

**Workers Compensation Large  
Deductible Policies in  
Insurance Insolvencies:  
A Status Update**

**March 24, 2018**

**Receivership Large Deductible Workers  
Compensation (E) Working Group**

# The National Conference of Insurance Guaranty Funds

- Non-Profit Association of P&C Insurance Guaranty Funds in 50 states and D.C.
  - Active Since 1989
- Has Coordinated and Supported Member Guaranty Funds in More than 70 Insolvencies
  - Both Large Commercial Insolvencies, such as Reliance, Legion, Lumbermens (Kemper), and Castlepoint (Tower), Plus Smaller and Middle Market Insolvencies

# Your Presenters

- **Tom Streukens** – Chief Operating Officer, American Guaranty Fund Group (Florida P&C Guaranty Funds)
- **Rowe Snider** – Partner, Locke Lord LLP – Counsel to Various P&C Guaranty Funds
- **Barb Cox** – Senior Vice President, Legal and Regulatory Affairs, NCIGF

# Our Most Important Points

- Making LD Policies Work in Insolvency Helps Claimants, Policyholders, Liquidators, Guaranty Funds, and the Insurance Buying Public
- Certainty is Needed Through Statutory Definition of Rights and Responsibilities
- Assuring Appropriate Collateral for LD Obligations is Critical
- Guaranty Funds' Post-Liquidation Payment of Claims Enables Collection of LD Reimbursements.

# Charge for Large Deductible Working Group

- Study states' receivership laws and practices regarding receivership of insurers with significant books of large deductible workers' compensation business, and evaluate the need for a model act/rule, or amendments to existing models, that governs the rights and duties of the various parties regarding large deductible business in insolvencies, including, but not limited to, consideration of a provision that expressly permits the collection of large deductibles from insureds during an insolvency proceeding. Provide any other recommendations for possible enhancements to the U.S. receivership regime based on this study. Complete by the 2018 Fall National Meeting.

# **NCIGF's Assistance with the Charge**

- Provide NCIGF's Experience in Insolvencies with Large Deductible ("LD") Programs
- Benefits of Clarity Regarding Parties' Rights and Responsibilities in Administering LD Programs in Insurer Insolvencies
- Benefits of Appropriate Regulatory Assurances Policyholders Will Perform Their Financial Obligations in LD Programs (E.g., Collateral)

# Large Deductible Workers Compensation Programs

- Have Been Developed Innovatively During the Last 25 Years
  - Competition with Self-Insurance
- Indisputably Have an Important, Legitimate Role in the WC Insurance Marketplace
- Allows Policyholders to Assume Structured Financial Risk (Payment Obligation) in Return for Reduced Premiums and Frictional Costs

# How LD Policies Should Work:

- Standard Workers Compensation Policy
- Large Deductible Endorsement--Often for a Deductible of \$100,000 +
- Insurance Company Liable “First Dollar”
- Policyholder Reimburses Deductible Amount
- Often Include “Side Agreements” With Additional Arrangements on Various Matters, Such as Claims Handling and Funding



# **LD Programs are a Significant Part of the Workers Compensation Insurance Market**

# Policy Year Percentage of Total Premium

2011	22.5%
2012	21.4%
2013	21.2%

Source: NAIC 2016 LD Study, P. 7, based upon NCCI statistics (App. B.)

# Large Deductible Credit (Florida only)

Written Premium: \$2,919,728,907

Deductible Credits: \$1,406,305,986

Total Assessable  
Premium: \$4,326,034,893

- Deductible Credits are about 33% of the total Assessable Premium.

California: 36.3% of written premiums in 2013 were for large deductible programs with a deductible of at least \$100,000.

Source: Workers' Compensation Insurance Rating Bureau of California (WCIRB), quoted in the NAIC 2016 LD Study, at p.8 and See App. C.

## **Some Problems NCIGF Has Seen**

- Post-2008, Several Smaller or Middle-Sized Insurers Writing LD Programs Have Become Insolvent
- Unusual and Ineffective Underwriting/Program Documentation Practices
- Collateral Insufficient or Intermingled or in Control of MGA/Program Manager
- Claims Improperly Reserved

# Guaranty Funds & Large Deductibles

- Improper LD Policies Adversely Affect Liquidators, Guaranty Funds and Policyholders, Generally
  - LD WC policies are a “Dollar One” Insurer Liability
  - Guaranty Funds Thus Pay the Entire Claims (No Caps)
  - LD Premium Credits Reduce the Insurer’s Available, Liquid Assets to Reimburse Guaranty Funds, Potentially Increasing Insolvency Shortfall and Assessments
  - Estate has Only Insured’s *Uncertain Promise to Reimburse*
- *Generally, Post-Liquidation LD Reimbursements Would Be Uncollectible Without Guaranty Funds Paying LD Claims*

# Critical Questions Arise in Insolvency

- Who Collects the LD Reimbursements?
- Who Handles the LD Claims?
- What Happens to the Insured's Collateral?
- Who is Entitled to the LD Reimbursements?
- These Questions are Already Answered by Existing Law in Eleven States
- The Issues Are Also Addressed in the NAIC's Insurance Receivership Model Act (“IRMA”)

# Legislation in Various States

## *Eleven States Have Enacted Focused Legislation:*

1. California (CastlePoint)
2. Florida (GIC)
3. Illinois (LMC)
4. Indiana
5. Michigan
6. Missouri
7. Pennsylvania (Reliance)
8. New Jersey
9. Texas
10. Utah
11. West Virginia

See statutes at

<http://ncigf.org/policyleg>



# Common Elements of State Legislation

- Most are Detailed Statutes in the Insurance Liquidation Act
  - New Jersey and West Virginia Have Simplified Provisions in Their Guaranty Fund Acts
- All Enacted State Laws Provide the Guaranty Fund Paying a Post-Liquidation LD Claim is Entitled to the Related LD Reimbursement
  - Either From Collateral or Policyholder Payments

# IRMA Section 712

- New in the 2007 Rewrite of NAIC Model
- Receiver Collects All LD Reimbursements
  - Receiver Controls and Draws on Collateral
- Guaranty Funds Handle Claims
  - Unless Insured-Funded and Allowed by State Law
- Guaranty Funds Receive Reimbursements as Early Access Distribution, i.e., as Estate Asset
- While Portions of IRMA have Been Enacted, Section 712 has not Been Enacted Anywhere

# **Lessons Learned From Insolvencies Without a Statute -- Uncertainty**

- Can be a Source of Friction/Conflict Between the Guaranty Funds and the Liquidator
- Complicates and Can Frustrate Collection of LD Reimbursements, Especially Without Collateral
- Complicates Administration of Collateral and Increases Uncertainty and Conflict with Insureds
- Other Issues Can Arise, as Secondary Effects

# The Added Wrinkle: Professional Employer Organizations (“PEOs”)

- Are Deemed a “Co-Employer” with the “Borrowing” or “Worksite” Employer
- PEO Contractually Assumes Various Administrative and Compliance Functions of the Employer
- Most Often, PEO Maintains WC Coverage
- PEOs Provide Valuable Assistance to Smaller Businesses, Recognized in 2016 Study



# PEO Statistics & Facts

- **The current size of the PEO industry is between \$136 and \$156 billion, in gross revenues.**
- **PEOs provide services to between 156,000 and 180,000 small and mid-sized businesses, employing between 2.7 and 3.4 million people.**
- **There are between 780 and 980 PEOs currently operating in the United States.**
- **The PEO industry has grown significantly. In each of the last 30 years, the industry has added, on average, roughly 100,000 worksite employees and 6,000 net new clients.**

**Source:** <https://www.napeo.org/what-is-a-peo/about-the-peo-industry/industry-statistics>

# PEOs & WC In Insolvencies

- PEO's Often Have Large Deductible WC Policies
  - Up to \$1,000,000 Per Claim, Often with No Aggregate Limits
  - Sell Smaller Deductibles to Their Clients
  - PEO Retains Financial Risk on the Deductible “Gap”
- Collateral Posted Often Insufficient or Unavailable
  - Reserves Insufficient, Ultimate Losses Understated
  - Collateral Intermingled or In Control of a Program Manager or MGA
- Cross-ownership of PEO and MGA and/or TPA
- Examples Detailed in Katie School 2015 White Paper
  - [The Role of Large Deductible Policies for PEOs in the Failures of Small Workers' Compensation Insurers](#)

# **Workers Compensation Insolvencies 2008-2017**

**Total # of Insolvencies: 27**

**Total # of Claims: Approximately 35,000**

# Recent Insurance Company Failures with Significant PEO Policyholder Liabilities

<b>Date of Liquidation</b>	<b>Carrier Name</b>	<b>Guaranty Fund Exposure</b>
Nov-09	Park Avenue Property & Casualty	\$75 million
May-10	Imperial Casualty	\$40 million
May-13	ULLICO	\$385 million
Aug-14	Freestone (formerly Dallas National)	\$124 million
May-16	Lumbermens Underwriting Alliance	\$110 million
Nov -17	Guarantee Insurance Company	\$265 Million+ (Est.)



# Other Experience With LD Policies in Major Insolvencies

- Reliance (PA)
- Legion (PA)
- Lumbermens Mutual Casualty (Kemper) (IL)
- Lumbermens Underwriting Alliance (MO)

# NAIC 2016 LD Study

- Recommended, Among Other Things, that Large Deductibles be Addressed in Insolvency Laws. We Agree.
- Recommended Guaranty Fund Laws be Amended to Give Guaranty Funds a Claim for LD Reimbursements on Claims They Pay. We Agree.
- Recommended Steps be Taken to Assure Appropriate and Effective LD Collateralization. We Agree.

# One Possible Approach to Collateral

- NCIGF Has a Focused Model Statute Requiring Full Collateralization of Certain LD Policies
  - Applies to Insurers with Less Than \$ 200 Million in Surplus and a Best Rating of Lower Than A-
  - Per-Claim Deductible Limit Cannot Exceed 20% of the Policyholder's Net Worth on Audited Financials
  - Collateral Must be (i) a Qualified Surety Bond, (ii) an Irrevocable Letter of Credit, or (iii) Cash or Securities Held in Trust and Expressly Pledged as Security for LD Reimbursements, or a Combination of These.
  - Enacted in Illinois, *See* 215 ILCS 5/155.44, and in Oklahoma by Regulation.

# The Need for Proactive Liquidation Planning

- Guaranty Funds Always Seek Pre-Liquidation Planning, as NAIC has Recognized
- In a Complex Liquidation with LD WC programs, Such Planning is Urgently Needed *For Timely Wage & Medical Benefits*
  - Multiple General Agents and Claims Administrators
  - Issues with Transfer of Data/Claims Files
  - Cooperative Approach on LD Collection and Quick Action (Time Not on Our Side)

## To Learn More...

- Katie School: [The Role of Large Deductible Policies for PEOs in the Failures of Small Workers' Compensation Insurers](#)
- NCIGF: [NCIGF website](#) - General Information on P&C insolvencies

# Conclusion/Q&A

Rowe W. Snider

Partner

Locke Lord LLP

111 S Wacker Drive

Chicago, IL 60606

Phone: 312-443-0667

Fax: 312-896-6667

[rsnider@lockelord.com](mailto:rsnider@lockelord.com)



Barbara F. Cox

Senior Vice President-Legal & Regulatory Affairs

NCIGF

300 N Meridian Street, Suite 1020

Indianapolis, IN 46204

Work: 317-464-8189

Mobile: 317-679-9011

[bcox@ncigf.org](mailto:bcox@ncigf.org)



Tom Streukens

Chief Operating Officer

American Guaranty Fund Group

1400 Oven Park Drive

Tallahassee, FL 32317

Phone: 850-386-9200

Fax: 850-523-1887

[tstreukens@agfgroup.org](mailto:tstreukens@agfgroup.org)

