» Insolvency
# TRENDS
Summer 2016

National Conference of Insurance Guaranty Funds NCIGF

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

## GUARANTY FUNDS WORK
in partnership with insurance regulators 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 three sources made available at the time of the 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

## Welcome to the 2016 Summer issue of the National Conference of Insurance Guaranty Funds' (NCIGF) *Insolvency Trends*.

Authored by the legal and public policy staff of the NCIGF, the publication provides an update on recent events in insolvency law and practice and a look ahead at what is on the horizon.

### *See inside for…*

- International and other regulatory developments
- Insurance insolvency developments; new liquidations
- Updates on run-offs of troubled companies
- Developments in state insolvency laws

## 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.

## INTERNATIONAL REGULATORY GUIDANCE ON RESOLUTION PLANNING UNDERSCORES NEW APPRECIATION OF POLICYHOLDER PROTECTION SAFEGUARDS BY FSB

The Financial Stability Board (FSB) has finalized its guidance on resolution planning for Systemically Important Financial Institutions (SIFIs). The final document includes several notable changes, most of which respond to suggestions made in the comments submitted by the National Conference of Insurance Guaranty Funds (NCIGF) and the National Organization of Life & Health Insurance Guaranty Associations (NOLHGA).

The FSB first released a consultative document on resolution planning in November 2015. The NCIGF and NOLHGA commented in early January and the consultation was the topic of a meeting in Basel, Switzerland earlier this year in which NCIGF CEO Roger Schmelzer participated.

The FSB issued a press release on June 6, 2016 entitled, "Developing Effective Resolution Strategies and Plans for Systemically Important Insurers ('Guidance')". Per the FSB, this document "provides guidance on developing effective resolution strategies and plans for systemically important insurers. The Guidance should assist authorities in meeting the resolution planning requirement under the Key Attributes of Effective Resolution Regimes for Financial Institutions (*Key Attributes*) and support Crisis Management Groups (CMGs) of Global Systemically Important Insurers (G-SIIs) in their resolution planning work."[1]

[1] See the FSB press release, which includes further explanation and links to pertinent material by clicking here.

Overall, the outcome of the Guidance was favorable to the U.S. guaranty fund system:

- The Guidance now puts policyholder protection on par with financial stability. The consultative document said that “authorities should develop resolution strategies with the aim of maintaining financial stability and, to the fullest extent possible, protecting policyholders when an insurer fails.” The final version says: “Authorities should develop resolution strategies with the aim of maintaining financial stability and protecting policyholders to the fullest extent possible when an insurer fails.”

- The prior reference to policyholder protection scheme contributions to a solvent run-off has been deleted. The NCIGF made reference in its letter to the guaranty funds being considered “only as a source of funds” in the original FSB document.

- The Guidance now acknowledges that policyholder protection schemes may borrow from the private sector.

- The Guidance now recognizes that the availability and coverage levels of a policyholder protection scheme may be a relevant consideration when identifying the points of entry into resolution.

Resolution planning on the international level relates to the strategy to deal with an insurance company in a financially troubled situation. It can be compared to the system of rehabilitation and liquidation of insurance companies in the United States, a system enabled by various state laws. The focus in the U.S. system of insurance insolvency has always been policyholder protection. This is evidenced by longstanding state law, which puts policyholder claims ahead of other claims against the insolvent insurance company’s estate. Moreover, all states have, via state law, created guaranty funds that pay covered consumer claims promptly and without regard to remaining assets available from the estate. At this point it appears that consumer protection as an outcome of resolution planning is also being acknowledged at the international level.

Some view as significant the fact that the Guidance apparently recognizes that insurance companies are inherently different from banks in the manner in which companies can be resolved. The FSB press release notes that “Patrick Montagner, Chair of the FSB Cross-border Crisis Management Group for Insurers, and Deputy Secretary General of the French Autorité de Contrôle Prudentiel et de Résolution (ACPR) welcomed the publication of the Guidance, noting that ‘the Guidance recognizes that insures are fundamentally different from banks, but resolution planning is important for all systemically important financial institutions, including insurers. This Guidance if effectively applied will greatly improve authorities’ preparedness to manage and resolve a crisis affecting systemic insurers should this ever become necessary.’”

This development is a significant step forward in ensuring that policyholder protection continues to be a priority in the U.S. and becomes the standard worldwide.

A link to the FSB release and related materials is available by clicking here.

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

There have been two new insolvencies in 2016. Affirmative Insurance Company, an Illinois domestic property and casualty insurer, was placed into rehabilitation on September 16, 2015. The company was ordered into liquidation on March 24, 2016, with Anne Melissa Dowling, the Acting Insurance Commissioner of the State of Illinois, appointed as the liquidator. Affirmative's primary line of business was substandard auto. The company also wrote a small number of Workers' Compensation policies. At the time of liquidation, the company was licensed in 35 states. Approximately 14 guaranty associations were triggered as a result of Affirmative's liquidation.

On May 23, Lumbermen's Underwriting Alliance, a reciprocal inter-insurance exchange organized under the laws of the State of Missouri, was ordered into liquidation by the Circuit Court of Cole County, Missouri. The court appointed John M. Huff, Director of the Missouri Department of Insurance, Financial Institutions & Professional Registration, and his successors in office, as the statutory Receiver of Lumbermen's U.S. Epperson Underwriting Company. This company wrote mainly Workers' Compensation along with a small book of liability and property coverage.

## 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 together with estate liquidators to ensure that guaranty fund loss and expense payments are reported on a timely basis and legal documentation is in place to permit available funds to flow to the guaranty associations on an expedited basis.

In 2016, more than $72 million has been received so far in distributions.

## RUN-OFF ACTIVITY

### Highlands Insurance Company in Rehabilitation

Highlands Insurance Company, a Texas property and casualty insurer licensed in 50 states and the District of Columbia, was placed into receivership on November 6, 2003. An order approving an Amended Plan of Rehabilitation was entered on June 6, 2008. As of March 31, 2016, Highland's total assets were $132.6 million and its total liabilities were $316.3 million. The receivership continues to process claims under policies of insurance issued by the company. There are currently 1,965 open policy claims and 1,324 open non-policy claims. The receiver's staff is focusing its efforts on collection of assets from various sources including reinsurance, retro premium recoveries, subrogation, and from the release of special deposits. The receiver continues to monitor the Second Amended Plan of Rehabilitation. The guaranty associations are not currently triggered in this matter.

## IN THE STATES – 2016 TO-DATE

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.[2] Several states have enacted liquidation act amendments to deal with this issue.[3] In 2016, two states floated bills to codify the treatment of these programs in an insurance liquidation context.

- Legislation was enacted in Indiana (HB 1136)
- Legislation was unanimously passed through the legislature in Missouri (HB 1763) but was vetoed by the governor. The Missouri legislature is expected to take the matter up again in its September veto session.

Florida may be considering similar legislation in 2017.

In Illinois, legislation is pending to revise the priority of distribution of remaining assets from an insolvent estate. If enacted, the bill would call for property casualty administrative expense claims to be paid after the receivers' administrative expenses, but with a wide range of expenses paid at this new Level 2 priority. (See Illinois SB 2609)

### ALTERNATIVE WORKERS' COMPENSATION

The Oklahoma Insurance Guaranty Association (OIGA) was tagged to administer two new guaranty funds created to deal with insolvencies related to Workers' Compensation opt-out coverage. (These guaranty funds are separately funded and any payments would not come out of the OIGA's coffers.) This relatively new coverage created by Oklahoma statute offers an alternative to traditional Workers' Compensation policies and self-insurance. Recently, the opt-out mechanism was determined to be unconstitutional by the Oklahoma Workers' Compensation Commission. In Jonnie Vasquez v. Dillard's, the commission determined that "although at first blush it appears that the Opt-Out Act requires that injured workers under an authorized benefit plan must be afforded benefits equal to or better than those under the Administrative Workers' Compensation Act, this is decidedly not so. A closer look at the statutorily authorized plan requirements reveals that the benefit plans permitted to be used to opt-out establish a dual system under which injured workers are not treated equally."[4]

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[2] See for example Oklahoma v. Staffing Concepts, CIV-12-409-C; U.S. District Court for the Western District of Oklahoma. January 24, 2014
[3] For a complete list please see http://ncigf.org/policyleg.
[4] Vasquez v. Dillard's, COMMISSION FILE NO.: CM- 2014-110601; February 26, 2016 available by clicking here.

## AT THE NAIC

### WORKERS' COMPENSATION (E) TASK FORCE

The Workers' Compensation (E) Task Force is spearheading a refresh of the *NAIC 2006 Workers' Compensation Large Deductible Study.* We anticipate this document will be released for public comment in the near future. The focus of this update is practical issues relating to high deductible Workers' Compensation programs and recommendations for addressing these complex insurance products. Look for a final product from the NAIC in 2016.

### MODEL ACTS WORKING GROUP

The NAIC "Model Acts Working Group" spearheads development of NAIC model law on insurance insolvency matters. Most recently the group has been focused on developing a short list of liquidation act provisions that would make the national system work better and have the tools it needs to deal with the insolvency of a Systemically Important Financial Institution (SIFI). We expect deliberations on this matter to continue at the August NAIC meeting.

## TO 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 2017.

**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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