



Highlights of [GAO-05-536](#), a report to the Chairman, Committee on Financial Services, House of Representatives

## Why GAO Did This Study

Congress authorized the creation of risk retention groups (RRG) to increase the availability and affordability of commercial liability insurance. An RRG is a group of similar businesses that creates its own insurance company to self-insure its risks. Through the Liability Risk Retention Act (LRRRA), Congress partly preempted state insurance law to create a single-state regulatory framework for RRGs, although RRGs are multistate insurers. Recent shortages of affordable liability insurance have increased RRG formations, but recent failures of several large RRGs also raised questions about the adequacy of RRG regulation. This report (1) examines the effect of RRGs on insurance availability and affordability; (2) assesses whether LRRRA's preemption has resulted in significant regulatory problems; and (3) evaluates the sufficiency of LRRRA's ownership, control, and governance provisions in protecting the best interests of the RRG insureds.

## What GAO Recommends

To strengthen the overall regulation of RRGs, GAO recommends that state insurance regulators adopt consistent regulatory standards for RRGs. Moreover, GAO suggests that Congress consider (1) granting the partial preemption only to states that adopt the standards and (2) establishing minimum corporate governance standards for RRGs.

[www.gao.gov/cgi-bin/getrpt?GA0-05-536](http://www.gao.gov/cgi-bin/getrpt?GA0-05-536).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Richard J. Hillman at (202) 512-8678 or [hillmanr@gao.gov](mailto:hillmanr@gao.gov).

# RISK RETENTION GROUPS

## Common Regulatory Standards and Greater Member Protections Are Needed

### What GAO Found

RRGs have had a small but important effect in increasing the availability and affordability of commercial liability insurance for certain groups. While RRGs have accounted for about \$1.8 billion or about 1.17 percent of all commercial liability insurance in 2003, members have benefited from consistent prices, targeted coverage, and programs designed to reduce risk. A recent shortage of affordable liability insurance prompted the creation of many new RRGs. More RRGs formed in 2002–2004 than in the previous 15 years—and about three-quarters of the new RRGs offered medical malpractice coverage.

LRRRA's partial preemption of state insurance laws has resulted in a regulatory environment characterized by widely varying state standards. In part, state requirements differ because some states charter RRGs as "captive" insurance companies, which operate under fewer restrictions than traditional insurers. As a result, most RRGs have domiciled in six states that offer captive charters (including some states that have limited experience in regulating RRGs) rather than in the states where they conduct most of their business. Additionally, because most RRGs (as captives) are not subject to the same uniform, baseline standards for solvency regulation as traditional insurers, state requirements in important areas such as financial reporting also vary. For example, some regulators may have difficulty assessing the financial condition of RRGs operating in their state because not all RRGs use the same accounting principles. Further, some evidence exists to support regulator assertions that domiciliary states may be relaxing chartering or other requirements to attract RRGs.

Because LRRRA does not specify characteristics of ownership and control, or establish governance safeguards, RRGs can be operated in ways that do not consistently protect the best interests of their insureds. For example, LRRRA does not explicitly require that the insureds contribute capital to the RRG or recognize that outside firms typically manage RRGs. Thus, some regulators believe that members without "skin in the game" will have less interest in the success and operation of their RRG and that RRGs would be chartered for purposes other than self-insurance, such as making profits for entrepreneurs who form and finance an RRG. LRRRA also provides no governance protections to counteract potential conflicts of interest between insureds and management companies. In fact, factors contributing to many RRG failures suggest that sometimes management companies have promoted their own interests at the expense of the insureds.

The combination of single-state regulation, growth in new domiciles, and wide variance in regulatory practices has increased the potential that RRGs would face greater solvency risks. As a result, GAO believes RRGs would benefit from uniform, baseline regulatory standards. Also, because many RRGs are run by management companies, they could benefit from corporate governance standards that would establish the insureds' authority over management.