>> Insolvency
TRENDS

National Conference of Insurance Guaranty Funds NCIGF[SM]

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

2017 SUMMER

GUARANTY FUNDS WORK

in partnership with insurance regulators and 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 the three sources made available at the time of 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

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.

HOUSE OF REPRESENTATIVES PASSES MAJOR REGULATORY REFORM PACKAGE

On June 8, 2017, the U.S. House of Representatives passed the Financial CHOICE Act, the House Republican alternative to the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA), which passed in 2010 in response to the global financial crisis.

The CHOICE Act, which passed on a near party-line vote, rolls back many key DFA provisions with regard to insurance, including consolidating the Federal Insurance Office with the Financial Stability Oversight Council (FSOC) Independent Member with Insurance Expertise, repealing FSOC's Title II nonbank designation and orderly liquidation authorities, and moving Covered Agreements to the Federal Register notice and comment process.

The CHOICE Act moves to the Senate, where it faces an uncertain fate. While Senate Banking Chairman Mike Crapo (R-ID) supports many provisions in the legislation, it is unlikely to receive the 60 votes needed to break a Democratic filibuster. The more likely path forward includes breaking the reform legislation into smaller, bipartisan pieces that can pass both bodies of Congress and make their way to the President's desk.

House Republicans are also exploring alternate vehicles to move select pieces of the CHOICE Act. Among other things, the Financial Services and General Government Appropriations bill, which passed out of the subcommittee at the end of June, removes FSOC's nonbank SIFI designation authority, abolishes the Office of Financial Research, and repeals the Volcker Rule, all items that were included in CHOICE. However, it is unlikely that a final spending bill containing these items will pass both the House and the Senate.

FSOC INDEPENDENT INSURANCE MEMBER

In a rare moment of bipartisanship, members of both the Senate Banking and House Financial Services Committees have agreed to legislation to allow FSOC's Independent Member with Insurance Expertise to serve past his stated term. Under current law, there is no definitive language on whether an acting member may fill the role upon completion of the appointment. An empty seat would leave the insurance industry without its only voting member on the Council. The term of Roy Woodall, the current Independent Member, is scheduled to expire in September. The recently announced legislation, introduced by Representatives Maxine Waters (D-CA) and Randy Hultgren (R-IL), as well as Senators Sherrod Brown (D-OH) and Mike Crapo (R-ID), would allow the Independent Member to stay on the Council for an additional 18 months, or until a successor is confirmed.

EXECUTIVE ACTION

President Donald Trump has released a number of Executive Orders and Presidential Memoranda, many of which have focused on financial regulation. One of the most significant, a February Executive Order on Core Principles for Regulating the U.S. Financial System, directed Treasury Secretary Steven Mnuchin to develop a series of reports identifying laws, regulations, and policies that inhibit federal regulation of the U.S. Financial System. The first report, which focused on the depository system, banks, and credit unions, was released in early June. Treasury has stated that three additional reports will be published, with the next two (capital markets, asset management and insurance) slated for a mid-September release.

Notably, Treasury's reports do not address Orderly Liquidation Authority or the Nonbank Designation Process, two areas important to the insurance industry and also targeted by President Trump's administrative action. Treasury appears to be saving these issues for separate reports, likely to be released in early to mid-October.

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

There have been two new property and casualty insolvencies so far this year. CastlePoint National, formerly the Tower Group, was ordered liquidated on March 30, 2017. The CastlePoint liquidation is a result of a cooperative effort among several state regulators to merge 10 different insurance companies into a single entity to be liquidated in California. Guaranty funds and the California Liquidation Office worked together during the transition period to ensure a seamless transition of Workers' Compensation and pharmacy benefits for claimants.

On May 31, 2017, the Missouri Department of Insurance obtained an order of liquidation against Galen Insurance Company. Galen was a small Missouri domestic insurer that wrote professional liability—medical malpractice—with some cyber liability coverage. The Missouri Department of Insurance worked hand-in-hand with the guaranty funds and Guaranty Support, Inc. (GSI), a subsidiary of NCIGF, to extract the relevant claim data from Galen's computer systems and send it to the affected guaranty associations within two weeks of the order of insolvency.

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 with estate liquidators to ensure that guaranty fund loss and expense payments are reported on a timely basis, and that 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. Several estates are cuing up distribution efforts for 2017.

RUN-OFF ACTIVITY

When a company wishes to exit a particular line of business it will often cease writing new policies and continue to pay on current liabilities until the claims are fully resolved, or "run-off." In the case of Highlands Insurance Company in Rehabilitation the company is financially troubled and has been placed into a rehabilitation proceeding under the supervision of the Texas Department of Insurance while it runs off its remaining liabilities.

Highlands Insurance Company, a Texas property and casualty insurer, licensed in 50 states and the District of Columbia, Guam and Puerto Rico, was placed into receivership on November 6, 2003. An order approving an Amended Plan of Rehabilitation was entered on June 6, 2008.

As of May 31, 2017, Highland's total assets were $117.2 million and its total liabilities were $296.9 million. The receivership continues to process claims under insurance policies issued by the company. As of March 31, 2017, there were 2,178 open proofs of claim. Of these, 1,765 were policy claims and 413 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 claim receipts, 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.

Division/Run-off Statutes – New Interest in States

Several years ago a "run-off" statute was enacted in Rhode Island[1]. This body of law allowed an insurance company to re-domesticate to Rhode Island and then "run-off" some of its liabilities. While it is an accepted practice for an insurer to run-off claims in a line of business it no longer wishes to write, the Rhode Island statute is somewhat unique in that it calls for classes of policyholders to vote on whether or not they are agreeable to the transaction. The plan may be implemented without all of the policyholders' consent. In addition, the statute calls for the business to be in some cases transferred to a different insurance entity, without recourse to the original insurer if the new entity would become insolvent and unable to pay claims.

The Rhode Island statute has been used once since it was enacted in 2002. This year, two other states, Oklahoma[2] and Connecticut, floated bills similar to the Rhode Island law. As of this writing, we are not aware of any final action on the Oklahoma bill. The Connecticut measure was adopted[3] and is now on the books in that state. We understand that interest in these types of arrangements may continue[4].

Large Deductible Legislation

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. Several states have enacted liquidation act amendments to deal with this issue. In 2017, two states enacted bills to codify the treatment of these programs in an insurance liquidation context: Florida and West Virginia. The Florida bill[5] follows the form of the NCIGF model legislation. West Virginia[6] added an amendment to its guaranty fund act to address deductible programs[7].

[1] See Rhode Island statutes § 27-14.5-1 et seq.
[2] See OK SB 606.
[3] See Connecticut HB 7025.
[4] For a study on related topics, see Alternative Mechanisms for Troubled Insurance Companies (NAIC 2009) at http://naic.org/store/free/AMT-OP.pdf.
[5] See Florida HB 837.
[6] See West Virginia HB 2683.
[7] For a complete list of states with large deductible statutes in place along with information about NCIGF model laws and other public policy information, see http://ncigf.org/policyleg.

AT THE NAIC: LARGE DEDUCTIBLE WHITEPAPER

The refresh of the 2006 Whitepaper 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)**

Several NAIC working groups are now giving consideration to implementing the recommendations embodied in the white paper. The Receivership and Insolvency Task Force has established a working group to study large deductible liquidation act legislation. We expect this working group to be active this fall.

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 January 2018.

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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