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Another Perspective
Protect The Integrity Of State Guaranty Funds
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Property and casualty insurers and the mechanisms that support their consumers face quite a storm these days, and it's not coming from the usual places. This one originates on Capitol Hill and from state capitals, with the prospect of fundamentally transforming every aspect of p-c insurance – including the state guaranty fund system.

Since the multiple hurricanes that ripped through Florida in 2004 and the 2005 Gulf Coast catastrophe, insurance has taken its shots from all quarters. As a result, a philosophical struggle seems to have developed that threatens to redirect the p-c industry away from its risk-sharing principles until it resembles something more like a mechanism for transferring income.

Even guaranty funds are not immune to these pressures, finding themselves on the defensive over nonlegislative attempts to stretch the legal definition of covered claims to mitigate the tragedy of company failure.

While representing different ends of the regulatory spectrum, these sorts of disputes invite potentially significant downsides to the very consumers policymakers are pledged to protect.

It's easy to forget, but p-c insurance is based on a delicate public policy balance – one that allows property risk to be shared among millions of consumers under the supervision of state governments. A key to that balance is the state guaranty fund system, which has seamlessly paid out over $21 billion in statutorily covered claims to thousands of affected consumers since 1968.

Guaranty funds are the last line of defense for consumers. Critical to the array of protections is the solvency monitoring responsibilities of insurance regulators, who are intended to spot problems early on.

Underwriting restrictions, rate adequacy, loss mitigation and land-use regulations are also public-sector responses that affect an insurer's ability to meet contractual obligations to its customers.

What has to be carefully watched for, however, are unintended consequences that may result from intervention into – rather than oversight of – the everyday business of insurance. Such acts could tip the balance intended to produce affordability, availability and dependability for consumers.

Consider the shot across the bow from U.S. Senator Trent Lott, R-Miss., and U.S. Rep. Gene Taylor, D-Miss., who propose to eliminate the insurance industry's limited antitrust exemption under the McCarran-Ferguson Act – the decades-old foundation on which states have based their insurance regulatory structures. Sen. Lott is joined by Senators Patrick Leahy, D-Vt., and Arlen Specter, R-Pa., the chairman and ranking minority member of the Senate Judiciary Committee, respectively.

Assemblage of this formidable team of advocates suggests a serious attempt to at least get someone's attention, if not to actually get something done.

State officials are also acting. Florida has enacted a variety of measures, including an "anti-cherry-picking" provision requiring carriers that write auto insurance in Florida – but homeowners elsewhere – to also write homeowners policies in Florida. (The attorney general of Mississippi later suggested the same idea for his state.)

In addition, Florida called for a rate rollback to reflect potential savings to a carrier created by cheaper reinsurance made available through the state's subsidized hurricane fund. This latter initiative is characterized by The Wall Street Journal as "largely abandoning the insurance market in favor of a guarantee that, whatever happens, Florida taxpayers will cover the tab."

With hundreds of millions of dollars at stake in a major company failure, guaranty funds are smack in the middle of the "risk-sharing versus income-transfer" conflict.

If insureds can depend upon an ad hoc widening of the scope of guaranty fund coverages during administration of an insolvency, a purchaser's motivation to buy coverage from the most financially sound companies will be reduced, thereby increasing the pool of potential guaranty fund payees.

Property and casualty guaranty funds are creatures of state law. They exist specifically to pay covered claims promptly.

However, the face of insolvency is changing. Reflective of this change is that state guaranty association policyholder claims and adjustment expenses stood at just half-a-billion dollars in 1997 but totaled $7.9 billion between 2001 and 2005.

This wave of insolvencies was so powerful because it didn't come from the average personal- or small-business insurance consumer – for whom the system was designed to protect – but from carriers that wrote primarily commercial policies for sophisticated insureds, resulting in claims that were (and are) long-tailed, unpredictable and geographically broad.

But who actually pays these costs? Ideally, guaranty fund claims would be paid by distributions from remaining assets of the insolvent insurer company. Unfortunately, those assets are seldom sufficient, leaving a substantial amount of the cost to be footed by guaranty association assessments to insurers writing licensed business in the state where the fund operates.

Solvent carriers are then permitted to "recoup" these costs by various statutory mechanisms. This means that the more money guaranty funds pay out above their statutory obligation, the higher the burden on taxpayers and the insurance-buying public. This is why following statutory coverages matter.

As policymakers and the insurance industry engage on fundamental marketplace issues, a top priority should be assuring the integrity of the state-based p-c guaranty fund system. Legitimate public policy concerns ought to be addressed.

The National Conference of Insurance Guaranty Funds board of directors has outlined a series of policy recommendations that speak to the original mission of the guaranty fund system – including a net-worth ceiling, treatment of large deductibles and a reasonable cut-off period for claims against a guaranty fund.

To establish predictability for insureds, policyholders and claimants, it is imperative these and any other questions be resolved in the state legislatures responsible for public policies that allow the industry to compete in their states.

The era of mega-catastrophes and terrorism risk – not to mention political interest in the regulation of insurance markets – threatens to disturb the important policy balance that makes insurance work. It is critical to American consumers that it be preserved.