Consumer Federation of America

CREATING INSURANCE ALTERNATIVES TO BRING DOWN RATES: THE NEED TO EXPAND THE LIABILITY RISK RETENTION ACT

In the last year, high rates for property-casualty insurance have been a serious problem, especially for mid-sized and larger firms. Moreover, insureds of all sizes have experienced rate gouging. The rate problem is caused by a classic turn in the economic cycle of the industry, which has been accelerated by--but not caused by--the terrorist attacks.

Congress should provide incentives for hastening the creation of private alternatives to the over-priced insurance of today's market. Among other possibilities, consideration should be given to such ideas as:

- Expanding the Liability Risk Retention Act to cover all commercial property/casualty insurance;
- Determining if there are any tax disincentives for the development of captive insurance or self-insurance mechanisms, and
- Developing proposals to encourage the securitization of risk.

The Liability Risk Retention Act

Congress has created incentives for private sector alternatives before, with the Risk Retention Act (RRA). The Product Liability Risk Retention Act of 1981 was developed by Congress as a direct result of the product liability insurance hard market of the mid-1979s. The current version of the Act, the Liability Risk Retention Act of 1986,[1] was passed to expand the Act to all commercial liability coverages as a direct response to the hard market of the mid-1980s. It allowed businesses to join together to form purchasing groups to buy liability insurance as a unit or to form self-insurance combinations by getting approved in only one state.

The National Association of Insurance Commissioners describes the RRA as follows:

> The purpose of the RRA is to increase the availability of commercial liability insurance which became severely restricted in the market crisis of the mid-1980s…An RRG[2] is a risk-bearing entity that must be chartered and licensed as an insurance company in one state…Once the group has obtained a license, it may operate in all states…and is regulated almost exclusively by the domiciliary commissioner…The RRA requires that the RRG be owned by its insureds and requires the insureds to have similar or related liability exposure. The

[1] 15 USC §3901 et sec.

[2] RRG is a Risk Retention Group operating under the RRA, the Risk Retention Act.

> only type of coverage an RRG is permitted to write is commercial liability insurance for its members and reinsurance with respect to the liability of any other RRG…A PG[3] may purchase only commercial liability insurance for its members…[4]

The creation and expansion of the RRA helped overcome the problems of the two previous hard markets and would do so again in the current hard market. Not only would expansion of the Act enable businesses to get together to cover other risks, but this option puts pressure on the insurance industry to stop the price gouging now underway or risk losing market share.

Expansion of the RRA to cover property damage could also help companies, especially small and mid-sized firms, to insure against future terrorism losses. Even firms, office buildings and public facilities with high exposure to terrorism risk could benefit. According to news reports,[5] U.S. airlines are planning to set up a RRG to cover liability war risks. Expansion of the RRA to cover property would offer the airlines—and similar insureds—the opportunity to spread risk and cover potential terrorism losses from property (e.g., the airplane hull) as well as liability.

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[3] PG is a Purchasing Group.

[4] Risk Retention and Purchasing Group Handbook, NAIC, 1999, Pages I1-I3.

[5] Airlines Discuss Own Insurance, Washington Post, February 11, 2002.