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THE NATIONAL CONFERENCE OF INSURANCE GUARANTY FUNDS

**The National Conference of Insurance Guaranty Funds:
After 40 Years the P/C Guaranty Fund System Thrives**

After nearly 40 years, the nation's property and casualty guaranty funds system remains strong, adaptable and true to its original intent of protecting policyholders by stepping in to pay covered claims of insolvent insurers.

That word comes from the National Conference of Insurance Guaranty Funds (NCIGF), a nonprofit national association that provides support and coordination to the state property and casualty guaranty funds.

"Since the guaranty fund system was established by industry and state lawmakers nearly four decades ago, it has performed well, meeting its obligations by paying claims to policyholders, beneficiaries and claimants when insurance companies fail," said Roger H. Schmelzer, president & CEO of the NCIGF.

"For all the challenges the guaranty fund system has met with along the way, it continues to work well and sustain a critical safety net for policyholders."

What are "The funds"?

The property and casualty guaranty funds make up a privately funded, non-profit, state-based system that pays outstanding claims of insolvent insurance companies.

The guaranty fund system has paid more than \$24 billion in claims.

Guaranty funds are active in every state, the District of Columbia, Puerto Rico and the Virgin Islands. State laws require that all licensed property and casualty insurance companies be members of and protected by the guaranty funds in every state where they are licensed to do business.

A guaranty fund system also exists for the life, health and annuity insurance industry; but it operates independently from the property and casualty system.

"No business is free from the threat of failure; insolvencies are unfortunate and inevitable in a competitive industry such as property/casualty insurance," Schmelzer said. "When failures occur, guaranty funds step in to cover claims, either within policy amounts or limits set by state laws. Without the guaranty fund system most claimants would receive only a small fraction of what they were owed under the insurance policy."

The Guaranty Funds: How they work

The failure of an insurance company is administered differently than other business bankruptcies. This is because insurance is regulated by the states and failures are not governed by federal bankruptcy law.

When an insurance company becomes insolvent and is unable to pay outstanding claims, a state's courts and the insurance commissioner begin a legal process to determine appropriate action for the company.

There are several approaches a commissioner might take with a troubled company. He or she might opt for conservation, a judicial proceeding that gives the commissioner direct control over the assets of an insurer. Another step a commissioner might take prior to liquidation is placing the company into rehabilitation. Under rehabilitation the commissioner takes title to insurers' assets, and closely supervises the company with the view toward rehabilitating it.

The "last resort" option is liquidation. During liquidation the commissioner or a representative becomes the receiver of the company's "estate." The receiver marshals the company's assets, determines liabilities and begins distributing assets to the estate's creditors. Current policies are cancelled, and policyholders are notified and directed to seek coverage elsewhere.

Enter the guaranty funds

But liquidation does not halt the obligation to pay outstanding claims against the company. Instead, it triggers involvement of the guaranty funds in all states where the insolvent insurer is licensed to transact its insurance business. The guaranty funds step into the shoes of the insolvent company to pay the covered claims of each state's residents. The funds pay claims to policy amounts or limits set by state law.

In this way, guaranty funds ensure covered claimants and policy beneficiaries are among the first to be paid. Guaranty funds free claimants from having to wait several years for what likely would be only a fraction of the claim amount they would receive were it not for the funds.

Covered within statutory limits

State statute determines coverage limits of the guaranty fund system. This means the guaranty funds pay claims at the policy amount or within statutory limits, whichever is lower: that is, "caps," fixed by the state.

Limits vary from state to state. Typically the claim limit is \$300,000 except for workers compensation claims that are paid in full. A small minority of states have limits that are above or below the \$300,000 threshold.

These caps, which were established in the early days of guaranty funds, reflect the original intent of the system: to protect individuals and small businesses – those potentially hardest hit by insolvencies. Caps enable the guaranty fund system to ensure sufficient funds, or "capacity," needed to serve all claimants.

Funded by assessments

Guaranty funds have a claim against the insolvent estate for their claim payments, and can often get access to such funds that are available on an accelerated basis. However, estate assets, which are almost always not readily available when the guaranty fund mechanism is first activated, often are not sufficient to pay guaranty fund obligations in full.

For this reason, guaranty associations are empowered by state law to obtain needed funds through mandatory assessments on the insurance industry. These assessments raise funds to pay claims and administrative and other estate-related costs.

Assessments and the means of collecting them vary from state-to-state. Generally, assessments are levied against solvent companies that write similar types of policies in the guaranty association's state. Usually annual limits on assessments are about two percent of business written, although the amount varies depending on funding requirements. Assessment costs are recouped by various means.

Challenges in a “new era” of insolvencies

Schmelzer says the origin of many of the system's challenges is a “new era” of insolvencies that has strained the system, especially over the past 10 years. Challenges to the guaranty fund system began to mount in the 1980s, an active period of insolvencies among insurers, many of which wrote large amounts of commercial insurance.

“The guaranty fund system was originally designed by state policymakers to cover straightforward, simple lines or personal and homeowners business. It wasn't designed to handle the kinds of large and complex multi-state commercial products that now make up a growing segment of the property and casualty business,” Schmelzer said.

Although there have been recent changes in the insolvency landscape, the property and casualty guaranty fund system remains healthy, flexible and resourceful, readily able to address current and emerging challenges.

“Those who express doubts about the guaranty fund system often fail to see the impressive proven record of its success over its history,” Schmelzer said. “The proof is in the claims paid: about \$24 billion to policyholders and beneficiaries.

“Despite challenges, the guaranty fund system continues to deliver on the original public policy charter industry and state lawmakers set for it nearly 40 years ago: the protection of policyholders by paying claims.”

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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, Puerto Rico and the District of Columbia.

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