Expanding the LRRA

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The Risk Retention Modernization Act of 2010would extend the LRRA to include commercial property coverages for risk retention groups, but will the proposals ever make it into law?

The Risk Retention Modernization Act of 2010' (HR 4802) was recently introduced in the US House of Representatives by Rep Dennis Moore (D-KS) and John Campbell (R-CA). The proposed legislation, based upon the 'Increasing Coverage Options for Consumers Act of 2008' (HR 5792) proposed in 2008 but never passed, has gained support. Whether it will become law this year is unclear.

The bipartisan legislation is aimed at bringing down property insurance costs and increasing coverage availability, specifically in higher-risk areas prone to natural disasters. This would be accomplished by amending the Liability Risk Retention Act of 1986 (LRRA) in three ways.

First, the bill would mandate new corporate governance standards similar to those suggested in the 2005 GAO report regarding risk retention groups (RRGs). Second, a federal dispute resolution process to achieve timelier and more cost-effective results would be implemented by giving the US Treasury Department broad new powers to oversee disputes involving RRGs and state regulators. Finally, the new legislation would expand RRGs' authority under the LRRA to include commercial property insurance. This article will focus on commercial property expansion, the impact on RRGs and issues that may arise at the state-level.

HR 4802

Under HR 4802, 'commercial property insurance' means:

insurance that indemnifies a business, nonprofit organisation, or governmental entity for damage to, theft of, or destruction of real property or business property, owned by or leased to such business, nonprofit organisation, or governmental entity, including insurance that indemnifies a business, nonprofit organisation, or governmental entity for damage to, theft of, or destruction of furniture, fixtures, and inventory, from any and all perils or causes of loss and against consequential loss or damage, including business interruption, other than non-contractual legal liability for such loss or damage.

Commercial property

In its current form, the LRRA only permits RRGs to offer commercial liability insurance for its members and reinsurance concerning the liability of any other RRG that meets the requirements for membership in the RRG which provides the reinsurance. The proposed legislation would expand the reach of the LRRA by permitting newly formed and existing RRGs to offer both commercial liability and commercial property coverage.

If the bill becomes law, RRGs could offer more affordable property coverage to areas that have been previously difficult to price (like Florida and other south-eastern states) and could create an affordable and accommodating property market for areas prone to catastrophic risk, especially flooding coastal areas.

This type of expansion to the LRRA has been attempted before. In earlier bills, including HR 5792, the proposed definition of 'commercial property' was considered unclear and subject to potential misconstruction of the intended purpose of the LRRA. Also, distinct standards for RRGs writing liability and RRGs writing property were offered, which could have led to confusion and inefficiency.

This bill, however, provides a clear definition and has also received support from national groups and organisations including the American Risk Retention Coalition, the Coalition to Expand the Risk Retention Act, the National Risk Retention Association, the Property Casualty Insurance Association of America, the Self-Insurance Institute of America (SIIA), and the Risk Insurance Management Society.

The National Association of Insurance Commissioners (NAIC) has not taken an official position on allowing RRGs to write commercial property insurance, generally, or on HR 4802, specifically. Some NAIC members support the need for increased competition in property insurance markets whereas others believe that neither the market availability nor affordability crisis requires LRRA expansion.

A representative of the NAIC noted that HR 4802 would be troublesome for many NAIC members as it ignores their substantial efforts in developing corporate governance standards for RRGs and instead gives full responsibility for their development to the Treasury. Furthermore, the bill allows the Treasury to review disputes between RRGs, their domestic regulators and non-domiciliary regulators. Therefore, the bill would allow the Treasury to pre-empt these regulators – a result opposed by the NAIC. NAIC representatives believe the bill will probably not be passed this year.

Impacts of LRRA expansion

Allowing RRGs to provide both liability and commercial property coverage would likely increase the appeal of RRG formation. Groups of common purpose could avoid partial state-specific regulations that frustrate the ability to pursue a single RRG for commercial property and liability exposures. Notably, municipalities would be beneficiaries of expanded coverage, specifically those in coastal areas already utilising RRGs to insure liability exposures.

These municipalities would be able to utilise a single RRG for liability and commercial property coverage. In turn, this could increase the number of providers in the commercial property market

and drive down costs associated with insuring commercial property.

Expansion of the LRRA would also provide an alternate risk transfer option to the commercial property insurance market. Since RRGs are currently unable to provide commercial property coverage, they are not able to compete against the traditional carriers. The bill would alleviate some of the problems of availability and affordability of commercial property insurance in the US by permitting alternative risk transfer solutions for commercial property owners.

Further, with the property expansion, new or existing RRGs adding property would likely create opportunities for the reinsurance market. As the number of RRGs writing commercial property grows, the necessity for reinsurance products such as quota shares, catastrophe excess of loss, risk excess of loss, and others in known catastrophe areas will increase as RRGs entering this market will likely look to reinsurers to share some of the risk. This may lead to growth in the property reinsurance sector. Thus, while the potential impacts are clear, the potential fallout, particularly at the state level, is less so.

Ocean Drive, Miami Beach: Florida has proved difficult to price for property coverages

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State-level issues

RRGs, with exception to their domiciliary state, are exempt from state laws, rules and regulations that would make unlawful or would regulate, directly or indirectly, the operation of RRGs, except as provided in the LRRA.

In 2008, Congress noted inappropriate efforts by certain states to regulate RRGs in an extraterritorial manner precluded by the LRRA. Regarding HR 4802, a provision that RRG advocates had largely supported which prevented states from issuing cease-and-desist orders against RRGs was deleted because of disapproval from state regulators and the NAIC.

Accordingly, a major issue remains whether the foundation of the LRRA, which permits RRGs to operate in any state without interference from non-domiciliary state regulators, will conflict with non-domiciliary state interests considering the proposed expansion to include commercial property. Certain types of property coverage written by RRGs may be properly included within the definition of 'commercial property,' but nevertheless be narrowly and unilaterally interpreted to violate the LRRA by a non-domiciliary state regulator.

Interestingly, the bill requires the comptroller of the US to study instances where non-domiciliary states attempt to unlawfully regulate the operation of RRGs through unilateral means. Although the state response to this proposed legislation remains to be seen, there is at least a federal acknowledgement that issues may arise and need to be thoroughly addressed in the future.

Under the current LRRA, disputes are generally handled through the courts systems. Under HR 4802, dispute resolutions would be handled by the Treasury Department in the attempt to achieve timelier and more cost effective results. However, some states may view this as an attempt to usurp a non-domiciliary state's ability to impose permissible oversight over RRGs should the Treasury determine that such oversight is inconsistent with or unduly burdensome considering the RRG's home state regulation. This strikes at the very heart of the state regulation of insurance.

Another issue is solvency. Despite enhanced corporate governance standards in HR 4802, concerns remain that financial failures will affect RRGs without thorough state-specific regulation. Unlike traditional insurance companies, RRGs are created under one state's law but authorised to operate in every other state without additional licensing requirements.

Therefore, RRG failures can affect residents of non-domiciliary states in which the LRRA permits them to legally write business. With the potential property coverage expansion, the ability of RRG groups to manage property risk, particularly natural catastrophes, will be paid close attention by state level interests both in government and the traditional market.

Also, allowing RRGs to provide additional coverage readily available in the market may provide an unfair competitive advantage to RRGs over traditional insurers. This in turn may lead to biased treatment against RRGs, especially by states financially invested in domiciled traditional commercial property insurance companies. CR

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