

NCIGF Recommendations to Deal with Large Deductible and PEO Insolvency Matters

Problems encountered in recent PEO insolvencies include inadequate collateral to secure deductible policy obligations, co-mingling of collateral with assets of the insurance company, deductible amounts inappropriate for either the PEO policyholder, the PEO client or both, collateral under the control of a third party rather than the insurance company and PEO insolvency simultaneous to the insurance company insolvency. All of these issues create a situation where the guaranty funds pay large liabilities with little possibility of significant distribution of assets. We have also encountered situations where there is extensive litigation on matters clearly addressed by our model large deductible statute such as the receiver's right to make collections of deductible amounts.

The Public Policy Committee has developed a package of recommendations. The specific recommendations are as follows:

- 1) Consider adoption of the attached language relating to financial requirements for large deductible agreements for workers' compensation insurance. (see attached legislation.) This language would be placed in the state codes within the general provisions governing insurance companies.
- 2) Consider a change to the NAIC accounting rules to add the following: "Any insurer that has an A. M. Best Company rating below A- and does not have at least \$200 million in surplus must fully collateralize all liability it has for workers compensation claims covered under large deductible policies issued to Professional Employer Organizations. Any liability it has in excess of the collateral must be fully reflected in its financial statement." (for reference see attached SSAP 65)
- 3) Require auditors to evaluate the credit worthiness of policyholders where their liability to reimburse the insurer for large deductible payments is unsecured.
- 4) Enact in the states the NCIGF Large Deductible Model Legislation that governs rights and duties of the various parties regarding deductible business in insolvencies (Copy of 8-13 Adopted model attached.)
- 5) Upon recommendations of the guaranty association (based on its detection and prevention powers) suggest regulators conduct a special examination of a PEO insurer which is in possible hazardous financial condition. Such examination would be conducted by a special examiner with expertise in this business and would be paid for by the guaranty association.
- 6) In states that do not already have this language, enact provisions from the NCIGF Model Guaranty Association Act permitting the collection of deductible amounts from insureds. This language is as follows:

“The Association shall have no cause of action against the insured of the insolvent insurer for any sums it has paid out except such causes of action as the insolvent insurer would have had if such sums had been paid by the insolvent insurer.”

TEMPLATE STATUTE ON FINANCIAL REQUIREMENTS

Financial requirements; large deductible agreements for workers' compensation insurance.

(a) Any insurer, as defined in subsection (b) of this Section, shall:

(1) Require full collateralization of the outstanding obligations owed under a large deductible agreement, as defined in subsection (c) of this Section, by using one of the following methods:

(A) a surety bond issued by a surety insurer authorized to transact business by the [local department of insurance or similar regulatory authority] and whose financial strength and size ratings from A.M. Best Company are not less than "A" and "V", respectively;

(B) an irrevocable letter of credit issued by a financial institution with an office physically located within the State and the deposits of which are federally insured; or

(C) cash or securities held in trust by a third party or by the insurer and subject to a trust agreement, for the express purpose of securing the policyholder's obligation under a large deductible agreement, provided that if such assets are held by the insurer those assets are not commingled with the insurer's other assets; and

(2) limit the size of the policyholder's obligations under a large deductible agreement to 20% of the total net worth of the policyholder at each policy inception, as determined by an audited financial statement as of the most recently available fiscal year end.

(b) For purposes of this Section, the term "insurer" means any insurer authorized to issue a workers¹ compensation policy covering risks located in this state that (1) has an A.M. Best Company rating below A- and (2) has less than \$200,000,000 in surplus.

(c) The term "large deductible agreement" means any combination of one or more policies, endorsements, contracts, or security agreements, which provide for the policyholder to bear the risk of loss of a specified amount per claim or occurrence covered under a policy of workers compensation insurance, and which may be subject to the aggregate limit of policyholder reimbursement obligations.

(d) Except when approved by the Director of Insurance, any insurer found to be in a financially hazardous condition pursuant to [state code provisions applicable to financially troubled companies or companies in rehabilitation or liquidation] or the equivalent in any other state is prohibited from issuing or renewing a policy that includes a large deductible agreement.

(e) This Section applies to large deductible agreements issued or renewed by any insurer on or after [date]

Section 99. Effective date. This Act takes effect on [].

DRAFT TEMPLATE STATUTE ON FINANCIAL REQUIREMENTS

ADDENDUM: Change paragraph (c) to read as follows:

The term “large deductible agreement” means any combination of one or more policies, endorsements, contracts, or security agreements, which provide for the policyholder to bear the risk of loss of ~~a specified amount~~ \$100,000 or greater per claim or occurrence covered under a policy of workers compensation insurance, and which may be subject to the aggregate limit of policyholder reimbursement obligations.

High Deductible Policies

34. Certain policies, particularly workers' compensation coverage, are available under high deductible plans. High deductible plans differ from self insurance coupled with an excess of loss policy because state laws generally require the reporting entity to fund the deductible and to periodically review the financial viability of the insured and make an assessment of the suitability of the deductible plan to the insured.

35. The liability for loss reserves shall be determined in accordance with SSAP No. 55. Because the risk of loss is present from the inception date, the reporting entity shall reserve losses throughout the policy period, not over the period after the deductible has been reached. Reserves for claims arising under high deductible plans shall be established net of the deductible, however, no reserve credit shall be permitted for any claim where any amount due from the insured has been determined to be uncollectible.

36. If the policy form requires the reporting entity to fund all claims including those under the deductible limit, the reporting entity is subject to credit risk, not underwriting risk. Reimbursement of the deductible shall be accrued and recorded as a reduction of paid losses simultaneously with the recording of the paid loss by the reporting entity.

37. If the reporting entity does not hold specific collateral for the policy, amounts accrued for reimbursement of the deductible shall be billed in accordance with the provisions of the policy or the contractual agreement and shall be aged according to the contractual due date. In the absence of a contractual due date, billing date shall be utilized for the aging requirement. Deductible recoverables that are greater than ninety days old shall be nonadmitted. However, if the reporting entity holds specific collateral for the high deductible policy, ten percent of deductible recoverable in excess of collateral specifically held and identifiable on a per policy basis, shall be reported as a nonadmitted asset in lieu of applying the aging requirement; however, to the extent that amounts in excess of the 10% are not anticipated to be collected they shall also be nonadmitted.

38. The financial statements shall disclose the amount of reserve credit that has been recorded for high deductibles on unpaid claims and the amounts that have been billed and are recoverable on paid claims.

39. Refer to the preamble for further discussion regarding disclosure requirements.

Asbestos and Environmental Exposures

40. Asbestos exposures are defined as any loss or potential loss (including both first party and third party claims) related directly or indirectly to the manufacture, distribution, installation, use, and abatement of asbestos-containing material, excluding policies specifically written to cover these exposures. Environmental exposures are defined as any loss or potential loss, including third party claims, related directly or indirectly to the remediation of a site arising from past operations or waste disposal. Examples of environmental exposures include but are not limited to chemical waste, hazardous waste treatment, storage and disposal facilities, industrial waste disposal facilities, landfills, superfund sites, toxic waste pits, and underground storage tanks.

41. Reporting entities that are potentially exposed to asbestos and/or environmental claims shall record reserves consistently with SSAP No. 55.

42. The financial statements shall disclose the following if the reporting entity is potentially exposed to asbestos and/or environmental claims:

- a. The reserving methodology for both case and IBNR reserves;

NCIGF Model Large Deductible Legislation

Section 712. Administration of Large Deductible Policies and Insured Collateral

This section shall apply to workers' compensation large deductible policies issued by an insurer subject to delinquency proceedings under this chapter; however, this section shall not apply to first party claims, or to claims funded by a guaranty association net of the deductible unless paragraph B. of this section applies. Large deductible policies shall be administered in accordance with their terms, except to the extent such terms conflict with this section.

A. Definitions. For purposes of this section:

- (1) "Large deductible policy" means any combination of one or more workers compensation policies and endorsements issued to an insured, and contracts or security agreements entered into between an insured and the insurer in which the insured has agreed with the insurer to:
 - (a) Pay directly the initial portion of any claim under the policy up to a specified dollar amount, or the expenses related to any claim; or
 - (b) Reimburse the insurer for its payment of any claim or related expenses under the policy up to the specified dollar amount of the deductible.

The term "large deductible policy" also includes policies which contain an aggregate limit on the insured's liability for all deductible claims in addition to a per claim deductible limit. The primary purpose and distinguishing characteristic of a large deductible policy is the shifting of a portion of the ultimate financial responsibility under the large deductible policy to pay claims from the insurer to the insured, even though the obligation to initially pay claims may remain with the insurer. A large deductible shall include any policy with a deductible of fifty thousand dollars or greater.

Large deductible policies do not include policies, endorsements or agreements which provide that the initial portion of any covered claim shall be self-insured and further that the insurer shall have no payment obligation within the self-insured retention. Large deductible policies also do not include policies that provide for retrospectively rated premium payments by the insured or reinsurance arrangements or agreements, except to the extent such arrangements or agreements assume, secure, or pay the policyholder's large deductible obligations.

- (2) "Deductible claim" means any claim, including a claim for loss and defense and cost containment expense (unless such expenses are excluded), under a large deductible policy that is within the deductible.

- (3) “Collateral” means any cash, letters of credit, surety bond, or any other form of security posted by the insured, or by a captive insurer or reinsurer, to secure the insured’s obligation under the large deductible policy to pay deductible claims or to reimburse the insurer for deductible claim payments. Collateral may also secure an insured’s obligation to reimburse or pay to the insurer as may be required for other secured obligations.
- (4) “Commercially Reasonable” means, to act in good faith using prevailing industry practices and making all reasonable efforts considering the facts and circumstances of the matter.
- (5) “Other secured obligations” means obligations of an insured to an insurer other than those under a large deductible policy, such as those under a reinsurance agreement or other agreement involving retrospective premium obligations the performance of which is secured by collateral that also secures an insured’s obligations under a large deductible policy.

B. Handling of Large Deductible Claims.

Unless otherwise agreed by the responsible guaranty association, all large deductible claims, which are also “covered claims” as defined by the applicable guaranty association law, including those that may have been funded by an insured before liquidation, shall be turned over to the guaranty association for handling. To the extent the insured funds or pays the deductible claim, pursuant to an agreement by the guaranty fund or otherwise, the insured’s funding or payment of a deductible claim will extinguish the obligations, if any, of the receiver and/ or any guaranty association to pay such claim. No charge of any kind shall be made against the receiver or a guaranty association on the basis of an insured’s funding or payment of a deductible claim.

C. Deductible claims paid by a guaranty association.

To the extent a guaranty association pays any deductible claim for which the insurer would have been entitled to reimbursement from the insured, a guaranty association shall be entitled to the full amount of the reimbursement, and available collateral as provided for under this section to the extent necessary to reimburse the guaranty association. Reimbursements paid to the guaranty association pursuant to this subsection shall not be treated as distributions under [cite to priority distribution statute] or as early access payments under [cite to early access statute].

To the extent that a guaranty association pays a deductible claim that is not reimbursed either from collateral or by insured payments, or incurred expenses in connection with large deductible policies that are not reimbursed under this section, the guaranty association shall be entitled to assert a claim for those amounts in the delinquency proceeding.

Nothing in this subsection limits any rights of the receiver or a guaranty association that may otherwise exist under applicable law to obtain reimbursement from insureds for claims payments made by the guaranty association under policies of the insurer or for the guaranty association's related expenses, such as those provided for pursuant to [insert cite to guaranty association net worth provision], or existing under similar laws of other states.

D. Collections

- (1) The receiver shall have the obligation to collect reimbursements owed for deductible claims as provided for herein, and shall take all commercially reasonable actions to collect such reimbursements. The receiver shall promptly bill insureds for reimbursement of deductible claims:
 - (a) Paid by the insurer prior to the commencement of delinquency proceedings;
 - (b) Paid by a guaranty association upon receipt by the receiver of notice from a guaranty association of reimbursable payments; or
 - (c) Paid or allowed by the receiver.
- (2) If the insured does not make payment within the time specified in the large deductible policy, or within sixty (60) days after the date of billing if no time is specified, the receiver shall take all commercially reasonable actions to collect any reimbursements owed.
- (3) Neither the insolvency of the insurer, nor its inability to perform any of its obligations under the large deductible policy, shall be a defense to the insured's reimbursement obligation under the large deductible policy.
- (4) Except for gross negligence, an allegation of improper handling or payment of a deductible claim by the insurer, the receiver and/or any guaranty association shall not be a defense to the insured's reimbursement obligations under the large deductible policy.

E. Collateral.

- (1) Subject to the provisions of this subsection, the receiver shall utilize collateral, when available, to secure the insured's obligation to fund or reimburse deductible claims or other secured obligations or other payment obligations. A guaranty association shall be entitled to collateral as provided for in this subsection to the extent needed to reimburse a guaranty association for the payment of a deductible claim. Any distributions made to a guaranty association pursuant to this subsection shall not be treated as distributions under [Insert state insurance liquidation priority distribution statute] or as early access payments under [Insert state early access statute]

- (2) All claims against the collateral shall be paid in the order received and no claim of the receiver, including those described in this Subsection, shall supersede any other claim against the collateral as described in Subsection (4) of this Section.
- (3) The receiver shall draw down collateral to the extent necessary in the event that the insured fails to:
 - (a) Perform its funding or payment obligations under any large deductible policy;
 - (b) Pay deductible claim reimbursements within the time specified in the large deductible policy or within sixty (60) days after the date of the billing if no time is specified;
 - (c) Pay amounts due the estate for pre-liquidation obligations
 - (d) Timely fund any other secured obligation; or
 - (e) Timely pay expenses.
- (4) Claims that are validly asserted against the collateral shall be satisfied in the order in which such claims are received by the receiver.
- (5) Excess collateral may be returned to the insured as determined by the receiver after a periodic review of claims paid, outstanding case reserves and a factor for incurred but not reported claims.