Insolvency TRENDS

Winter 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

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

Welcome to the 2016 Winter 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 $27 billion to policyholders, beneficiaries, and claimants related to more than 550 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.

GUARANTY FUNDS (POLICYHOLDER PROTECTION SCHEMES) IN THE INTERNATIONAL FINANCIAL STABILITY DEBATE

International issues and the way they are ultimately addressed in the international forum can shape how insurance companies in the United States do business in the future. Many companies point to the property and casualty guaranty fund system in the U.S. as a solid regulatory and consumer protection backstop. The existence of this proven system with a 40-year history of effective insurance consumer protection is an important link in the nation's commitment to policyholder protection. We anticipate that regulatory focus on resolution in the upcoming year will ensure the guaranty funds will be more in the public eye than ever.

Here's a run-down on recent developments on the federal regulatory front and how they may affect the guaranty funds.

In January, the Financial Stability Board (FSB) convened an invitation-only workshop to discuss insurance resolution matters. Representatives of the NCIGF and its life and health guaranty fund counterpart, The National Organization of Life & Health Insurance Guaranty Associations (NOLHGA) were on hand to educate workshop participants about the U.S. guaranty fund system and its policyholder protection charge. The event was the U.S. guaranty system's first opportunity to be directly involved in the international standard setters' resolution activities. The event gave the organizations the opportunity to showcase to policymakers the U.S. guaranty fund system and its policyholder benefits. The presentation emphasized:

1. U.S. guaranty funds stabilize consumer behavior and can mitigate "run on the bank" behavior.

2. U.S. guaranty funds focus on policyholder protection; they do not bail out companies.

3. The U.S. guaranty fund system has deep experience in resolving (or in some cases, averting the need to resolve) failing insurers. In addition, U.S. guaranty funds are not simply payment mechanisms, but provide useful perspectives and ideas, drawing upon past experiences.

4. The U.S. guaranty funds can handle Systemically Important Financial Institution (SIFI) failures. While a U.S.-styled guaranty fund system is not the solution for every problem of each Global Systemically Important Insurer (GSII), there will be companies for which the guaranty fund system's effective resolution mechanism will substantially address the resolution challenge.

The NCIGF made similar points in written comments to the FSB regarding a consultation paper titled "Developing Effective Resolution Strategies and Plans for Systemically Important Insurers." Our comments can be viewed by clicking here.

FEDERAL AFFAIRS

POLICYHOLDER PROTECTION ACT OF 2015

On December 18, 2015, as part of the year-end omnibus appropriation bill, Congress passed the Policyholder Protection Act. The Act serves to clarify three important points related to state insurance regulators' authority:

- State regulators historically have had the authority to "wall off" insurance company assets designated from insurers' affiliates to benefit policyholders. While this authority has been expressly recognized in the context of traditional insurance holding company and bank holding company systems, the law governing savings and loan holding companies does not contain the same recognition. *The Act clarifies that state regulators have the same "walling off" authority, regardless of holding entity type.*

- Under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, if a state regulator fails to initiate a receivership within 60 days of a determination that the failure of that insurer will destabilize the economy, the Federal Deposit Insurance Corporation (FDIC) may step in and initiate such proceedings in accordance with state law. As originally adopted, Dodd-Frank appears to permit the FDIC to initiate *liquidation* proceedings if the state regulator has only initiated *rehabilitation* proceedings. *The Act corrects a drafting error by adding rehabilitation as a state regulatory action that would avoid FDIC back-up authority, allowing the state to choose the appropriate resolution process.*

- The FDIC previously adopted a rule that requires the FDIC to consider the impact on policyholders of the insurance company before taking a lien against an insurance company's assets. The FDIC must notify state insurance regulators before taking any such lien and consult with them on the impact to policyholders. The Act codifies this rule.

2016 CONGRESSIONAL ACTIVITY

Congressional committees continue to conduct oversight hearings or undertake reports; several are expected to continue their focus on the Financial Stability Oversight Council's (FSOC) systemic determinations, the Federal Reserve, and international standard setting. And with international standard setters turning to resolution policy issues, the Congressional oversight spotlight could move there as well.

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

There were two new insolvencies in 2015. Both are Pennsylvania-domiciled companies. The Regis Insurance Company, a Pennsylvania domiciled company, was liquidated on October 30. Remaining claims were predominantly in Pennsylvania. The Lincoln General Company, a company that had been in run-off for some time was liquidated on November 5. Also a Pennsylvania domicile, Lincoln had open claims throughout the country at the point of liquidation.

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 2015, distributions of $749.4 million were received by the property and casualty guaranty funds. These are related to 36 active insolvencies.

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. On June 6, 2008, Highlands was placed into rehabilitation under the Second Amended Plan of Rehabilitation. The property and casualty insurance guaranty associations have not been triggered. As of September 30, 2015, Highlands had total assets of $147.9 million and total liabilities of $330.8 million. The receiver continues to pursue recovery of money owed to the Highlands estate, including reinsurance and policyholder deductibles. The receiver also continues to pay claims under policies of insurance issued by the company. There are 4,067 open claims. Of these claims, 2,078 are policy claims and 1,359 are non-policy claims. Six hundred forty-eight of the policy claims are workers' compensation claims.

IN THE STATES – 2015 ROUNDUP

CALIFORNIA (AB 822) – This bill provides that the laws governing the California Insurance Guarantee Association (CIGA) do not require a final determination of a claim in an insolvent insurer's liquidation proceeding before a covered claim may be submitted to CIGA. The bill would ensure that these laws do not require a claim to be first determined and approved by the liquidator before CIGA pays and discharges a covered claim. The bill would also provide that if the association supplies written denial of a non-workers' compensation claim, the person asserting the claim against the association has one year to bring an action challenging the denial, including an action for declaratory relief. This bill would also require, if the written denial is based on a failure to exhaust other insurance available to pay the claim, a claim be reasserted against the association within six months after all other insurance has been exhausted. This bill has been adopted.

CONNECTICUT (HB 6868) – This legislation raises the covered claim cap to $500,000. It includes assumed business in the definition of covered claim, but excludes claims issued by surplus line insurers, risk retention groups and self-insurers and group self-insurers. The bill has been enacted.

FLORIDA (SB 165) – A bill has been enacted to eliminate the prohibition on advertising for guaranty association coverage. Guaranty fund limits must be part of the disclosure.

FLORIDA (HB 836) – A bill revising the Florida Insurance Guaranty Association assessment process has been enacted.

ILLINOIS (SB 1782) – This new law provides that if the Illinois Insurance Guaranty Fund pays a covered claim without the exhaustion of other coverage, the fund shall have an independent right of recovery against each insurer whose coverage was not exhausted. It provides that the extent of the fund's subrogation rights and any other rights of reimbursement with respect to its covered claims payments shall be determined independently by taking into account the fund's independent rights of recovery. The bill has been enacted.

ILLINOIS (SB 1805) – Illinois adopted legislation to manage certain large deductible arrangements encountered in insolvent companies. The new law would revise the insurance code to call for minimal collateral requirements for certain insurers writing such programs and strengthen requirements for policyholder eligibility to qualify to purchase large deductible policies. The bill has been enacted.

ILLINOIS (SB 1781) – The bill calls for guaranty fund obligations on policies for excess of self-insured retention to be subject to the covered claim cap. It has been enacted.

ILLINOIS (SB 1806) – Provides that the board of directors of the Illinois Insurance Guaranty Fund shall submit a financial report to the Director of Insurance no later than April 30 (previously March 30) of each year. The bill has been enacted.

NEVADA (SB 67) – The bill adds coverage for assumed business when the obligation becomes a direct obligation of an insolvent insurer through a novation. The bill has been adopted.

ANTICIPATED FOR 2016

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. Recent insolvencies have made it clear that the complex issues that arise in large deductible programs are best dealt with by statutory clarification.[1] This activity is expected next year:

- More proposals on deductible collateral similar to a law enacted in 2015 in Illinois; this type of law is of interest in jurisdictions such as Florida.
- More legislation to clarify rights and obligations of various parties in insolvencies when large deductible programs are part of the claims portfolio – Indiana and Missouri have introduced bills.

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.* An exposure draft was released for comment; comments were due on January 19. 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

At this point the working group's focus has changed from efforts related to the Insurer Receivership Model Act (IRMA) to conducting a survey of liquidation laws in place in the various states in order to evaluate their consistency with the Financial Stability Board's October 2014 *Key Attributes of Effective Resolution Regimes for Financial Institutions.* Survey results are now in. Comments have been submitted; they address:

---

[1] For an in-depth look at the issues that arise in high deductible insolvencies, see James Jones' ***The Role of Large Deductible Policies for PEOs in the Failures of Small Workers' Compensation Insurers.*** It is available on the Katie School website by clicking here.

1) Recommendations for specific areas of existing state receivership laws and practices that should be improved; and,

2) Any related recommendations for improvement that the Working Group should consider, including recommendations for enhancing consistency between states' receivership laws.

Click here to view the NCIGF/ NOLHGA joint comments.

TO LEARN MORE…

More information about the property and casualty guaranty fund system is available on our Website at http://www.ncigf.org

Look for a new issue of NCIGF's *Insolvency Trends* in July 2016.

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.

National Conference of Insurance Guaranty Funds (NCIGF)
300 N. Meridian St.
Suite 1020
Indianapolis, IN 46204