

## INSOLVENCIES...AN OVERVIEW

*The following information is intended to provide only a basic overview of the insolvency process and guaranty fund laws. It is not intended to provide individual or legal advice on a specific situation. For questions about your specific situation, please consult with your state guaranty association and/or legal counsel.*

### Introduction

Businesses and consumers purchase property and casualty insurance to protect themselves from financial losses arising out of a variety of risks and perils, including such things as fires, accidents, natural disasters, worker's compensation injuries, or liability to third parties due to negligent acts. What happens though, when the company responsible to pay those claims becomes impaired (operating in a financially hazardous manner) or becomes insolvent (its assets are not sufficient to pay its policy claims) and as a result, cannot meet its policy obligations?

### Troubled Companies

Each state has a regulatory agency, usually called the State Department of Insurance, which is responsible for monitoring the financial health of companies authorized to do business in the state. When the Commissioner of Insurance determines a company is in financial trouble, he is empowered by law to take appropriate steps to protect the policyholders and claimants of the company. Depending upon the severity of the problem, the Commissioner can take a variety of corrective actions. These may include an *Order of Supervision*, an *Order of Suspension*, an *Order of Rehabilitation*, or an *Order of Liquidation*.

In an *Order of Supervision*, the Commissioner can require the company to take specific corrective steps, or to obtain the Commissioner's approval before it undertakes certain transactions. Usually, an Order of Supervision alone does not result in changes to policies issued by the company or the payment of claims.

Using an *Order of Suspension*, the Commissioner can order the company to stop all or a portion of its business in the state.

The Commissioner may request a state court to issue an *Order of Rehabilitation* in situations where the problems are more severe or where the Commissioner believes it appropriate for the protection of the policyholders and creditors. In these situations, the Commissioner is appointed as the Rehabilitator of the company, and is given the authority to manage the company until the problems are corrected. In his/her capacity as Rehabilitator, the Commissioner takes ownership and control of the company's books, records, and assets, and assumes all powers of the company's directors, officers, and managers. The Commissioner has broad discretion to take whatever corrective actions he/she believes appropriate, subject to oversight by the court. Once the problems are resolved, control can be turned back over to the company.

If the Commissioner does not believe the problems can be corrected and that continued operation of the company would be harmful to the company's policyholders and creditors, he can seek an *Order of Liquidation* from a state court. Under the Order of Liquidation, the Commissioner is appointed as Liquidator. The Liquidator will then appoint a Receiver to manage the Liquidation process.

### The Liquidation Process

After the court issues the Order of Liquidation, the Receiver and his/her staff take possession of the company's offices, records, equipment and assets. A notice is sent to all policyholders and claimants informing them of the company's liquidation and the steps they must take in order to file a claim against the company's estate. The policyholders and claimants will also be informed that a guaranty association may handle the future processing of claims and that their insurance policy will be cancelled at a specified date.

### Guaranty Associations

Guaranty associations are non-profit organizations created by statute for the purpose of protecting policyholders from severe financial losses and delays in claim payment due to the insolvency of an insurance carrier. They do this by assuming responsibility for the payment of claims that would otherwise have been paid by the insurance carrier, had it not become insolvent. However, only certain types of claims are eligible for coverage, and there are certain limits on how much the guaranty association will pay per claim and in the aggregate per policy.

Each state has one or more guaranty association, with each association handling certain types of insurance. Insurance companies are required to be members of the state guaranty association as a condition of being licensed to do business in the state. Guaranty associations obtain funds for their operations and payment of claims through assessments against the solvent insurance companies licensed to do business in the state and from the recovery of amounts paid on claims from the insolvent estate.

There are different types of guaranty associations. Some guaranty associations handle only claims related to life and health insurance. Some deal only with property and casualty insurance claims. Others address only worker's compensation claims or other special lines of insurance.

The remaining information in this website will discuss only property and casualty and worker's compensation guaranty associations.

For additional information on life and health guaranty associations, please visit the website of the National Association of Life and Health Guaranty Associations ([NOLHGA](#)) or your state life and health insurance guaranty association webpage.

Although guaranty association laws are generally similar from state to state, significant differences do exist. For this reason, it is important to determine which state guaranty association has responsibility for your claim, because this can affect where your claim must be filed, the type of claim that is covered, and the maximum amount the guaranty association can pay for a covered claim.

### Frequently Asked Questions

Q: My company is in rehabilitation and my claim has not been paid. Will the guaranty fund pay my claim?

A: Usually not. The provisions of the state guaranty laws in most states apply only when a state court issues an Order of Liquidation with a finding of insolvency.

Q: If my company is in liquidation, which state guaranty association should I contact with questions regarding my claim?

A: In most instances, the guaranty association for your state of residence will be responsible for your claims. However, if your claim relates to property located in another state, that state's guaranty association will generally have responsibility for the claim.

Q: Will the guaranty association cover all claims that would have been covered under my policy?

A: No. Although most policy claims will be covered, certain types of claims, for example, claims for punitive damages, or amounts in excess of your policy limits, will not be covered. Additionally, the maximum amount of coverage available is capped at a certain amount. This amount differs from state to state, with the most common limit being \$300,000. In any event, the amount of coverage provided by a guaranty association will be the *lesser of* the policy limits or the maximum amount provided in the state guaranty fund statute. Many guaranty associations apply a deductible, usually \$100, which is subtracted from the amount paid on a claim. A claim for less than \$100 will not be paid in these states.

Q: What requirements have to be met in order for my claim to be covered by a guaranty association?

A: To be covered by a guaranty association, a number of conditions must be met. At a minimum, the claim must:

- 1) Be unpaid- that is, the claim must not have been previously paid by the insurance carrier or other party.

- 2) Exist before the insolvency or arise within 30 days after the Order of Liquidation- the claim must arise while the policy is still in force.
- 3) Be on a policy written by an insolvent insurer that was licensed to do business in the state, and in a line of business covered by the guaranty association- policies sold by companies that are not members of the guaranty association are not covered.
- 4) Be brought by a claimant or insured who is a resident of the state- only claims brought by residents or insureds of the state, or where the claim relates to property located in the state, are covered by the state guaranty fund.
- 5) Be filed with the guaranty association before the claims cut off date- most guaranty associations establish a claims cut-off date. Your claim must be filed before that date in order to be covered.
- 6) Not be covered by other insurance- if there is other insurance from which your claim can be paid, you must first exhaust that coverage before the guaranty fund will pay any portion of the claim.

Q: What happens if the amount of my claim is larger than the maximum amount paid by the guaranty association?

A: If the amount of your claim exceeds the maximum limits of the state guaranty association, you may file a claim for the unpaid portion with the Liquidator.

Q: Do I need to file my claim with both the Liquidator and the guaranty fund?

A: The claims filing process differs from state to state. In some states, you need only file a claim with the Liquidator and it is automatically considered to be filed with the guaranty association. In other states, it is necessary to file the claim separately with the Liquidator and the guaranty association. For this reason, it is important that you carefully read all information you receive and follow the instructions you are provided. If in doubt, you should contact your state guaranty fund.

Q: Can I file my claim with more than one guaranty fund?

A: The state guaranty association system is intended to assign a given claim to only one guaranty association. In rare instances, it may be possible that one association has primary responsibility for a claim, and another state guaranty association has secondary liability. In such cases it may be possible to file a claim with both associations, but in any event, the total amount paid cannot exceed the amount of coverage provided under your policy.

Q: How long will it take for the guaranty fund to pay my claim?

A: The amount of time it takes for a guaranty association to pay a claim can vary widely depending upon a number of factors, but claim payments usually begin as soon as possible following the Order of Liquidation. A period of 60-90 days is not uncommon. Many insurance carriers have their claims processed by a Third Party Administrator (TPA). If this is true with your claim, the amount of time needed to get all claim information might be extended as files are gathered from TPAs and transmitted to the guaranty associations.

Q: Before my company went into liquidation, it was defending me in a lawsuit brought under my policy. What will happen now?

A: If the company is already defending the case, the guaranty association will take control of the case and will continue to defend or negotiate a settlement on your behalf. The defense and amount of coverage provided will be on the same terms and conditions provided for in your policy. However, once the guaranty fund pays the policy limits, it may no longer be obligated to continue providing a defense and will not pay any additional amounts above your policy limits.

Q: Am I covered by a state property and casualty guaranty association if I purchased my policy from an unlicensed carrier or a managed care plan?

A: No. Guaranty associations cover only licensed insurers. Companies not licensed in the state, surplus lines carriers, managed care plans, preferred provider organizations (PPOs), Health Maintenance Organizations (HMOs) and self insured plans are not covered under the property and casualty guaranty association statutes. If you purchased coverage from one of these entities, and the company is now insolvent, you may file a claim with the Liquidator. There may also be other guaranty associations that may provide coverage for policies issued by these types of organizations. Your state Department of Insurance can provide you additional information.

Q: How can I find out if my company was licensed in my state?

A: Check with your state Department of Insurance. They should have a listing of all admitted companies.

Q: If my insurance company is insolvent, why isn't it in bankruptcy?

A: Insurance is a state regulated industry and many federal statutes, including bankruptcy laws, do not apply to them. When an insurance company becomes insolvent, the company's estate is administered the

Commissioner of insurance, as Liquidator, and overseen by the state court.

Q: If my policy has been terminated as a result of my company's Order of Liquidation, will the guaranty association provide me a new policy?

A: No. The purpose of the guaranty association is to protect policyholders and claimants from losses due to unpaid claims of policies issued by the insolvent insurance company. Guaranty funds cannot sell insurance policies. To obtain new coverage, you will need to contact a licensed insurance carrier or an insurance agent or broker.