» Insolvency TRENDS

WINTER 2017

National Conference of Insurance Guaranty Funds NCIGF

A biannual publication providing updates on recent property and casualty insolvencies and public policy developments

GUARANTY FUNDS WORK

in partnership with insurance regulators to protect policyholders.

A state court finds an insurance company insolvent and orders it liquidated.

Policyholder claim files are transferred to the guaranty funds for servicing.

Covered claims are paid from a pool of money drawn from three sources made available at the time of the insolvency: a) the insolvent insurance company's remaining assets, b) statutory deposits collected in certain states, and c) assessments on insurers licensed to write business in a state.

Payments are made promptly.

HOW THE GUARANTY FUND SYSTEM IS FUNDED

Recoveries

To the extent possible to fulfill guaranty fund statutory duties, monies are obtained from remaining estate assets.

- The insurance company's remaining assets (including reinsurance)
- Statutorily mandated deposits collected in certain states while the company is still writing business

Assessments from Insurers

Charged to insurance companies licensed to write business in a state

- Typical cap is 2% of "net direct written premium"
- Assessment is determined by the amount of money needed by the guaranty fund to supplement the funding pool described above
- Some guaranty funds have separate "assessment accounts" allowing them to segregate assessment billing and payments into various lines of business—a typical structure would be workers' compensation, auto, and all other property & casualty lines covered by the funds

Welcome to the 2017 Winter issue of the National Conference of Insurance Guaranty Funds' (NCIGF) *Insolvency Trends*.

Authored by the legal and public policy staff of the NCIGF, the publication provides an update on recent events in insolvency law and practice and a look ahead at what is on the horizon.

See inside for…

- Projected impact of the 2016 elections
- International and other regulatory developments
- Insurance insolvency developments; new liquidations
- Updates on run-offs of troubled companies
- Developments in state insolvency laws

PROPERTY AND CASUALTY GUARANTY FUNDS: CONTINUING TO EVOLVE TO PROTECT POLICYHOLDERS

The guaranty fund system was established in 1969 by the property and casualty insurance industry, insurance regulators, and states to provide a safety net that protects insurance consumers if an insurance company fails. The system is an innovative and common-sense mechanism that draws first on the assets of the failed insurance company and, in turn, assessments of healthy insurers in each state. Since its inception, the system has paid out more than $30 billion to policyholders, beneficiaries, and claimants related to more than 600 insolvencies.

Following liquidation, the statutorily created guaranty funds seamlessly step into the shoes of a defunct company and pay the covered claims of policyholders and claimants whose claims otherwise would go unpaid by an insolvent insurance company.

Today, the guaranty fund system remains true to its original intent: delivering protection to those least able to weather the impact of insurance company insolvencies.

2016 ELECTIONS: KEY IMPLICATIONS FOR INSURANCE INSOLVENCY MANAGEMENT

President-elect Donald Trump defeated Secretary of State Hillary Clinton to become the 45th President of the United States. The Republicans have retained control of the U.S. Senate with 52 seats. Democrats picked up two seats with Sens. Mark Kirk (R-IL) and Kelly Ayotte (R-NH) losing their re-elections. The Republicans lost seven House seats and will retain control of the House of Representatives by a margin of 240 to 194.

We expect the election results to create a significant shift in regulatory and legislative policymaking. The Financial CHOICE Act will likely be reintroduced by the new Congress. (CHOICE stands for “Creating Hope and Opportunity for Investors, Consumers and Entrepreneurs.”) The CHOICE Act reforms Title V of Dodd-Frank by consolidating the Federal Insurance Office (FIO) and the Financial Stability Oversight Council (FSOC) Independent Member with Insurance Expertise into the new Office of the Independent Insurance Advocate (IIA).

Responsibilities of the new office will include those of the current FIO and FSOC insurance Member, including: coordinating federal efforts on the prudential aspects of international insurance matters; representing the U.S. on the International Association of Insurance Supervisors (IAIS); and participating in negotiating Covered Agreements.

- The bill requires Covered Agreements to be published in the Federal Register by the Treasury Secretary and to be subject to a public comment period of not fewer than 30 and not longer than 90 days. (The Covered Agreement process, initiated by FIO and the United States Trade Representative, seeks to reach agreement with the European Union on reinsurance collateral, group supervision and regulatory confidentiality. Once complete, the Covered Agreement would preempt conflicting state law.)

- The bill repeals Dodd-Frank's Title II "too big to fail" provisions by repealing retroactively the authority of FSOC to designate nonbank firms as systemically important financial institutions (SIFIs); and replacing the FDIC's "orderly liquidation authority" with a new chapter of the Bankruptcy Code designed to accommodate the failure of large, complex financial institutions.

  Reforms to the Consumer Financial Protection Bureau include: tasking it with a dual mission of consumer protection and competitive markets; restructuring it as an independent agency outside of the Federal Reserve; replacing the current single director of the agency with a five member bi-partisan commission subject to Congressional oversight and appropriations.

- The bill repeals the Chevron deference doctrine, eliminating the current judicial practice of favoring agency interpretations of the law in court.

STATE ELECTIONS

- Twelve elections could impact insurance commissioners across the country (five Insurance Commissioner elections and seven gubernatorial elections where the Insurance Commissioner is appointed).

- See the chart on the next page for complete results.

FEDERAL DEVELOPMENTS

HR 6436 HR 6436 was introduced in the U.S. House of Representatives in early December. The bill provides that before assenting to any international insurance regulatory proposal, including proposals developed by the International Association of Insurance Supervisors (IAIS), parties representing the federal government shall ensure that: (1) the proposal is consistent with, and reflective of, existing federal and state laws, regulations, and policies on regulation of insurance, including the primacy of policyholder protection in solvency regulation; and (2) existing federal and state laws, regulations, and policies on the regulation of insurance would be recognized as satisfying such proposals.

The bill also provides that parties representing the federal government in any international regulatory standard-setting, or supervisory forum, or in any negotiations of any international agreements relating to insurance shall, on matters related to insurance, consult with and seek to include in such meetings, state insurance commissioners or their designees.

2016 ELECTION RESULTS IMPACTING STATE INSURANCE REGULATORY LANDSCAPE

STATE	ELECTION TYPE	RESULT
Delaware	Commissioner of Insurance	Trinidad Navarro (D) def. Jeff Cragg (R) 59.3% to 40.7%
Indiana	Gubernatorial	Eric Holcomb (R) def. John Gregg (D) 51.4% to 45.4% No change in Governor's party
Missouri	Gubernatorial	Eric Greitens (R) def. Chris Koster (D) 51.3% to 45.4% Party change from current Governor, Jay Nixon (D)
Montana	Commissioner of Insurance	Matt Rosendale (R) def. Jesse Laslovich (D) 53.6% to 46.4%
New Hampshire	Gubernatorial	Chris Sununu (R) def. Colin Van Ostern (D) 49.0% to 46.7% Party change from current Governor, Maggie Hassan (D)
North Carolina	Commissioner of Insurance	Mike Causey (R) def. Wayne Goodwin (D) 50.4% to 49.6% Note: Wayne Goodwin was the incumbent
North Dakota	Commissioner of Insurance	Jon Godfread (R) def. Ruth Buffalo (D) 64.5% to 26.8%
Oregon	Gubernatorial	Kate Brown (D) def. Bud Pierce (R) 50.5% to 43.8% No change in Governor's party
Utah	Gubernatorial	Gary Herbert (R) def. Mike Weinholtz (D) 67.0% to 28.6% No change in Governor's party
Vermont	Gubernatorial	Phil Scott (R) def. Sue Minter (D) 52.9% to 44.2% Party change from current Governor, Peter Shumlin (D)
Washington	Commissioner of Insurance	Mike Kreidler (D) def. Richard Schrock (R) 59.7% to 40.3%
West Virginia	Gubernatorial	Jim Justice (D) def. Bill Cole (R) 49.1% to 42.3% No change in Governor's party

NEW INSOLVENCIES THIS YEAR: THE PROPERTY AND CASUALTY GUARANTY FUNDS CONTINUE TO PROTECT CLAIMANTS

There were two new insolvencies in 2016. Affirmative Insurance Company, an Illinois domestic property and casualty insurer, was placed into rehabilitation on September 16, 2015. The company was ordered into liquidation on March 24, 2016. Affirmative's primary line of business was substandard auto. The company also wrote a small number of Workers' Compensation policies. At the time of liquidation, the company was licensed in 35 states. Approximately 14 guaranty associations were triggered as a result of Affirmative's liquidation.

On May 23, Lumbermen's Underwriting Alliance, a reciprocal inter-insurance exchange organized under the laws of the State of Missouri, was ordered into liquidation by the Circuit

Court of Cole County, Missouri. This company wrote mainly Workers' Compensation along with a small book of liability and property coverage.

ESTATE DISTRIBUTIONS

An important component of the guaranty funds' ability to pay claims of insolvent insurance companies in a timely manner is the distribution of remaining assets of the insolvent estates. Guaranty funds work together with estate liquidators to ensure that guaranty fund loss and expense payments are reported on a timely basis and legal documentation is in place to permit available funds to flow to the guaranty associations on an expedited basis.

In 2016, more than $181 million was received in distributions.

RUN-OFF ACTIVITY

Highlands Insurance Company in Rehabilitation

Highlands Insurance Company, a Texas property and casualty insurer licensed in 50 states and the District of Columbia, was placed into receivership on November 6, 2003. An order approving an Amended Plan of Rehabilitation was entered on June 6, 2008. As of November 7, 2016, Highland's total assets were $124.6 million and its total liabilities were $303.8 million. The receivership continues to process claims under insurance policies issued by the company. As of September 30, 2016 there were 2,918 open proofs of claim. Of these, 1,840 were policy claims and 1,078 were non-policy claims. The receiver's staff is focusing its efforts on collection of assets from various sources, including reinsurance, retro premium recoveries, and subrogation, and from the release of special deposits. The receiver is also analyzing the current and future impact of Highland's environmental and mass tort claim liability. The receiver continues to monitor the Second Amended Plan of Rehabilitation. The guaranty associations are not currently triggered in this matter.

IN THE STATES

Many recent insolvencies have involved a large portfolio of Workers' Compensation large deductible business. In these complex programs, the insured is called upon to pay in the first instance and obtain reimbursement from the insured involved in a high deductible program. By entering into a large deductible arrangement, the insured realizes significant premium savings. If the insurance company becomes insolvent there can be much confusion about who should make the deductible collections, who should benefit from any collateral securing these obligations, and who should handle claims that may have previously been handled by a third party administrator (TPA) selected by the insured.[1] Several states have enacted liquidation act amendments to deal

[1] See for example Oklahoma v. Staffing Concepts, CIV-12-409-C; U.S. District Court for the Western District of Oklahoma. January 24, 2014.

with this issue.[2] In 2016, two states floated bills to codify the treatment of these programs in an insurance liquidation context. As a result:

- Legislation was enacted in Indiana (HB 1136)
- Legislation was unanimously passed through the legislature in Missouri (HB 1763) but was vetoed by the governor. The veto was overturned in the fall of 2016; the Missouri bill is now law.

Florida may be considering similar legislation in 2017.

In Illinois, in 2016, legislation was pending to revise the priority of distribution of remaining assets from an insolvent estate. If enacted, the bill would call for property casualty administrative expense claims to be paid after receivers' administrative expenses, but with a wide range of expenses paid at this new Level 2 priority (see Illinois SB 2609). This legislation did not pass during the 2016 session, but is likely to be reintroduced in 2017.

ALTERNATIVE WORKERS' COMPENSATION

The Oklahoma Insurance Guaranty Association (OIGA) was tagged to administer two new guaranty funds created to deal with insolvencies related to Workers' Compensation opt-out coverage. (These guaranty funds are separately funded and any payments would not come from the OIGA's coffers.) This relatively new coverage created by Oklahoma statute offers an alternative to traditional Workers' Compensation policies and self-insurance. Recently, the opt-out mechanism was determined to be unconstitutional by the Oklahoma Workers' Compensation Commission. In Jonnie Vasquez v. Dillard's Inc., the commission determined that "although at first blush it appears that the Opt-Out Act requires that injured workers under an authorized benefit plan must be afforded benefits equal to or better than those under the Administrative Workers' Compensation Act, this is decidedly not so. A closer look at the statutorily authorized plan requirements reveals that the benefit plans permitted to be used to opt-out establish a dual system under which injured workers are not treated equally."[3] This finding was upheld in the Oklahoma Supreme Court (the decision is available by clicking here.) Policyholders involved in opt-out programs are expected to transition to traditional Workers' Compensation coverage early in 2017.

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[2] For a complete list please see http://ncigf.org/policyleg

[3] Vasquez v. Dillard's, COMMISSION FILE NO.: CM- 2014-110601; February 26, 2016 available by clicking here.

AT THE NAIC

LARGE DEDUCTIBLE WHITE PAPER

The refresh of the 2006 White Paper concerning large deductible products was adopted by the NAIC Executive/Plenary Committee at the Winter 2016 NAIC Miami meeting. The paper focuses on:

- Employer insurance buying trends
- Solvency concerns
- Claims
- State filing requirements
- Special considerations for Workers' Compensation underwriters
- Unique concerns of professional employer organizations (PEOs)

The paper makes several recommendations, including institution of clear statutory parameters governing collateral, credit risks and other concerns relating to the use of these products; the need for statutory guidance related to dealing with these products in an insurance insolvency; and consideration of accounting rule changes related to these products. We expect that consideration of these recommendations will be taken up in 2017 by the NAIC. The adopted paper can be downloaded by clicking here.

MODEL ACT REVISION WORKING GROUP

The focus of the Model Act Revision Working Group in 2016 was to study states' receivership laws and practices in comparison to the Financial Stability Board's (FSB) Key Attributes of Effective Resolution Regimes for Financial Institutions (KA) and Assessment Methodology (AM), and to identify and provide recommendations for possible enhancements to the U.S. receivership regime based on the study as well as recommendations to the FSB for possible future enhancements to either the KA or AM. Most recently, the group met via conference call and discussed out of state enforcement of liquidation court stays and general reciprocity issues.

TO LEARN MORE…

More information about the property and casualty guaranty fund system is available on our Website at www.ncigf.org

Look for a new issue of NCIGF's *Insolvency Trends* in July 2017.

The NCIGF is a nonprofit association incorporated in December 1989 and designed to provide national assistance and support to the property and casualty guaranty funds located in each of the fifty states and the District of Columbia.

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