» Insolvency
TRENDS
Summer 2015

National Conference of Insurance Guaranty Funds NCIGF

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

GUARANTY FUNDS WORK

in partnership with insurance regulators 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 three sources made available at the time of the 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

Welcome to the 2015 Summer issue of the National Conference of Insurance Guaranty Funds' (NCIGF) *Insolvency Trends*.

Authored by the legal and public policy staff of the NCIGF, the publication provides an update on recent events in insolvency law and practice and a look ahead at what is on the horizon.

See inside for…

- International and other regulatory developments
- Insurance insolvency developments; new liquidations and status of estates
- Developments in state insolvency laws
- Updates on run-offs of troubled companies

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 $27 billion to policyholders, beneficiaries, and claimants related to more than 550 insolvencies.

Following 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.

THE INTERNATIONAL SCENE

INTERNATIONAL NEWS: IMF RELEASES TECHNICAL NOTE ON REVIEW OF THE KEY ATTRIBUTES OF EFFECTIVE RESOLUTION REGIMES FOR THE BANKING AND INSURANCE SECTORS.

On July 7, the International Monetary Fund (IMF) released a "Technical Note on Review of the Key Attributes of Effective Resolution Regimes for the Banking and Insurance Sectors."[1]

On April 2, 2015 the IMF released its assessment[2] of U.S. observance with the insurance core principles (ICPs). Overall, the assessment found a "reasonable level of observance" with the ICPs. While resolution of troubled insurance companies is not the main focus of the assessment, it is covered by ICP 12, and the U.S. system is deemed to be in observance with the core principle. The guaranty system is mentioned in connection with ICP 12, ICP 26 and in paragraphs 16 (under the background description of institutional framework and arrangements) and 40 (under preconditions for effective supervision).

In July, the highly anticipated technical note regarding alignment with the Financial Stability Board's (FSB) **Key Attributes** was released. The technical note was in many ways critical of the current system of insurance liquidation and guaranty funds. The concerns in large part relate

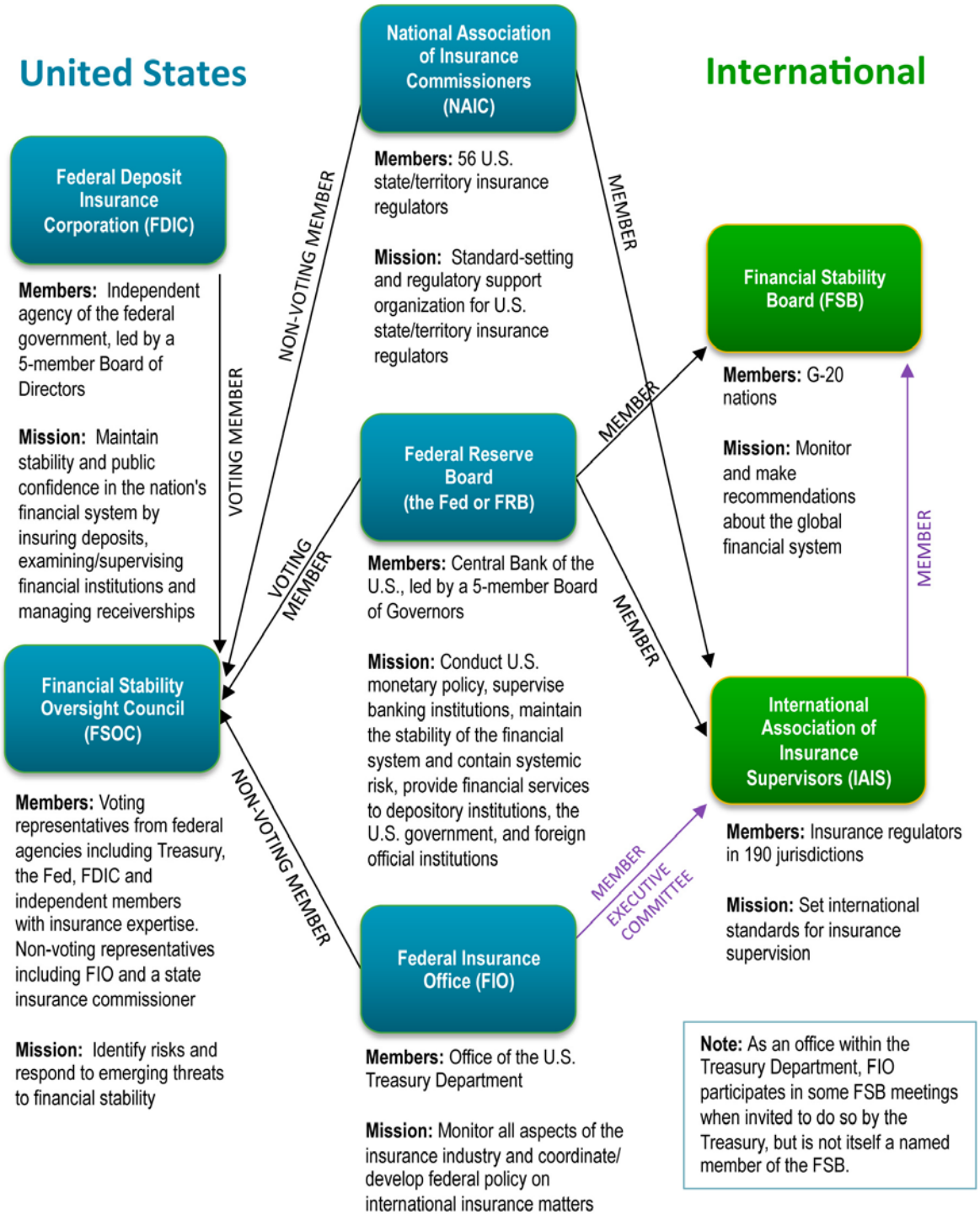
[1] Full text available at http://www.imf.org/external/pubs/ft/scr/2015/cr15171.pdf

[2] http://www.imf.org/external/pubs/ft/scr/2015/cr1590.pdf

to the concept that the resolution scheme should have a primary focus on “bailouts” of troubled companies and this goal should have equal importance to the historical bailiwick of the system in the United States – the protection of policyholders and payment of their claims when an insurance company becomes insolvent. Many believe that company bail outs run counter to the whole purpose of the guaranty fund system and the stated goal of the Dodd-Frank Act. We anticipate spirited discussion on this issue in the near future. See the schematic on the following page for details about the key bodies impacting international insurance regulation.

Key Players Impacting Insurance Regulation

A Complex Web of Interactions



INTERNATIONAL CAPITAL STANDARDS

The International Association of Insurance Supervisors (IAIS) has continued to meet with stakeholders regarding the International Capital Standard (ICS), which applies to internationally active insurance groups (IAIGs).[3] The latest stakeholder meetings were held in New York and Tokyo, after the launch of 2015 Quantitative Field Testing to discuss the field testing developments. (Field testing will continue until September 2015.) The IAIS heard presentations from industry stakeholders, many of which were focused on the valuation and asset classification components of the ICS. IAIS representatives made clear that development of the ICS will be an iterative process, and that the capital standard will continue to evolve for some time.

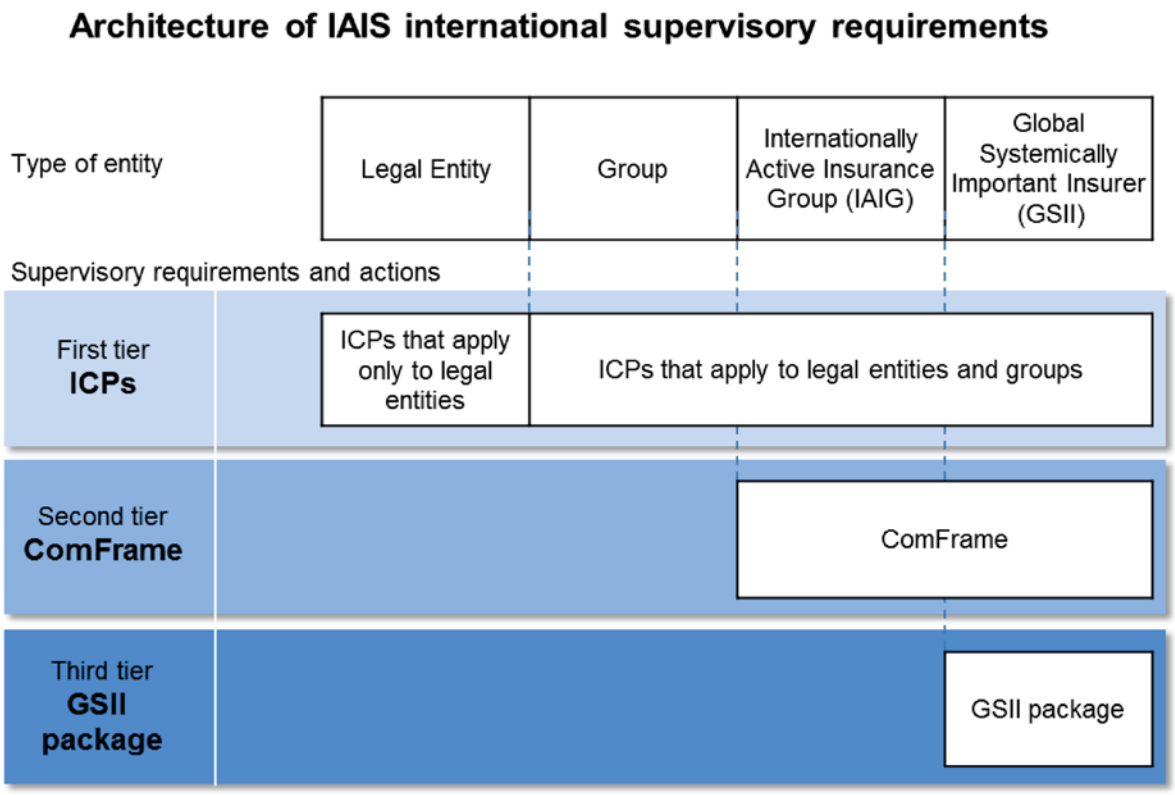
The IAIS and stakeholders met again regarding capital standards on June 18-19 at the IAIS' Global Seminar and stakeholder dialogue in Macau. The supervisors gave presentations on the status of their thinking on the ICS, as well as overviews of comments received in response to the ICS public consultation.

The IAIS has two additional capital-related stakeholder meetings scheduled in 2015. On August 4, the organization will hold a stakeholder meeting in Basel, Switzerland, focused on comments received during the ICS consultation and the Higher Loss Absorbency[4] capital standard, which is scheduled to be released for public consultation in June. (The HLA is still scheduled for adoption by the end of the year.) The last stakeholder meeting in 2015 also will take place in Basel on October 5, after the HLA consultation closes and the IAIS has had a chance to further consider ICS consultation comments at the IAIS' September meetings.

---

[3] The IAIS defines an IAIG as a large, internationally active group that includes at least one sizeable insurance entity. There are two criteria for an insurance group to be identified as an IAIG: 1) International Activity — premiums are written in not fewer than three jurisdictions, and percentage of gross premiums written outside the home jurisdiction is not less than 10 percent of the group's total gross written premium; and 2) size-based on a rolling three-year average, total assets of not less than USD $50 billion, or gross written premiums of not less than USD $10 billion.

[4] HLA is a capital standard potentially applicable to global systemically important insurers (GSII) that will come on top of the basic capital requirements (BCR) and is designed to address the insurers' systemic importance in the international financial system standards. For a depiction on how the ICPs, Comframe and GSII regulations interact, see the IAIS chart on the following page.



UPDATE ON FEDERAL MATTERS

CONGRESSIONAL ACTIVITY

Insurance regulation was front and center in Congress in April. On April 28, the Senate Banking Committee held the hearing "The State of the Insurance Industry and Insurance Regulation." On April 29, the House Financial Services Subcommittee on Housing and Insurance held the hearing "The Impact of International Regulatory Standards on the Competitiveness of U.S. Insurers." On April 30, the Senate Banking Subcommittee on Securities, Insurance, and Investment held the hearing "Examining Insurance Capital Rules and FSOC Process." Much of the action centered on the establishment of appropriate capital requirements for insurers, the impact of international regulatory standards and the role of the Fed and Federal Insurance Office (FIO) in developing such standards, and the Financial Stability Oversight Council's (FSOC) process for designating (and un-designating) non-bank financial companies as systemically important.

Congress is considering a number of changes to the Dodd-Frank Wall Street Reform and Consumer Protection Act, some of which could impact the insurance industry. Among other things, the Financial Regulatory Improvement Act of 2015 (S. 1484), introduced by Sen. Richard Shelby (R-AL), would:

- Provide for greater transparency in the FSOC's systemically important financial institution (SIFI) designation process and allow non-bank SIFIs to submit a remedial plan and meet with FSOC representatives during FSOC's annual reevaluation of the company's designation
- Restrict the FDIC's ability to impose liens on the assets of insurance companies and their subsidiaries in the event of a Title II receivership
- Limit the U.S. Treasury Department's ability to use an insurance company as a source of strength for an affiliated savings and loan.

The NCIGF provided technical assistance to the National Association of Insurance Commissioners (NAIC) and the Property and Casualty Insurers Association of America (PCI) with respect to certain portions of the bill.

Senate Democrats have proposed a shorter bill that would significantly scale back on the reforms contained in the Shelby bill.

While we do not expect anything to happen this year, we anticipate these efforts will continue in the next several years.

FEDERAL RESERVE'S CAPITAL STANDARDS FOR INSURANCE SIFIS

The U.S. Treasury Department, or "Fed," has not yet provided the capital requirements that will be imposed on insurance SIFIs. Thanks to the Insurance Capital Standards Clarification Act of 2014 (the so-called "Collins fix"), the Fed has greater flexibility to tailor capital standards to insurers and doesn't need to take a bank-centric approach. The Fed is reportedly considering an industry proposal that would rely heavily on existing state-based capital requirements.

COURT DECISION ON AIG BAILOUT

In 2011, Starr International Company filed suit against the United States, arguing that the Federal Reserve Board's takeover of AIG constituted a taking without just compensation. (Starr was one of AIG's largest shareholders, and its controlling shareholder is Maurice Greenberg, AIG's former CEO.) On June 15, the Federal Court of Claims in Washington, DC, ruled that the Fed overstepped its authority in connection with the AIG bailout. The court's opinion stated:

"The weight of the evidence demonstrates that the Government treated AIG much more harshly than other institutions in need of financial assistance. In September 2008, AIG's international insurance subsidiaries were thriving and profitable, but its Financial Products Division experienced a severe liquidity shortage due to the collapse of the housing market. Other major institutions, such as Morgan Stanley, Goldman Sachs, and Bank of America, encountered similar liquidity shortages. Thus, while the Government publicly singled out AIG as the poster child for causing the September 2008 economic crisis, the evidence supports a conclusion that AIG actually was less responsible for the crisis than other major institutions. The notorious credit default swap transactions were very low risk in a thriving housing market, but they quickly became very high risk when the bottom fell out of this market. Many entities engaged in these transactions, not just AIG. The Government's justification for taking control of AIG's ownership

and running its business operations appears to have been entirely misplaced. The Government did not demand shareholder equity, high interest rates, or voting control of any entity except AIG. Indeed, with the exception of AIG, the Government has never demanded equity ownership from a borrower in the 75-year history of Section 13(3) of the Federal Reserve Act." [5]

At the same time, the court said that AIG's shareholders were not entitled to damages, as AIG would have filed for bankruptcy were it not for the government's intervention. The court recognized that "[i]n a bankruptcy proceeding, AIG's shareholders would most likely have lost 100 percent of their stock value."

Greenberg announced that he will appeal the decision and continue to pursue damages. Federal Reserve Chair Janet Yellen also was unhappy with the decision and said that the Fed's actions were "legal, proper and effective."

METLIFE LITIGATION OVER SIFI DESIGNATION

MetLife and the federal government continue to do battle over FSOC's determination last December that the company is systemically important and should be regulated by the Federal Reserve. MetLife filed a complaint challenging the determination in federal district court in DC in January; the government asked the court to dismiss the case or enter summary judgment in the government's favor in May. MetLife moved for summary judgment in June. This case is significant, and not just for MetLife. The outcome is likely to have far-reaching consequences for other non-bank financial companies that may be considered systemically important, as well as for FSOC.

NEW INSOLVENCIES THIS YEAR: THE PROPERTY CASUALTY GUARANTY FUNDS CONTINUE TO PROTECT CLAIMANTS

There have been no new insolvencies in 2015. Seven small insolvencies occurred in 2014: CAGC Insurance Company, a writer of workers' compensation coverage, domiciled in North Carolina and licensed in North Carolina and South Carolina; Georgia Mutual Insurance, an automobile insurance company, domiciled in Georgia and licensed in Georgia, Tennessee and Alabama (claims in Georgia only); Professional Liability Insurance Company of America, a medical malpractice and workers' compensation insurance company, domiciled in New York and licensed in 31 states with claims in Illinois and Missouri only; National Guaranty Insurance Company, an automobile insurance company domiciled in Nevada and licensed in Indiana and Nevada (claims in Nevada only); Sunshine State Insurance Company, which wrote fire, allied, inland marine, homeowners multiperil and other liability, domiciled in Florida and licensed in Florida, Mississippi and South Carolina; Freestone Insurance Company, domiciled in Delaware, and licensed in 41 states; and Red Rock Insurance Company, domiciled in Oklahoma, and

[5] Starr International v United States. 121 cl. 428. June 15, 2015 at 433.

licensed in 48 states and Washington, DC. The seven insolvencies that occurred in 2014 can be found in the table that follows.

2014 INSOLVENCIES

Name of Company	Liquidation Date	State of Domicile	Direct Losses Unpaid	Type of Company	States Licensed
CAGC Insurance Company	1/17/14	NC	$17,993,440	Workers' compensation	NC, SC
Georgia Mutual Insurance, a Stock Company	2/7/14	GA	$2,623,725	Private passenger auto, auto physical damage	GA, TN, AL (claims in GA only)
Professional Liability Insurance Company of America	2/10/14	NY	$26,160,348	Medical malpractice, workers' compensation	31 states (claims in IL and MO only)
National Guaranty Insurance Company	5/6/14	NV	$6,278,278	Private passenger auto, auto physical damage	IN, NV (claims in NV only)
Sunshine State Insurance Company	6/3/14	FL	$9,103,518	Fire, allied, inland marine, homeowners multiperil, other liability	FL, MS, SC
Freestone Insurance Company	8/15/14	DE	$111,609,173	Workers' compensation, homeowners multi-peril, group accident and health, other liability, private passenger auto, auto physical damage	41 states
Red Rock Insurance Company	8/21/14	OK	$37,553,715	Workers' compensation, commercial multi-peril, other liability, commercial auto liability, auto physical damage, aircraft, surety, credit	All states except FL and NH

ESTATE DISTRIBUTIONS

A important component of the guaranty funds' ability to pay claims of insolvent insurance companies in a timely manner is the distribution of remaining assets of the insolvent estates. Guaranty funds work together with estate liquidators to ensure that guaranty fund loss and expense payments are reported on a timely basis and legal documentation is in place to permit available funds to flow to the guaranty associations on an expedited basis.

In 2015, distributions of approximately $70.4 million were received by the property and casulaty guaranty funds. These are related to four active insolvencies.

IN THE STATES

CALIFORNIA (AB 822) This bill would provide that the laws governing CIGA do not require a final determination of a claim in an insolvent insurer's liquidation proceeding before a covered claim may be submitted to CIGA. The bill would provide that these laws also do not require a claim to first be determined and approved by the liquidator before CIGA pays and discharges a covered claim. The bill would also provide that if the association provides written denial of a non-workers' compensation claim, the person asserting the claim against the association has one year to bring an action challenging the denial, including an action for declaratory relief. This bill would also require, if the written denial is based on a failure to exhaust other insurance available to pay the claim, that a claim be reasserted against the Association within six months

after all other insurance has been exhausted. This bill is currently in the State Assembly to reconcile amendments in the Senate.

CONNECTICUT (HB 6868) The bill raises the covered claim cap to $500,000. It includes assumed business in definition of covered claims but excludes claims issued by surplus line insurers, risk retention groups and self-insurers and group self-insurers. The bill is awaiting the governor's signature.

ILLINOIS (SB 1805) Illinois is considering legislation to deal with professional employer organization (PEO) arrangements encountered in insolvent companies. The current proposal would revise the insurance code to strengthen collateral requirements for PEO programs, strengthen eligibility requirements for carriers authorized to write large deductible policies and strengthen requirements for policyholder eligibility to qualify to purchase large deductible policies. The bill has passed both houses of the legislature and awaits the governor's signature.

ILLINOIS (SB 1781) The legislation calls for guaranty fund obligations on policies for excess of self-insured retention to be subject to the covered claim cap. The bill has passed both houses.

MISSOURI (HB 609) Large deductibles are complex commercial coverage arrangements where the insured takes on a large deductible (often $500,000 or more) in exchange for lower premium. In the case of workers' compensation, the insurer is obligated to pay first dollar of the coverage regardless of the ability of the insured to fulfill its reimbursement obligation or the availability of collateral to secure the arrangement. The NCIGF has developed model liquidation act language to clarify the rights and duties of the parties if the insurer becomes insolvent and the guaranty fund assumes claim payment responsibility. HB 609 was introduced in the Missouri legislature to enact large deductible legislation based on the NCIGF model. The bill passed out of committee and was progressing. It did not pass this year but we anticipate it will be floated again in the 2016 session.

AT THE NAIC

WORKERS' COMPENSATION (E) TASK FORCE. The Task Force is spearheading a refresh of the *NAIC 2006 Workers' Compensation Large Deductible Study.* Focus groups have commenced work. We expect the final product to include updated information on PEO use of large deductibles and recent experiences with deductible products in insurance liquidations.

MODEL ACTS WORKING GROUP. At this point the working group's focus has changed from efforts related to the Insurer Receivership Model Act (IRMA) to conducting a survey of liquidation laws in place in the various states in order to evaluate their consistency with the Financial Stability Board's October 2014 *Key Attributes of Effective Resolution Regimes for Financial Institutions.*

TO LEARN MORE…

More information about the property and casualty guaranty fund system is available on our Web site at http://www.ncigf.org

Look for a new issue of NCIGF's *Insolvency Trends* in January 2016.

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.

National Conference of Insurance Guaranty Funds (NCIGF)
300 N. Meridian St.
Suite 1020
Indianapolis, IN 46204

www.ncigf.org