>> Insolvency
TRENDS

National Conference of Insurance Guaranty Funds NCIGF℠

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

2018 WINTER

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 $35 billion to policyholders, beneficiaries, and claimants related to more than 600 insolvencies.

Following a 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.

NCIGF CEO SELECTED AS NORTH AMERICAN REPRESENTATIVE TO THE INTERNATIONAL FORUM OF INSURANCE GUARANTEE SCHEMES EXECUTIVE COMMITTEE

Roger Schmelzer, President of the National Conference of Insurance Guaranty Funds (NCIGF), has been selected as the North American representative to the Executive Committee of the International Forum of Insurance Guarantee Schemes (IFIGS).

Schmelzer, who has led the NCIGF for 11 years, will be joined on the IFIGS Executive Committee by representatives from Greece, Kenya, Romania, Spain and Thailand.

The IFIGS facilitates and promotes international cooperation between insurance guarantee schemes and other stakeholder organizations with an interest in policyholder protection. The IFIGS is made up of 24 full and associate members, 22 of which are Insurance Guarantee Schemes (IGSs) from Africa, Asia, Europe and North America. There are more than 30 IGSs worldwide.

IGSs explore mechanisms for protecting policyholders of insurance companies that fail. Many IGSs provide expertise in stabilization or restructuring resolutions, and all IGSs can provide expertise and some form of insurance protection and/or financial support to assist in the liquidation of an insolvent insurer.

The National Organization of Life and Health Insurance Guaranty Associations (NOLHGA), the NCIGF's life and health insurance guaranty fund support organization counterpart, is also a member of IFIGS.

"Over the four-plus decades of its existence, the U.S.' policyholder protection system has learned a lot about insurer resolutions, and Roger is the ideal person to convey to our international colleagues the valuable lessons that we have learned," said Peter Gallanis, President of NOLGHA.

"The U.S. property and casualty guaranty fund system has paid more than $35 billion in claims resulting from about 600 insurer insolvencies for five decades," said Schmelzer. "Our affiliation with IFIGS allows the NCIGF and NOLHGA to share our policyholder protection experience with the international insurance regulatory community."

Schmelzer noted the efforts of the NCIGF and NOLHGA as part of IFIGS have already made a difference, citing the recent version of the resolution-related elements of the International Association of Insurance Supervisors' (IAIS) Insurance Core Principles (ICPs), which underscore the primacy of policyholder protection and the importance of pre-insolvency cooperation and collaboration between the guaranty system and receivers.

"Working with IFIGS members to help elevate protection of the policyholder and claimant to the same level of consideration as financial stability by international regulators is a huge accomplishment," he said. "The risk management marketplace is highly competitive. The customer, industry and economy are best served when the insurance promise is secured. I'm enthusiastic about working with our global partners to further advance that objective."

A TREND TOWARD AN ACTIVITIES-BASED APPROACH TO SYSTEMIC RISK EVALUATION

Over the past few months, both domestic and international bodies have taken meaningful steps to move toward an activities-based approach for systemic risk evaluation. The Treasury Department and its Federal Insurance Office (FIO), the International Association of Insurance Supervisors (IAIS), and the Financial Stability Board (FSB) have collectively moved away from entity-based evaluations, focusing more on the activities and products of an institution when evaluating systemic risk, rather than simply looking at size.

On the domestic side, Treasury has released multiple insurance-related reports in response to Executive Orders and Presidential Memoranda issued by President Trump last year. In late October, the Department released its third of four reports relating to Core Principles for Regulating the U.S. Financial System, this time focusing on the insurance and asset management industries. The report contained a section-by-section analysis of key insurance initiatives, with legislative and administrative recommendations to improve the overall system for businesses and customers.

Overall, the report focused on a strengthening of the state-based system and better coordination between states and federal regulators. But, again, the biggest takeaway for many who follow the industry was the recommendation that insurance regulators focus on activities-based systemic risk evaluations, moving away from an entity-based approach. Significantly, Treasury notes that while Financial Stability Oversight Council (FSOC) is the primary body for identifying and addressing systemic risks, states are the primary regulators of the industry, and that the work should be done in close coordination with state regulators and stakeholders.

Additionally, in November Treasury released a report on FSOC nonbank designation processes, continuing the Departmental momentum of a shift to an activities-based approach to financial stability. While assessing and addressing the potential risks to financial stability posed by a nonbank financial company, the report recommends FSOC look at the institution's activities and products, while working with state insurance regulators to address any potential risks.

Internationally, in late November the FSB, in consultation with the IAIS, announced that it had decided not to publish a new list of global systemically important insurers (G-SIIs) for 2017, adding that the policy measures from the 2016 communication will continue to apply to firms listed in 2016. The announcement also welcomed and encouraged the recent IAIS work on an activities-based approach to determining systemic risk in the insurance sector, noting the potential implications on G-SII identification and policy when the activities-based approach has been developed.

Both domestically and abroad, there is clearly a substantial shift toward an activities-based approach to systemic risk evaluation. As the process moves from theory to implementation, policymakers and stakeholders will be watching how that policy shift intersects with existing and contemplated state regulatory initiatives.

NEW INSOLVENCIES IN 2017: THE PROPERTY AND CASUALTY GUARANTY FUNDS CONTINUE TO PROTECT CLAIMANTS

There were five new property and casualty insolvencies in 2017:

CastlePoint National Insurance Company, Galen Insurance Company, Millers First Insurance Company, IFA Insurance Company, and Guarantee Insurance Company.

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 and the process went smoothly. This estate brought approximately $900 million in liabilities to the guaranty fund system.

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 insolvency brought about new claims for handling by guaranty associations in three states: Illinois, Missouri and New Jersey. Initial liability reserves were about $4 million.

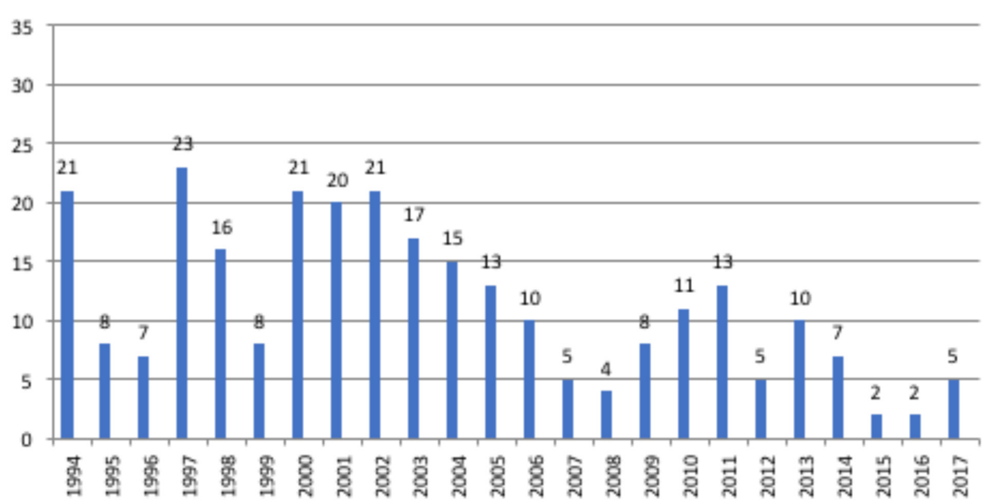
On August 30, 2017, Millers First Insurance Company, a small Illinois domiciliary insurer, was placed into insolvency. Millers First wrote primarily Workers' Compensation policies in 14 states. The company sent fewer than 100 claims, mostly Workers' Compensation, to the guaranty funds.

IFA Insurance Company, a New Jersey domiciled company licensed to write property and casualty insurance, was declared insolvent on May 4, 2017. IFA provided private passenger auto insurance to New Jersey, Pennsylvania, Delaware and Maryland residents.

On November 27, 2017, Guarantee Insurance Company was ordered into liquidation, triggering coverage from more than 30 guaranty funds. A Florida domicile, the company wrote primarily Workers' Compensation, and a significant portion of this business was written on a high-deductible basis.

Anticipated liabilities for this estate total about $263 million.

Number of Property & Casualty Insolvencies 1994-2017



ESTATE DISTRIBUTIONS

An important component of the guaranty funds' ability to pay claims of insolvent insurance companies promptly 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 be expedited to the guaranty associations.

In 2017, more than $256 million was received in distributions.

RUNOFF ACTIVITY

When a company chooses 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 runoff. 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.

The receiver's staff is focusing its efforts on the 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/RUNOFF STATUTES – NEW INTEREST IN STATES

Several years ago a run-off statute was enacted in Rhode Island. This body of law allowed an insurance company to re-domesticate to Rhode Island and then runoff some of its liabilities. While it is an accepted practice for an insurer to runoff claims in a line of business it no longer chooses 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[1], 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. The Connecticut measure was adopted[3] and is now on the books in that state. The Oklahoma bill went through a study group process over the summer; we may see more activity on this proposal in Oklahoma in the 2018 session. We understand that interest in these types of arrangements may continue.

1: See Rhode Island statutes § 27-14.5-1 et seq.
2: See Oklahoma SB 606.
3: See Connecticut HB 7025.

LARGE DEDUCTIBLE LEGISLATION

Many recent insolvencies have involved a large portfolio of Workers' Compensation large deductible business. In these complex programs, the insurer 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[4] follows the form of the NCIGF model legislation. West Virginia[5] added an amendment to its guaranty fund act to address deductible programs[6]. We expect to see Florida float a bill to institute certain collateral requirements for some companies writing large deductible business.

AT THE NAIC:

The Receivership Model Law Working Group (RMLWG) was busy in 2017 designing amendments to the Model Life and Health Guaranty Fund Act to address long term care programs. The amendments propose to add Health Maintenance Organizations (HMOs) to the assessment and coverage base of the Life and Health model act. We expect that the NAIC will have considered adoption of these amendments at a special conference call scheduled for December 2017.

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, and
- Unique concerns of professional employer organizations (PEOs)

Several NAIC working groups are now giving consideration to implementing the recommendations embodied in the whitepaper. 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 in 2018.

4 See Florida HB 837.
5 See West Virginia HB 2683.
6 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.

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 July 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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