 insurers surveyed do offer standalone property coverages in some form, including Cincinnati Insurance Company, Seneca Insurance Company, the Hartford, and AIG.¹⁰

⁴ See, Insurance Information Institute, Facts + Stats: Industry Overview, available at: <https://www.iii.org/fact-statistic/facts-statistics-industry-overview>.

⁵ See, the Liberty Mutual website at: <https://business.libertymutualgroup.com/business-insurance/industries/nonprofit-insurance-coverage>.

⁶ See, the Travelers website at: <https://www.travelers.com/business-insurance/non-profit-insurance>.

⁷ See, the GuideOne™ Insurance website at: <https://www.guideone.com/insurance/nonprofit>.

⁸ See, the Philadelphia Insurance Companies website at: <https://www.phly.com/products/NonProfit.aspx>.

⁹ See, the Farmers Insurance website at: <https://www.farmers.com/business/industry/education-non-profit>.

¹⁰ The survey conducted in March and April 2015 found that four insurance companies offer standalone commercial property insurance to nonprofits, however the survey sample was only 46 of approximately 2,500 property and casualty insurance companies nationwide and was conducted by 11 individuals emailing companies seemingly at random. Because this represents less than two percent of insurance companies that can write commercial property coverage and because there is no information in the survey to indicate that uniform questions and follow up procedures were used across the group surveyed, it is not possible for IABA to confirm that the survey results are statistically valid. The association believes it is likely the survey misstates the realities of the market, but uses the

While only a handful of companies are specifically referenced in this statement as examples, there are many insurance companies that independent insurance agents and brokers work with to help nonprofit organizations obtain a variety of insurance coverages at reasonable rates. As such, there is no demonstrated marketplace need to expand the narrow purpose of RRGs. The insurance marketplace today is very competitive, and insurers offer commercial property (and liability) coverage to nonprofits at reasonable rates. In fact, some insurance regulators have gone so far as to question the need for RRGs to even continue to provide commercial liability insurance.¹¹

IV. Expanding the types of insurance that RRGs can provide would undermine state insurance regulation, distort insurance markets, and could ultimately harm consumers.

RRGs enjoy preferential regulatory treatment vis-à-vis traditional insurers. Under federal law, RRGs are subject to significantly less oversight than traditional insurance carriers. Traditional insurance companies must be licensed and comply with the insurance rules of each state in which the company operates. RRGs however can be licensed to operate in only one state but offer insurance in all other states with minimal additional regulation. RRGs are generally not subject to the insurance laws of any state except the state where the RRG is domiciled.

Interestingly, about 80 percent of RRGs are domiciled in only five states (Vermont, South Carolina, Nevada, Hawaii, and Arizona) and the District of Columbia, but RRGs write about 95 percent of their premiums outside their state of domicile. This suggests that federal preemption of multi-state regulation has allowed RRGs to choose their domicile state based on certain regulatory advantages.¹² As such, expanding the products that RRGs are permitted to offer would only further exasperate this regulatory arbitrage.

Lax oversight of RRGs has been consistently criticized by many state insurance regulators, particularly as some RRGs have gone insolvent.¹³ While insolvency rates for RRGs are low overall, according to NAIC data, historically RRGs fail at a rate that is roughly double that of traditional property and casualty insurance companies. Furthermore, RRGs do not pay into nor are they covered by state guaranty funds, which are used to pay policyholders should an insurance company be financially unable to pay claims, an important consumer protection.

State regulators have also expressed concerns that allowing RRGs to write commercial property insurance like a traditional insurer, while retaining a weaker and preferential system of regulatory oversight will place traditional commercial insurers at a tremendous disadvantage, distort the competitive balance within the insurance industry, and place consumers at greater risk.¹⁴ RRGs have narrowly offered commercial liability insurance to their members for nearly 30 years, but permitting these entities to offer property and potentially other commercial coverages does not make sense. The members of individual

survey in this statement to point out that even given the survey's shortcoming and goal to derive a specific answer (whether or not it was the market reality) the survey still concluded that nonprofits can obtain property coverage in the traditional insurance market.

¹¹ See, "Risk Retention Groups: Clarifications Could Facilitate States' Implementation of the Liability Risk Retention Act," U.S. Government Accountability Office (Dec. 2011) at page 23, available at: <http://www.gao.gov/assets/590/587531.pdf>.

¹² Id. at pages 19-22.

¹³ Id. at page 33.

¹⁴ Id. at pages 40-42.

RRGs are homogeneous in ways that expose them (by definition) to comparable liability risks, but these same traits do not exist when it comes to property insurance. The property risks of an RRG's membership are inherently dissimilar because they are based in disparate geographic locations and are vulnerable to a diverse set of property perils. Expanding federal law to allow RRGs to offer commercial property and auto insurance unnecessarily lowers insurance regulatory standards and puts consumers at risk.

V. There is an option for RRGs that wish to offer commercial property and auto insurance coverage that does not lower regulatory standards and protects consumers: convert to a traditional insurance company.

IIABA believes that allowing RRGs to offer commercial property insurance while maintaining a system of preferential regulation in contrast to traditional insurers would cause competitive imbalances in insurance markets, and leave consumers less protected. Should an RRG wish to expand its offerings beyond the scope of federal law it should take the regulatory steps necessary to convert to a traditional insurance company.

The majority of RRGs are small, according to the GAO about half of RRGs write less than \$5 million in annual in premium.¹⁵ The biggest RRGs, however, account for hundreds of millions in premium and have the resources to comply with state insurance law. Yet, it has thus far been large RRGs that have expressed the desire to expand their product offerings to compete directly with traditional insurers, while maintaining weaker regulatory oversight.

For example, the Nonprofits Insurance Alliance Group (NAIG) provides insurance products to its nonprofit members in 32 states, and has an RRG. NAIG has over \$443.7 million in assets at the group level.¹⁶ Furthermore, the Alliance for Nonprofits of Insurance (ANI) the RRG that is part of NAIG has \$128.9 million in assets.¹⁷ NAIG has over 54,000 policies in force and is larger than a number of traditional insurance carriers currently in the market, suggesting that NAIG or ANI could reasonably convert to a traditional insurance carrier subject to more appropriate regulatory and consumer protection standards should the organization desire to expand to offer a wider range of insurance products to its nonprofit members.¹⁸

The Big "I" is aware of some RRGs that have successfully converted to traditional insurance companies in recent years, including but not limited to the Podiatry Insurance Company of America (PICA) based in Tennessee, ALPS Corp. based in Montana, and Coastal Insurance Company Inc., which was originally an RRG based in Alabama.¹⁹ IIABA is aware of no compelling reason, other than a desire to avoid state solvency and consumer protection laws, why a large RRG that wishes to offer commercial property coverages cannot convert to a traditional insurance carrier.

VI. Conclusion

The Big "I" understands the importance of having readily available insurance coverage options for nonprofits, but does not support significant preemption of state law to allow RRGs to provide commercial property or auto insurance because:

¹⁵ GAO Report at page 9, figure 1.

¹⁶ See, the Nonprofits Insurance Alliance Group 2016 Annual Report at page 9.

¹⁷ *Id.* at page 11.

¹⁸ *Id.* at page 9.

¹⁹ This information was obtained from various articles in Risk Retention Reporter.

- Congress authorized the use of RRGs in the 1980s for the targeted purpose of increasing the supply of commercial liability insurance in response to an economic crisis and did not intend for RRGs to be used broadly to insure multiple types of risks. That is why Congress carefully limited RRGs to providing only commercial liability insurance.
- There is no compelling reason to expand the types of coverages RRGs can offer because commercial liability and property coverage are readily available in regular insurance markets. Traditional insurance companies provide both standalone and bundled liability and property insurance products at an appropriate price in a highly regulated environment.
- Allowing RRGs to broadly provide different types of insurance would undermine the state regulation of insurance, distort insurance markets by giving certain companies statutory competitive advantages, and put consumers at risk.
- If an RRG wishes to offer products outside of those that RRGs are permitted to offer in any state, the RRG can become a traditional insurance company.

Finally, if there are regulatory conditions in state insurance markets that exist today that make it difficult to find certain types of insurance coverage, then policymakers should address those issues at the state level. IIABA members support competitive state insurance markets and encourages Congress not to pick winners and losers in the marketplace by further preempting state solvency and consumer protection laws for certain insurers. The Big "I" hopes that the Committee will consider the information provided here should legislation to expand the role of RRGs be introduced in the future. The Big "I" thanks the Committee for considering the views of independent insurance agents and brokers.



**Statement for the Record
From the National Association of Insurance Commissioners
for the House Financial Services Committee
Subcommittee on Housing and Insurance
Hearing on “Examining Insurance for Nonprofit Organizations”
September 28, 2017**

Chairman Duffy, Ranking Member Cleaver, and members of the subcommittee, the National Association of Insurance Commissioners (NAIC)¹ appreciates the opportunity to submit this written statement for the September 28, 2017 hearing on “Examining Insurance for Nonprofit Organizations.”

As state insurance regulators, our focus is on the dual objectives of protecting insurance consumers and ensuring competitive and stable insurance markets in our states. We assure the solvency and reliability of insurers, promote availability and affordability of insurance coverage, and enforce fair and equitable treatment of insurance consumers. We recognize the importance of exploring nonprofit organizations’ access to insurance products and appreciate the subcommittee’s attention to these issues. As the subcommittee examines these matters, we urge caution and would oppose legislative proposals that seek to expand the scope of the Liability Risk Retention Act (LRRA) to allow Risk Retention Groups (RRGs) to write commercial property insurance.

During the 1980s, the availability of commercial liability insurance became severely restricted. The purpose of the LRRA was to address this availability crisis by limiting the regulation of RRGs. RRGs have different regulatory and financial solvency requirements that are designed to address concerns with the availability for liability coverage as compared to admitted market requirements for property coverage, which is widely available. The LRRA contains limitations on the regulatory authority of state insurance commissioners. An RRG is regulated almost exclusively by its domiciliary state regulator and there are prohibitions against other non-domiciliary states. A traditional admitted insurer must receive a license and submit to regulation from every state where it writes business. By comparison, admitted insurers must comply with all consumer protection laws in all states where they do business while RRGs are only required to comply with the laws of their domiciliary state and the unfair claim settlement practices laws and certain laws related to deceptive, false or fraudulent practices in their non-domiciliary states. In the admitted market, the regulatory oversight of the financial solvency of an insurer is generally the responsibility of the domiciliary state, but oversight is enhanced by the ability of any state to examine a non-domiciliary admitted insurer. Further, the LRRA prohibits RRGs from participating in state guaranty funds, which serve as a backstop and protect policyholders of property and casualty

¹ Founded in 1871, the NAIC is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and the five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

insurance. This is particularly concerning as RRGs have historically had a higher rate of insolvencies when compared to admitted insurers.

While such an approach may have been appropriate in the 1980s when the liability insurance market faced dramatic increases in commercial liability insurance premiums and reductions in coverage availability, we are not aware of such a large scale crisis in the commercial property insurance market today that would merit the expansion of the LRRR and preemption of state insurance regulatory laws that are designed to protect policyholders. At the NAIC's 2015 Fall National Meeting, insurance regulators heard a presentation regarding the availability of certain lines of property coverage for nonprofits. However, no compelling evidence was presented that suggested the existence of a widespread availability crisis of property coverage for nonprofits that might merit broad based state regulatory action, let alone the drastic remedy of federal preemption.

The NAIC is concerned that allowing RRGs to sell property coverage could create more risks for the RRGs and ultimately, their insureds. The current regulatory framework for financial oversight of RRGs was designed with the more limited purpose of promoting the availability of liability coverage not for protecting policyholders of property insurance. The nature of this framework coupled with the lack of state guaranty fund protection, could expose nonprofit organizations and those who rely upon them to unnecessary risks. We encourage RRGs interested in expanding into writing commercial property coverage to explore converting to an admitted carrier, be subject to the same regulatory requirements as traditional admitted property and casualty insurers and compete with those insurers on a level playing field.

In conclusion, we are not currently aware of a large scale property insurance availability problem for nonprofit organizations. Even in the event such concerns develop or become imminent, expansion of the LRRR is not an appropriate solution to the problem. Rather, we encourage any nonprofit policyholders that have difficulties with obtaining property coverage to bring them to the attention of state insurance regulators so we can seek to address such issues through appropriately tailored state-based regulatory solutions as we do with all other lines of insurance. We appreciate your consideration of our views and thank you for the opportunity to submit this written statement for the record.

Question 3 – Tom Santos, Vice President, Federal Affairs, American Insurance Association

Your testimony mentions that 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.

How would they go about doing this?

As my testimony noted, Risk Retention Groups (RRGs) can become admitted insurance carriers if they'd like to offer property coverage. In fact, there are examples of RRGs doing just that. I am attaching two articles highlighting the conversion of three RRGs into admitted carriers, one - the Podiatry Insurance Company of America - converted into an Illinois mutual insurer in January 2014.

To effectuate such a conversion, the RRG would have to meet state requirements to become an insurer and subject itself to the regulatory requirements of the state(s) in which it would like to offer property coverage, including insurance coverage requirements and consumer protections incorporated into state law.

Why do you think this hasn't happened?

As noted previously, there are examples of RRGs converting to admitted carriers. That said, it is the RRG that makes decisions about its own growth and operations and how to best serve its members. Thus, it is speculative for me to answer why this has not happened for any given RRG, but one reason may be that an RRG does not want to become subject to a more rigorous regulatory system.

Question 4 – Tom Santos, Vice President, Federal Affairs, American Insurance Association

Can you discuss some of the risks of federal preemption in the context of the Liability Risk Retention Act of 1986?

As noted in my written statement, the exemption from state laws and regulations afforded RRGs under the Liability Risk Retention Act (LRRA) is quite broad. The effect is that the RRGs are primarily subject to the insurance regulatory requirements of the state in which it is domiciled. The LRRA significantly limits the non-domiciliary state insurance regulator's oversight of the RRGs operating in their states. Insolvency guaranty funds, that protect policyholders, are not available for RRGs. This is particularly concerning given that RRGs have historically had a higher rate of insolvencies when compared to admitted carriers. In terms of property-casualty coverage, the less rigorous solvency requirements are particularly concerning, as property insurance frequently involves large losses in catastrophes and casualty insurance often involves risks that develop over long periods of time.

A Special Reprint of RRG BOARDS' BEST PRACTICES from

The
**Risk Retention
 Reporter**

Coastal RRG Completes Conversion to Traditional Insurer

Coastal Insurance RRG, Inc. (CIRRG) has completed its conversion to a traditional insurer—**Coastal Insurance Company, Inc.** Coastal was the only RRG domiciled in the state of Alabama and was formed in response to the 2003 failure of **Reciprocal of America (ROA)**.

CIRRG's path to becoming the only RRG domiciled in Alabama began when hospitals and physicians in Alabama established the self-insured **Trust Fund** to provide medical professional liability (MPL) insurance in the state. The Trust subsequently merged into ROA in 2000. In 2003, soon after the merger, ROA was found to be insolvent by more than \$200M and was placed into liquidation along with three associated RRGs (See *RRR, May 2003*). As a result, many healthcare providers in the state of Alabama were left without MPL insurance.

"Coastal Insurance Risk Retention Group, Inc. was established by hospitals and physicians in Alabama to provide medical professional liability insurance when the Reciprocal of America financially failed leaving a huge hole in availability of MPL," said Mel Capell, president and CEO of Coastal Insurance Company, Inc. "One challenge of the Trust was that it could not conduct business outside Alabama. The creation of an RRG was designed to avoid this shortcoming."

At the time of CIRRG's formation, the risk retention group was an effective vehicle for filling the gap in MPL insurance in Alabama. "So, for the lines of business that RRGs can write—professional liability, general liability—it is an effective technique to use for an industry or group of companies to provide insurance," Capell said. "RRGs should always have an advantage, even in a soft market, because they are owned and controlled by the very people that need to insure a continued, stable, affordable market in all conditions."

Given their specificity on lines of insurance offered and that groups are owned by the insureds, RRGs often serve as an effective risk management vehicle in addition to providing insurance. Given these advantages, "RRGs have a definite place in the insurance industry," Capell noted. However, the specificity of the RRG model can also be restrictive when a company needs to expand.

"In performing strategic analysis of the company's future, it was recognized that the amount of MPL being purchased from commercial insurance companies was declining, and that this trend was not going to change in the future," said Capell. "Therefore, the company needed other sources of revenue, including writing other lines of business. The RRG structure will not allow this type of flexibility." Due to this need for expanded lines of business, Capell made the decision to convert CIRRG into a traditional insurer.

A Special Reprint of RRG BOARDS' BEST PRACTICES from

The Risk Retention Reporter

ALPS RRG To Soon Finish Transition to Admitted Company

ALPS Corp. (ALPS) the holding company for the insurance subsidiary historically known as the **Attorneys Liability Protection Society, A Mutual Risk Retention Group**, is well on its way to completing the process of transforming itself into a traditional admitted insurer by next year, according to David Bell, president and chief executive officer of the Missoula, Montana company.

This will be the second largest conversion of an RRG into a traditional carrier when measured in terms of gross premium. The largest is still **Podiatry Insurance Company of America (RRG)**, which reported premium of \$64.9M in 2003 before converting into an Illinois mutual insurer in January 2014.

"We've really taken our time," Bell acknowledged, noting that the company first began considering the transition in 2010. "We had the blessing of not really being under a time crunch, and we wanted to do it right."

ALPS has been converting itself to an admitted carrier state-by-state, first in the states where it has a significant presence then in states where it plans to expand once the transition is finalized.

"Every state is different," Bell noted, in terms of what they want ALPS to do to complete the transition and the timeline for making the change. And until the company is admitted in every last state, it continues to be a RRG and to comply with the *Liability Risk Retention Act*, he said.

ALPS was founded in 1998 to provide liability coverage to attorneys who were facing difficulties finding insurance in the traditional marketplace at the time. In 2009, the CEO Robert W. Minto Jr. asked the board of directors to analyze the possibility of becoming an admitted insurer, and in 2010 they voted to begin the process.

A major goal has been making the transition as smooth as possible for the company's clients, Bell said. In some cases, there have been challenges where the company was trying to quote renewals 90 days out during the exact time period when it was making the switch in a particular state, he said. "It can be pretty complicated, but the process has been a non-event for our insureds....it's all behind the scenes."

While his company is leaving the RRG fold, Bell said that he does not think becoming an admitted company is necessarily the only option for RRGs that grow to a large size.

"Our decision was based on our strategic plan, coupled with our existing capital structure, which determined what type of structure would be best for us

to be successful in the future," Bell said. "Our growth strategy just really necessitated a transition."

He also noted that there are particular advantages to being a RRG. "I miss dealing with one regulator," he said. "I miss the cost...the simplicity." Being an admitted carrier instead of a RRG also means "when you are responding to information that your data is telling you about your company you're less of a regulatory speedboat and more of a barge."

However, as an admitted carrier, his firm will be able to offer a wider range of products to its insureds and be better able to tailor its coverage to be state-specific. Plus the company will be able to participate in state guaranty funds and attract a wider array of potential investors. "There are pros and cons, but for us it was time to convert," he said.



Statement to the
United States Representatives
Committee on Financial Services
Subcommittee on Housing and Insurance
Hearing entitled
Examining Insurance for Nonprofit Organizations
September 28, 2017

Introduction

The National Association of Mutual Insurance Companies (NAMIC) is pleased to provide comments to the House Financial Services Subcommittee on Housing and Insurance regarding the possible expansion of the role of Risk Retention Groups (RRGs) into the commercial property insurance market.

NAMIC is the largest property/casualty insurance trade association in the country, with more than 1,400 member companies representing 39 percent of the total market. NAMIC supports regional and local mutual insurance companies on main streets across America and many of the country's largest national insurers. NAMIC member companies serve more than 170 million policyholders and write more than \$230 billion in annual premiums. Our members account for 54 percent of homeowners, 43 percent of automobile, and 32 percent of the business insurance markets.

NAMIC opposes broadening the scope of Risk Retention Groups to allow them to offer commercial property insurance. Thus, NAMIC opposes the Nonprofit Property Protection Act and other legislative concepts that expand the scope of RRGs. RRGs were given a unique regulatory structure and were created as a result of very specific circumstances to serve a very specific purpose. The sole purpose of RRGs was to fill a perceived void created by conditions in the product liability and commercial liability insurance markets.

Offering commercial property insurance products would be inconsistent with the original intent and reasoning of Congress when RRGs were first established. Allowing RRGs to sell commercial property lines of business already and extensively offered in the admitted markets would give them an unfair competitive advantage over traditional insurance companies that abide by the regulatory standards and consumer protections of each state in which they operate. Ultimately, this would unnecessarily expose commercial property policyholders to weakened consumer protections.

Creation of Risk Retention Groups

RRGs were created to help address a crisis in the commercial product liability insurance market. In the 1970's and 1980's this area of the insurance market was faced with a number of challenges that forced many traditional insurance companies to exit the market. Number one among them was a sharp increase in the risk associated with these products.

Risk factors that had not previously been seen in the market caused losses, and the potential for losses, to increase to untenable levels for many product liability carriers. A primary risk factor was a sharp uptick in litigation. Prior to this time, there were far less product liability lawsuits brought by consumers. As consumers began filing and winning suits at an unprecedented pace, claims on these policies and particularly the size of the claims steadily increased. This caused a sharp contraction in the market for these products.

While contractions in insurance markets are a normal part of the business cycle of the insurance industry, the contraction of this particular market was irregularly intense. As the market contracted and the availability of products decreased, so did the number of carriers offering the products, which led to a high level of risk concentration. Additionally, as the risks associated with product liability increased, so did the demand for the insurance policies to protect against those risks. The combination of increased risk, market contraction, and increased demand led to sharp cost increases.

Facing challenges of both availability and affordability, industries dealing with increasing product liability found themselves in a crisis. Without available and affordable product liability insurance products, some industries vital to American society such as the medical device industry could have become unsustainable. Recognizing this as a serious threat, Congress responded by passing the Products Liability Risk Retention Act in 1981. This allowed the creation of Risk Retention Groups. RRGs are group self-insurance mechanisms that are licensed to underwrite product liability insurance for their owners. Owners of an RRG must be engaged in similar business activities or exposed to similar risks. Following another crisis of availability of commercial liability policies – particularly for non-profits – in 1986, Congress revised the law in passing the Liability Risk Retention Act (LRRRA). The LRRRA allowed RRGs to expand into commercial liability insurance lines.

Risk Retention Group Regulatory Regime

To help facilitate the creation of RRGs and enable them to offer products that were challenging for traditional insurance markets, RRGs were given a unique regulatory regime. This regulatory regime provides RRGs with a less stringent regulatory system that allows them to reduce regulatory costs and evade many of the same requirements that traditional insurance companies must follow. RRGs are allowed to operate nationwide, but they are only subject to the regulations of the state in which they are domiciled. On the other hand, traditional admitted insurance companies must abide by the state insurance laws of every state in which they offer policies. This allows each state to regulate insurance in the way that fits its residents best.

Reductions in consumer protections are a concern. Every state has determined the best method to regulate their insurance industry based on factors that could be inherent to that particular state. States may have encountered different situations and circumstances that have led them to institute consumer protections that different states have not found necessary. Since RRGs may not be subjected to the same measures as admitted writers, attempts by state regulators to tailor the regulatory conditions in their state would not apply equally to all companies operating in their state.

An additional component that the RRG regulatory regime is missing and is fundamental to protecting policyholders is mandatory participation in all guaranty funds. Every state has some version of a guaranty fund. A guaranty fund is a state sponsored backstop to protect policyholders in the event of a failure. In the case of a failure in which the assets of the failing company cannot cover policy claims, policies are paid by the guaranty fund. While guaranty funds are state sponsored, they are funded by assessments on traditional insurance companies – only funds from the private sector are utilized. As a result, insurance companies inherently desire adequate regulation to ensure safety and soundness because ultimately, they would pay the price for the failure of an insolvent insurance company.

Competitive Advantage

The Nonprofit Property Protection Act seeks to allow RRGs to offer commercial property insurance to federal tax-exempt nonprofit charitable or educational institutions when there is currently no shortage of available and affordable products in the market. The predominant reasoning behind the unique regulatory structure of RRGs is to help make insurance products available for areas in the market in which conditions have made it difficult to offer insurance. To help facilitate a market for insurance products that presented an unusual and unsustainably high level of risk, Congress through the LRRRA created a regulatory structure to ease the challenges for RRGs. Traditional insurers face a daunting multi-state compliance burden. Since RRGs are only regulated in the state in which they are domiciled, they do not face the same burden or costs associated with compliance.

Tyler Leverty has estimated¹ that the structure of RRGs reduces the cost of compliance by 26% in comparison to similar traditional insurers. RRGs were given this advantage for one reason, which was to ensure products were available in high risk product lines that had availability and affordability issues. However, the commercial property insurance market does not fit this description. With passage of the Nonprofit Property Protection Act or similar legislative concepts, RRGs would enjoy an unfair competitive advantage in markets where there is no demonstrable need. Since the commercial property insurance needs are already being met, the only purpose the Nonprofit Property Protection Act or similar legislative concepts would serve is putting traditional insurers at a competitive disadvantage.

Ultimately, if there is an interest among RRGs in expanding into other, admitted lines markets, there is an option that some have already utilized which avoided an unfair and unlevel playing field: reorganize as a traditionally admitted insurance company.

¹ Leverty, Tyler. "The Cost of Duplicative Regulation: Evidence from Risk Retention Groups," 2012.

Conclusion

Given that there is a strong, thriving, and competitive commercial property insurance market, it would be both unnecessary and imprudent to expand the role of RRGs to include commercial property insurance.

RRGs were created out of necessity to serve a niche market that presented unusually difficult challenges to the traditional insurance industry. Therefore, their structure and regulatory requirements were designed specifically to allow them to operate under special conditions. When Congress created the RRG structure they did not intend for it to expand into insurance lines that were and continue to be well served by traditional insurers. Allowing RRGs to expand into commercial property would be ill-advised and Congress should not pass legislation allowing them to do so.

