Guaranty Funds Safeguard Consumers When Insurance Companies Fail

Businesses and consumers purchase property and casualty insurance to protect themselves from financial losses arising out of a variety of possible damages, including fires, accidents, natural disasters, Workers' Compensation–covered injuries or liability to third parties due to negligent acts. But what if your insurer gets into trouble and fails? What happens to your claim then?

The good news is that when an insurance company fails, there's a safety net for the average policyholder: the state-based guaranty fund system. This system guarantees that claims will be paid up to the allowable limits set by state law, even when an insurer can't pay them. Here's how it works.

When an insurance company fails
When a court orders a troubled insurance company to suspend its business, finds the company insolvent and orders it to liquidate its assets, it is called liquidation. At liquidation, the court cancels all policies of the insolvent company.

The state insurance commissioner, or a representative, is appointed as receiver and begins the process of collecting assets and determining the company's outstanding liabilities. When this process is concluded, a final distribution is made to the company's creditors. This is almost always less than 100 percent of what is owed; usually thie final distribution is made several years after the company is ordered liquidated.

The role of the guaranty funds
Guaranty funds are non-profit organizations created by statute for the purpose of protecting policyholders from financial losses and delays in claim payments due to the insolvency of an insurance carrier. They do this by assuming responsibility for the payment of claims that otherwise would have been paid by the insurance company had it not become insolvent.

The coverage guaranty funds provide is fixed by the policy and state law and does not include a "replacement policy."

State law grants the authority to guaranty funds to provide two important benefits: prompt payment of covered claims and payment of the full value of covered claims up to the limits set by the policy and state law.

Once claims are transferred to the guaranty funds, their trained adjusters (sometimes assisted by contracted adjusters) review the claims, determine the amount of loss covered by the policy, and issue payments to the policyholder. While there may be some delay as the court proceeding and transfer of claims take place, every effort is made to get the policyholder claims paid as quickly as possible.

Most guaranty funds limit the amount they pay to the amount of coverage provided by the policy or $300,000, whichever is less. These coverage "caps" are fixed by state law;

the guaranty funds play no role in setting coverage caps. All guaranty funds pay 100 percent of their state's statutorily defined Workers' Compensation benefits. Limits on guaranty fund coverage are necessary to provide a safety net to those who would be most harmed by the insolvency of their insurance company, and to keep the cost of the safety net low.

The guaranty fund system is intended to serve as a limited backstop to protect average policyholders from insurance company failures that inevitably arise in competitive markets. Overall, the system ensures the sanctity and solidity of the insurance contract.

Protecting policyholders

The guaranty fund system is designed with support of the insurance industry to protect policyholders and claimants by providing benefits in a timely fashion when insurance companies fail.

Under guaranty fund statutes, policyholders essentially become "preferred creditors" to the extent defined by their claim. Policyholders not covered by a guaranty fund – large organizations, for instance – are still preferred creditors as to priority of distribution, but they will not see their claims paid as quickly as policyholders who are covered by a guaranty fund.

The state guaranty fund responsible for payment of the policyholder's covered claims is usually determined by the policyholders' state of residence; however, coverage of Workers' Compensation claims is usually the charge of the state of residence of the claimant.

Guaranty fund limits

When the court declares an insurer insolvent and puts it into liquidation, many of the policy claims are thereafter handled by the guaranty fund. Per the liquidation order, policyholders will have to find a new carrier for their future insurance coverage. Generally, they must find replacement coverage within 30 days of the date the company is liquidated.

Guaranty fund coverage may not be available to policyholders or claimants who have net worth over an amount established in their state's guaranty fund law; this is referred to as a "net worth exclusion." To determine net worth, claimants may be asked by a guaranty fund to provide some evidence of their net worth prior to the guaranty fund providing benefits.

Net worth exclusions reflect the public policy position that the guaranty fund system is squarely focused on helping the average citizen policyholder, which has long been the system's mission.

Most guaranty funds refund unearned premiums. An unearned premium claim is a policyholder's unearned portion of premium paid in advance and remaining on a policy term after cancellation. For example, with a six-month premium, at the end of the first month of the premium period, five-sixths of the premium is unearned by the insurance company. At the time of an insolvency, virtually all policyholders covered by the failed insurer will have an outstanding unearned premium claim.

Unearned premiums are generally calculated by the receiver and paid to policyholders by the guaranty fund.

Payment of unearned premium is subject to residency and net worth requirements.

What guaranty funds do not pay
The state insurance guaranty funds are designed as a safety net to pay certain claims of policies issued by licensed insurance companies. They do not pay non-policy claims or claims of self-insured groups, or other entities that are exempt from participation in the guaranty fund system.

In addition, some lines of business are typically excluded from guaranty fund coverage, such as surety bonds, warranty coverage, or credit insurance.

Guaranty fund coverage is limited to licensed insurers. Policyholders do not have guaranty fund coverage if the company is writing non-admitted or unlicensed products, such as surplus lines, or is a self-insurer covered in the non-admitted market.

Remaining flexible, marshaling claims data

In insolvencies where several state guaranty funds are impacted, the funds, with coordinating support from the National Conference of Insurance Guaranty Funds (NCIGF), will typically form a coordinating committee to serve as an intermediary between the guaranty funds and receivers to resolve any outstanding issues or challenges.

The guaranty funds also work with receivers to get money from the failed insurers. Distributions from insolvent companies vary from case to case. These estate distributions are instrumental in keeping the public cost for insurance insolvencies to a minimum.

Guaranty funds paid for by company assessments
Guaranty funds largely are funded by industry assessments, which are usually collected following insolvencies. These assessments raise funds to pay claims and administrative and other costs related to the guaranty fund involvement.

Assessments typically are capped at 2 percent of a company's net direct premium written in similar lines of business in the state of domicile the prior year, although in exceptional circumstances amounts can be increased by state legislatures. The other source of funding is recoveries from the estates of the insolvent insurance companies.

Guaranty funds' proven record of success
The property and casualty guaranty fund system remains healthy, flexible and resourceful, readily able to address current and emerging challenges. The proof the

system works is in the claims paid – about $35 billion to policyholders and beneficiaries related to nearly 600 insolvencies.

The guaranty fund system continues to deliver on the original public policy charter that industry and state lawmakers set when they created it nearly 50 years ago: the protection of policyholders.

The NCIGF: supporting the property and casualty guaranty funds
The National Conference of Insurance Guaranty Funds (NCIGF) is an Indianapolis, Indiana–based non-profit association that provides national assistance and support to the property and casualty guaranty funds located in each of the 50 states and the District of Columbia.

The NCIGF monitors and responds to issues related to the state-based guaranty funds. The organization serves as a trusted expert in guaranty fund policy and law, informing trade and other organizations as they develop model legislation that ensures smooth and efficient operation of the overall insurance resolution system.

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