



TESTIMONY FOR THE RECORD
OF
THE NATIONAL CONFERENCE OF INSURANCE GUARANTY FUNDS
BEFORE THE
HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON INSURANCE, HOUSING AND
COMMUNITY OPPORTUNITY
HEARING ENTITLED
“INSURANCE OVERSIGHT AND LEGISLATIVE PROPOSALS”
NOVEMBER 16, 2011

While they may not know it, American insurance consumers are protected by a nationwide system of insurance guaranty associations (sometimes also called “guaranty funds”). State lawmakers and insurance regulators formed this system over 40 years ago to pay the claims of the average property/casualty and life/health/annuity insurance policyholder if an insurance company fails. The safety net operates in every state and territory and is coordinated by two national entities – the National Conference of Insurance Guaranty Funds (NCIGF) and the National Organization of Life & Health Insurance Guaranty Associations (NOLHGA). NCIGF is pleased to submit the following testimony regarding the state based property/casualty insurance guaranty system to the House Financial Services Committee, Subcommittee on Insurance, Housing and Community Opportunity. NOLHGA is submitting similar testimony describing the life/health/annuity guaranty system.

THE CURRENT SYSTEM OF INSURANCE RECEIVERSHIP

To understand the property/casualty insurance safety net, it is important to understand some of the fundamentals of state insurance receivership. Just as insurance companies are regulated almost entirely at the state level, insurance receiverships are administered by the insurance commissioner of the state where the company is chartered – in effect, its state of incorporation – pursuant to the insurance receivership laws of that state, and under the supervision of a court in that state. The insurance receivership laws in each state have as a primary goal to make sure that a failed insurer's policyholder obligations are honored to the greatest extent possible. The guaranty funds work with state receivers to ensure that this happens quickly and efficiently.

HOW THE PROPERTY/CASUALTY INSURANCE GUARANTY SYSTEM WORKS

How the Guaranty Fund System is Structured.

Generally speaking, every state and the District of Columbia have a property/casualty fund created by state law, overseen by the state's insurance regulator, and typically operated as a non-profit association.¹ Each property and casualty insurance company licensed to do business in that state is required by state statute to be a member of the guaranty fund. Typically, a guaranty fund is governed by a board of directors, drawn mostly from the fund's member insurance companies. Some guaranty funds also have public members when mandated by statute.

A state guaranty fund manager (often assisted by staff) delivers the policyholder protections required by statute, working in coordination with the receiver of the failed insurer. Although most guaranty funds are subject to the supervisory oversight of their state insurance commissioner, they are not generally² or in any meaningful sense operated by state government, and they do *not* have a role (even in their own states) in monitoring or policing the solvency of insurers. Similarly, guaranty funds almost never serve as the receiver of a failed insurer.

Protection for consumers generally is provided by the guaranty fund of the state where the consumer resides or, in the case of property insurance, where the property is located. Each guaranty fund responds to an insolvency by paying claims of the residents of that fund's state, regardless of where the failed company may have been domiciled, regulated, or placed in receivership.

How the Guaranty Fund System Protects Policyholders.

The nationwide property/casualty insurance guaranty system honors the contractual commitments made by failed insurers to their *policyholders*. The safety net does not provide liquidity support to failed (or failing) insurers, nor does it protect their general creditors.

Guaranty funds are "triggered" once a state court finds that an insurance company is insolvent and orders it into liquidation. Once that occurs, the receiver of the failed company physically transfers the claim files (either in paper or electronic form) to the state's guaranty fund. Essentially, the guaranty fund "steps into the shoes" of the insolvent company to pay claims consistent with a state's insurance code and, by law, policyholders are at the "head of the line" of an estate's creditors. Covered policyholders are paid promptly by means of the guaranty association mechanism.

¹ Several states have separate guaranty mechanisms to provide protection in respect of certain specific types of benefits or programs, such as workers' compensation insurance.

² The form of most insurance guaranty funds is that of a special, non-governmental, not-for-profit entity established by specific state enabling legislation. However, in four states (Arizona, Arkansas, New York and Pennsylvania), at least some elements of the guaranty mechanism are operated as part of state government

When an insurer fails, there are two overriding policyholder concerns addressed by existing public policy– (1) the continuation of the insurance coverage that the policyholder has lost as a result of the insurer's failure and (2) payment of valid outstanding claims.³

The answer to the first concern is fairly straightforward; in a competitive insurance marketplace, consumers can find another company to underwrite a potential loss. Policyholders who do not have a claim pending with the failed carrier do not need significant protection from the guaranty fund system; they need only purchase a new insurance policy. In most states the guaranty funds cover claims for unearned premium, thereby helping policyholders pay for replacement coverage.

The second concern – payment of claims – is the core responsibility of the guaranty system and is much more than simply writing checks to policyholders with claims. Guaranty fund representatives adjust the pending claims, just as claims adjusters in a solvent company would do. This requires insurance claims specialists qualified to analyze contract duties under the law of their state, analyze bodily injury claims and assess liability as well as the litigation risk associated with the claim.

Each state's law establishes the coverage for the residents of its state. Nearly all states have guaranty fund laws adapted to local conditions by each state legislature from the model property/casualty guaranty fund statutes promulgated by the National Association of Insurance Commissioners (NAIC). Guaranty funds pay covered claims within the limits set by individual state laws and the insurance contract. Typically, the claim limit for personal injury and property damages is \$300,000 on covered claims, with some states covering as much as \$500,000 to \$1,000,000. Notably there is one state with a covered claim cap of \$5 million. (Nine states provide limits higher than \$300,000, and eight states and territories have somewhat lower limits.) Most guaranty funds pay 100% of statutorily-defined workers' compensation benefits. Claim caps allow the system to have sufficient money to pay claims and ensure “capacity” needed to serve all claimants. Guaranty funds play no role in setting coverage caps.

³ Under insurance liquidation laws, virtually all property and casualty insurance contracts are cancelled within thirty days of the date of liquidation, leaving the guaranty funds responsible for the adjudication and payment of claims that had accrued prior to liquidation and thirty days thereafter.

How the Guaranty Fund System is Funded.

Guaranty funds do not have the same immediate funding requirements that banks require because of the long-term nature of many insurance obligations. State laws require guaranty funds to pay claims “promptly,” but many claims become due, and consequently are paid out, over a period of several years. By design, guaranty funds draw from several sources of funding to pay claims:

- The assets remaining in the insurance company, including those from ongoing reinsurance collections, which can be made available to the guaranty funds on an expedited basis. These assets are usually substantial and provide the primary source of funding guaranty fund payments to consumers in most insolvencies.⁴
- Statutory deposits that may have been collected in some states to secure the insurance company’s claim payment obligations.
- Assessments collected from member insurance companies.

This funding mechanism was designed to use as much of the failed company’s remaining cash as possible. The guaranty funds levy assessments on viable insurance carriers only to the extent that a shortfall remains after the available estate assets have been exhausted. In that case, the state guaranty fund assesses the healthy insurers who do business in that state, up to annual statutory limits, typically 2% of net direct written premium in the year prior to the assessment. The amount of the assessment is determined by the amount of money needed by the guaranty fund to supplement the initial sources of funding.

The guaranty fund system delivers on its policyholder protection mission economically. Nationwide, annual guaranty fund general operating expenses are about \$66 million, with a staffing level of approximately 650 employees. The fact that guaranty funds deliver maximum consumer protection at a low cost is underscored by the system’s overall operating costs when contrasted with those of the insurance industry. Research by the NCIGF shows that historically, the Loss Adjustment Expenses and General Operating Expenses of guaranty funds were on par with those of the insurance industry.

National Coordination – The Role of NCIGF. The protections provided by as many as 50 or more property/casualty guaranty funds are coordinated through the National Conference of



⁴ Estate assets typically are sufficient to cover 55-65% of policy level claims in property and casualty insolvencies.

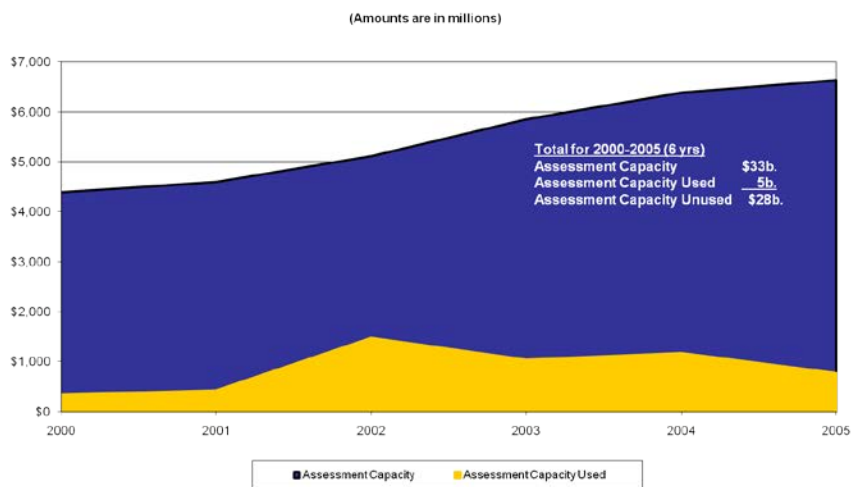
Insurance Guaranty Funds, a 501(c)(6) not-for-profit organization incorporated in Illinois and based in Indianapolis, Indiana and made up of independent property and casualty insurance guaranty funds in every state and the District of Columbia. NCIGF does not pay claims, but rather coordinates the multi-state claims-paying activities of its member guaranty funds, monitors litigation that may affect guaranty funds, coordinates with the property and casualty insurance company trade associations on state legislative matters, conducts education and training seminars for guaranty funds, provides financial information concerning the guaranty system, serves as a clearinghouse of relevant information, and provides a national forum for discussion and liaison with the NAIC and insurance receivers.

HISTORY OF DEPENDABLE CONSUMER PROTECTION

The existing property/casualty insurance guaranty system has a proven track record of protecting policyholders. Since the early 1970s, the guaranty system has provided protection to policyholders in more than 550 cases of insurer insolvencies, paying a total of approximately \$27 billion in claims and expenses. The insurance guaranty system has met all of its obligations and promptly provided protection to all consumers for whom they are responsible in each and every case of insurer failure.

During the heaviest period of insolvency activity – 2000-2005 – the guaranty fund system paid out \$10 billion against assessment capacity of about \$33 billion. Of that \$10 billion paid, \$5 billion came from the insolvent companies' assets and statutory deposits.

**Property & Casualty Insurance Guaranty Fund System
Period of Heavy Insolvency 2000-2005
Assessment Capacity and Assessment Capacity Used**



Today, the overall assessment capacity of the property and casualty guaranty fund system is about \$6.7 billion, renewable every year. Reliance on assessments to pay claims has never exceeded 35 percent of capacity in a single year. When assessment capacity is laid on top of estate assets (again, the primary funding source for guaranty fund payments) and statutory

deposits, the guaranty system has more than ample funding available to handle multiple large insolvencies – especially considering the often long-term nature of insurance obligations.

**THE GUARANTY SYSTEM IS PREPARED TO DEAL
WITH FUTURE INSOLVENCIES**

The nationwide network of property/casualty insurance guaranty funds has proven extremely effective at achieving its principal mission — the protection of policyholders. As with any effective organization, the insurance guaranty system has evolved over the years and operates with a high level of cooperation, coordination, and consistency that comes only with experience.

NCIGF has also evolved over the years into a national coordinating mechanism that has established effective and credible working relationships with both insurance regulators and industry members. NCIGF employs a complete complement of full-time staff professionals who are well versed in the technical and practical complexities inherent in any insolvency.

The resources and coordination NCIGF provides helps minimize costs by facilitating a national response plan for protecting policyholders in multi-state insolvencies. This coordination of effort also reduces the length of time it takes to respond to a multi-state insolvency and provide policyholders their statutorily prescribed benefits.

While NCIGF serves as the national coordinating body for protecting policyholders, its individual guaranty fund members are aware of and sensitive to local circumstances and respond quickly to the concerns of resident policyholders when an insolvency occurs. The volume of calls and letters from concerned policyholders is understandably high in the aftermath of an insolvency. Individual guaranty fund staffs respond quickly to explain coverage benefits and the claim submission and payment process; provide status reports; and resolve specific inquiries. NCIGF's member funds understand their states' tort law and court systems and how to adjudicate claims promptly and efficiently. For these reasons, the existing insurance guaranty system is able to enjoy the operational efficiencies of a national system, while effectively responding to the often-local concerns of insurance consumers experiencing financial and other stresses associated with the failure of their insurance company.

Given its significant experience, operating efficiency, and credibility, the current state-based insurance guaranty system is prepared to fulfill its statutory duty: protection of the nation's insurance consumers from future insolvencies of property/casualty insurers.

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NCIGF and NOLHGA have worked together the past several years to educate Congress, federal agencies, and other policy and decision makers about the insurance consumer safety net. We appreciate this opportunity to continue that effort.

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