National Conference of Insurance Guaranty Funds NCIGF℠

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Reforming the Goals of Solvency Regulation

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As insurance markets become more complex and more competitive, it is imperative to define realistic and attainable goals for solvency regulation. An attitude has historically existed that a regulator is performing successfully only if there are no insolvencies during his or her term of office. While everyone wants to avoid insolvencies, the absence of business failures is not possible in an active insurance market with many aggressive competitors and vigorous price competition.

Even under protective regulatory environments, there have been more than 600 insurer insolvencies in the last three decades. Preventing all insurer insolvencies is simply impossible. The focus should be on minimizing the cost of the inevitable business failures and liquidations that result, and in those cases assuring that guaranty fund protection is available for the appropriate policy claimants. Here are two things to think about in this regard:

Role of the Regulator. The circumstances and timing of taking early regulatory action with troubled companies is a subject that needs careful study. Some regulators may find it difficult to place a company in liquidation and will tend to give the company additional time. The decision to liquidate, while difficult, should be timed such that remaining company resources, rather than extensive guaranty fund member assessments, fund the lion's share of all policyholder liabilities. Early monitoring and intervention in appropriate circumstances may help avoid a potential insolvency or may do much to preserve remaining assets so that the burden on the guaranty associations' funding mechanisms is not so great.

Cooperation and Coordination in Regulator's Liquidation of Insurers. The regulators and the guaranty funds share a common goal of protecting the interests of insureds and claimants. For the guaranty funds to be able to protect insureds and claimants by paying covered claims promptly, information, cooperation and a coordination of efforts are needed from the regulator and receiver (if different) to ensure an orderly transition to liquidation. The NAIC has said that "one developing, shared assumption (regarding the involvement of guaranty associations in a troubled company) is that effective communication and coordination among state regulators, their receivership operations and the guaranty associations is critical in providing essential protections to consumers in the event that insolvency occurs."

An orderly transition must include providing needed information so that guaranty funds are in a strong position to discharge statutory obligations promptly upon being triggered. As the business of the insolvent insurers has become more intricate, the need for pre-liquidation planning has grown. Guaranty funds need to commence their own planning well before liquidation. That occurs when the receiver has provided the guaranty funds some early warning of the liquidation on a confidential basis. Also, since guaranty funds cannot pay claims prior to being triggered by a liquidation order and a transfer of responsibility can be completed, it is critical that an orderly transition includes a plan to satisfy the obligation on the part of the receiver to meet critical policy obligations until the transfer of orderly electronic data, related physical files, and payment responsibility can be completed.

While few and far between at present, new insolvencies are inevitable. So much was learned from the intense days from just a few years back, lessons from which we can develop new practices. The state guaranty fund system is tested and dependable. Consumers would be well-served by the strongest possible partnership between regulators and the guaranty funds.