» Insolvency
TRENDS Winter 2013

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 claims 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 2013 winter issue of the National Conference of Insurance Guaranty Funds' (NCIGF) *Insolvency Trends*. Authored by the legal and public policy staff of the NCIGF, this paper provides an update on recent events in insolvency law and practice and a look ahead at what is on the horizon in the coming year.

SEE INSIDE FOR…

- **Updates on Dodd-Frank and other developments on Capitol Hill – and how they impact the state-based insolvency system**
- **International developments**
- **Insurance insolvency developments; new liquidations this year; and a status of estates**
- **Developments in state laws**
- **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 guaranty fund system is an

innovative and common-sense mechanism. The system draws first on the assets of the failed insurance company before turning to 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.

DODD-FRANK, RESOLUTION OF SYSTEMICALLY IMPORTANT FINANCIAL COMPANIES, AND THE 2012 ELECTIONS

Enacted in 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act creates a new system for regulating large, interconnected bank holding companies and nonbank financial companies whose distress or failure could threaten the financial stability of the United States.

The law calls for large, interconnected financial companies that are systemically important to be identified by the Financial Stability Oversight Council (FSOC) chaired by Treasury Secretary Timothy Geithner. Systemically important financial companies could include insurance companies and insurance holding companies, although most observers contend that few, if any, insurers are systemically significant. Once identified, these companies will be subject to stringent regulation by the Federal Reserve Board.

The legislation also creates a new mechanism for liquidating systemically important financial companies whose failure could destabilize the economy. **While the Federal Deposit Insurance Corporation (FDIC) will be appointed receiver of – and will liquidate – most types of financial companies, insolvent insurers (including any deemed systemically important) will remain subject to state receivership and guaranty association processes.**

Resolution of Systemically Important Financial Institutions (SIFIs) will be funded by a post-liquidation resolution fund. If any insurers are tapped to contribute to such a fund, the amount of their contributions will take into account guaranty fund assessments already paid.

Even though insurer insolvencies will be conducted under state law, the FDIC could be appointed receiver of certain subsidiaries of insurance companies if those companies are in default or in danger of default, if their failure would have a significant adverse effect on the U.S. economy and other criteria are met. Any value remaining after claims are paid would be paid to the parent company.

THE FUTURE OF DODD-FRANK AND THE 2012 ELECTION

The 2012 elections brought about changes to the environment in which Dodd-Frank implementation will continue. The Democrat-controlled Senate is expected to protect Dodd-Frank in its current form and ramp up projects to implement its provisions. The Republican-controlled House is expected to have interest in alternative resolution ideas.

FEDERAL INSURANCE OFFICE: ANTICIPATING THE REPORT

We continue to anticipate the release of the Federal Insurance Office (FIO) report, which has been delayed from its scheduled January 2012 delivery. As of this writing there is no firm date for its release. As part of the study, the FIO was charged with examining the potential consequences of subjecting insurance companies to a federal resolution authority.

Both the NCIGF and National Organization of Life and Health Guaranty Associations (NOLHGA) provided input to the FIO as the agency drafted the report. For property and casualty guaranty associations, the comments focused on:

- The operation of state insurance guaranty fund systems, including the loss of guaranty fund coverage if an insurance company is subject to a federal resolution authority; and
- Policyholder protection, including the loss of the priority status of policyholder claims over other unsecured general creditor claims.

To view the joint comments, filed on December 16, 2011 click here.

HR 6423 – the Insurance Consumer Protection and Solvency Act of 2012

Introduced by Rep. Bill Posey (R-FL), HR 6423, the “Insurance Consumer Protection and Solvency Act of 2012” was, according to its stated purpose, “to exclude insurance companies from the FDIC’s ‘orderly liquidation authority.’”

The bill seeks to amend Dodd-Frank by excluding insurance companies from the definition of a “financial company” in section 201 of the Act, which would exclude them from the FDIC’s orderly liquidation powers. Additionally, the bill seeks to exclude certain insurance companies from the fees assessed by the FDIC for the liquidation authority costs. Some witnesses in prior House Financial Services hearings have argued that the state-based guaranty systems are sufficient, and that insurance companies should not be doubly assessed under two systems.

While there was a hearing on the bill, no vote or other action was taken on it in Congress. However, the NCIGF was extensively consulted on how the orderly liquidation authority might be changed in a way that ensures guaranty fund coverage is not interrupted.

THE FINANCIAL STABILITY OVERSIGHT COUNCIL (FSOC)

The Financial Stability Oversight Council (FSOC) was established by Dodd-Frank. It is charged with three primary responsibilities:

- To identify risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace.

- To promote market discipline by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the U.S. government will shield them from losses in the event of failure.

- To respond to emerging threats to the stability of the U.S. financial system.

Pursuant to Dodd-Frank, the council consists of 10 voting members and five nonvoting members; it brings together the expertise of federal financial regulators, state regulators, and an insurance expert appointed by the President.

Insurance representatives now include former Kentucky insurance commissioner Roy Woodall (a voting member), Missouri Insurance Director John Huff, and FIO Director Michael McRaith.

The FSOC is making progress on its charge to identify Systemically Significant Financial Institutions ("SIFIs"). Initial notice has been sent to companies that are on a preliminary list. AIG, a large financial entity that includes many insurance companies among its affiliates – has stated that it, not unexpectedly, has received such a notice.[1]

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[1] AIG Statement Regarding Receipt of Financial Stability Oversight Council Notice of Consideration. *New York Times.* October 2, 2012

THE INTERNATIONAL SCENE: DEALING WITH INSOLVENCY IN A WORLD ECONOMY

The IAIS studies "Guarantee Schemes"

The International Association of Insurance Supervisors (IAIS) has undertaken a study of guaranty associations, which they call "guarantee schemes." The Organization for Economic Cooperation and Development (OECD) is also developing a white paper on guarantee schemes in OECD-member countries and selected non-OECD countries. The OECD paper "examines the rationale for a policyholder protection scheme; the relationship between certain design features and moral hazard; the role of a policyholder protection scheme within the overall resolution framework; and some cross-border features of these schemes. While the paper focuses on protection schemes for policyholders, it seeks to draw lessons from compensation schemes in the banking and occupational pension fund sectors, while recognizing sectoral differences."[2] Both papers feature information on the state-based system in the United States along with a wealth of information on various guaranty schemes throughout the world. At this point neither of the organizations has finalized a work product.

NAIC'S SOLVENCY MODERNIZATION INITIATIVE (SMI)

Solvency Modernization Initiative

The financial crisis has brought about increased efforts to globalize regulation and accounting principles. Many changes have already occured in major insurance markets, including those in the U.S. and Europe. These insurance regulatory and accounting changes potentially impact the ability to detect insolvencies.

The NAIC consolidated its regulatory improvement and update efforts under its Solvency Modernization Initiative. According to the NAIC's Web site: "SMI is a critical self-examination to update the United States' insurance solvency regulation framework and includes a review of international developments regarding insurance supervision, banking supervision, and international accounting standards and their potential use in U.S. regulation." SMI has been described as the NAIC looking at all the "tools" in its "tool box" and

[2] "Policyholder protection schemes: Selected considerations" OECD discussion draft, May 2012.

deciding what stays, what goes and what needs to be changed. The current plan calls for all major policy decisions completed by the end of 2012.

There are three topics the NAIC's Solvency Modernization Initiative is studying that could potentially have an impact on the property and casualty guaranty associations.

NAIC's ORSA: The first is the NAIC's Own Risk Solvency Assessment (ORSA). On September 12, 2012, the NAIC adopted the ORSA Model Act, which will be a regulator resource to assess and monitor insurers' and groups' risk management processes, and to align regulatory requirements with business practices and the insurers' ability to withstand stresses. The NAIC's ORSA is expected to increase the chances that the U.S. insurance regulatory system will be viewed as "equivalent" to Europe's regulatory system under Solvency II. As encouraged by industry, the ORSA will be less burdensome to complete than Europe's.

The Model Act provides for an effective date of January 1, 2015.

An annual ORSA report will be required by large insurers (at least $500 million in annual premiums that are part of an insurance group with at least $1 billion in annual premiums). Under certain circumstances, the report could be requested by state regulators, federal agencies or international insurance supervisors.

The NAIC adopted the ORSA Guidance Manual in March 2011. The manual provides general guidance to an insurer or insurance group for completing the annual ORSA report.

Future of GAAP and Statutory Accounting: The second item of interest is the international and U.S. accounting board (IASB and FASB) project that seeks to converge to a single set of global accounting standards. Because Statutory Accounting evaluates GAAP accounting and makes adjustments when called for, Statutory Accounting will be affected by whichever method (U.S. GAAP vs. International Financial Reporting Standards) is adopted by the U.S. Some maintain it may be more difficult to assess solvency if the U.S. moves toward IFRS because it is principles-based, and therefore more subjective than the U.S. rules-based method.

The SEC's final staff report released during the second quarter of 2012 "declined to recommend IFRS, in a paper that was more negative than observers had expected."[3] The paper originally was expected to make a recommendation regarding using IFRS. Rob Esson, Senior Policy Fellow of International Affairs

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[3] *The Economist.* "Global accounting standards: Closing the GAAP," July 21, 2012, New York (print edition.)

at the NAIC, stated in his August 8 memorandum to the NAIC International Solvency and Accounting Standards Working Group: “Whether due to it being an election year, or any other reason, the report scrupulously avoided making any recommendation, thereby pushing any such decision into the future with commitment uncertainty reigning.”

Insurance Contracts: The third item of interest is the U.S.-based Financial Accounting Standards Board and London-based International Accounting Standards Board’s convergence project on insurance contracts. Despite pressures from the G20, the chairman for the U.S. accounting standards board, the FASB, acknowledged it is unlikely that the two boards will converge to a single standard. The IASB’s initial exposure draft did not distinguish the differences in practices between life and property/casualty insurers, especially with regard to short-term contracts. The IASB made some progress toward recognizing these differences, but not enough to satisfy many in industry. The IASB is currently proposing a safe harbor for discounting short-term property and casualty policies within one year. Many in industry think this time frame should be expanded for up to three years. The FASB is expected to issue their exposure draft and the IASB their re-exposure draft during first quarter 2013.

IN THE STATES…

State Workers’ Compensation Funds (Colorado and Oklahoma)

There was interest in 2012 in privatizing state-run workers’ compensation funds and making them “member companies” of the state guaranty fund. This would mean that the newly formed companies would pay guaranty fund assessments and that the guaranty funds would pay covered claims in the event of their failure. The approach was being discussed in Colorado, with regard to the Pinnacol fund, and in Oklahoma, with regard to Compsource (HB 2445 was pending in the Oklahoma 2012 legislature but died at the end of the session.) In both cases proponents cite the merits of making these funds “members” of the guaranty fund going forward. These organizations would pay assessments and be afforded guaranty association coverage for any new policies written. An important question in both states is how old liabilities of these funds – before they became guaranty association members – would be resolved. While no action was taken in either state in 2012, we expect it to resurface as the states’ 2013 legislative sessions convene.

Premium Tax Offsets (Indiana, Oklahoma, Washington)

Legislation was proposed in three states in 2012 to alter the ability of guaranty fund member insurance companies to take tax offsets for their assessment payments. In none of these states was there sufficient support to pass these measures in 2012; however, by no means would we consider such proposals “off the table” in 2013.

Business Transfers (Vermont – H. 533)

A proposal was floated in Vermont in 2012 to allow an insurance company to transfer business into a new entity without policyholder consent and without re-domestication to Vermont. Under this proposal all liabilities of the transferring entity would be extinguished. The version of the bill that passed the House purported to make guaranty association coverage available for Vermont resident claims under policies subject to a transaction under this proposal – presumably in the event that the assuming carrier liquidated.

While it was not indicated in the bill, we would surmise other states' laws would govern the question of whether guaranty fund coverage would be made available in their jurisdictions. Certain fees, including a fee of 1 percent of the business transferred up to the first $100 million would be due the insurance department on such transactions. The proposal excluded workers' compensation and personal lines business. The property-casualty trades and the Reinsurance Association of America submitted letters opposing the bill. While the bill progressed, it did not pass during the 2012 session. It is expected to be introduced again in 2013.

Citizens in Florida

Legislation was proposed in the 2012 session to allow surplus lines companies to pick up certain policies of the state-run insurer Citizens Property Insurance Corporation. Surplus lines policies are not typically covered by the guaranty fund system. Hence, under this proposal, homeowners could find themselves without recourse if their surplus lines insurer became insolvent. The measure failed to pass this year, and is unlikely to be reintroduced in 2013.

Guaranty Fund Act Developments

Interest continues in the latest version of the NAIC's Property and Casualty Insurance Guaranty Association Model Act. This latest revision of the longstanding NAIC model, on which most state property and casualty guaranty association acts are based, was adopted by the NAIC in 2009.

States, while expressing interest in the model, are cautiously evaluating how the specific provisions of this legislative scheme would impact their guaranty funds. The best source of information on this topic is a state's individual guaranty fund manager who is available to provide technical advice on any proposed changes. A proposal in Hawaii based on the model (HB 2505) was enacted in 2012. We understand that Utah will be considering an amendment soon. States that have already adopted the NAIC model in part are Illinois, Iowa, Oklahoma, Louisiana and Rhode Island. The NAIC continues to monitor its progress in the states.

Perennial efforts to raise the covered claim cap from the typical $300,000 in Massachusetts (SB 459) and New Jersey (SB 1104) were floated once again in the 2012 sessions. Neither measure gained much traction in 2012, but we will likely see them again in 2013.

Liquidation Act Developments

Swaps and Derivatives. While it's been some time since there has been an attempt to propose a comprehensive liquidation act bill based on the Insurer Receivership Model Act (IRMA), we have seen IRMA language regarding treatment of swaps and derivatives – investment vehicles used by insurance companies, proposed in several states. We understand that 20 states now have adopted IRMA swaps language; this continues to be a matter of interest to both property and casualty and life and health insurance companies – both of which use these devices to some extent. In light of the high interest in the states, the NAIC took another look at the provision inviting experts on the topic to address the working group. After extensive review, the NAIC working group concluded that it could support states enacting IRMA 711 as embodied in the IRMA model. This recommendation was returned by its parent committee requesting that additional matters be addressed. Recently, a draft guideline was exposed for comment regarding a stay provision that would apply to these transactions.

IRMA Critical Elements. The NAIC is developing a list of provisions from the IRMA model that are non-controversial and that would be advisable for all states to have as part of their insolvency statutes. We understand that the final list of provisions will be part of an education program the NAIC plans to make available to the states.

Dodd-Frank Amendments. States are considering revisions to insurance liquidation acts designed to allow current state law to interplay with the resolution authority embodied in Dodd-Frank. Revisions are based on some guidance provided by the Dodd-Frank Working Group at the NAIC. So far, amendments have been adopted in Texas and California. We expect other states to follow suit in 2013.

Federal Home Loan Banks. Recently the Federal Housing Finanace Agency (FHFA) issued a notice regarding standards to guide agency staff in the supervision of secured lending to insurance company members by Federal Home Loan Banks (No. 2012-N-14). Some commentary on related matters was also included in the FHL Bank of Pittsburgh Briefing Book. Generally, both actions concern the status of secured loans from FHL banks should an insurance company member become financially troubled.

The FHFA notice focuses on evaluating FHL banks' ability to understand their rights vis-à-vis secured loans when dealing with an insurance company; in addition, it concerns evaluating the financial strength of that insurance company. The guidance recognizes that insurance companies are regulated under state law and the fact that working with these entities requires an understanding of how their financial condition is evaluated under state law. It also recognizes the need to consider the status of a secured claim, including that of an FHL bank, if the insurance company becomes financially troubled or, in a worst case, must be liquidated. The complexities that arise from variances in state law and data gathering practices are noted in this guidance. Some have a concern that the guidance set by the proposed rule goes beyond what is necessary in these highly collateralized transactions.

The FHL Pittsburgh Briefing Book goes a step further suggesting that there is a need for an FHL bank under certain circumstances to deal with a financially troubled company. In fact, a loan under such circumstances could provide needed liquidity at a critical time – potentially preventing the company from going into liquidation. The Briefing Book suggests that there are proposed amendments to state insolvency law that would provide some certainty to banks making loans under such circumstances. We have seen proposed amendments to the Insurer Receivership Model Act (IRMA) to exempt FHL banks from preference avoidance and stay provisions embodied in the model. (The NAIC is currently evaluating these proposals.)

Impact on Guaranty Associations. Guaranty funds are activated and obligated to pay claims when an insurance company becomes insolvent and is ordered into liquidation. To the extent of their claim payments, the guaranty funds have a high priority claim for the remaining ***general*** assets of an insolvent company. However, if a claim is a secured claim it is not be a part of the general assets from which the guaranty funds would take distribution. For this reason, funding for claim payments comes from other sources – generally from insurance company member assessments. Commentators on this matter suggest there would be no impact on guaranty funds from the proposed rule or amendments to the model law, as FHL banks already are considered secured creditors. Insurance companies will likely consider possible impact in liquidation as well as in their ongoing dealings with FHL banks.

New Insolvency Activity

The property and casualty guaranty fund system, as always, stands ready to fulfill its statutory mission to protect policy claims in the event of an insolvency. From 2008 through 2012, 41 property and casualty companies went into liquidation. The Florida guaranty funds were particularly heavy hit with many single-state or regional companies being liquidated in this hurricane-prone area.

The list of liquidations from 2008 through 2012 can be found in the following table.

Name of Company	Liquidation Date	State of Domicile	Type of Company	States Licensed
New Jersey Exchange Insurance Company	2/11/2008	NJ	Auto, commercial	NJ only
Guarantee Title and Trust Company	10/27/2008	MI	Title	MI only
Austin Indemnity Lloyds Insurance Company	12/29/2008	TX	Homeowners multiperil, private passenger auto, auto physical damage	TX only
MIIX Insurance Co	4/9/2008	NJ	Workers' compensation, fire, allied, commercial multiperil, ocean marine, medical malpractice	NJ, PA, NY, TX, OH, MI, MD
Valor Insurance Company, Inc.	5/27/2009	MT	Workers' compensation	MT only
Colonial Indemnity Insurance Company	7/7/2009	NY	Other liability, private passenger auto, commercial auto, and auto physical damage	KY, NY, SC (All claims in NY)
Consumer First Insurance Company	7/21/2009	NJ	Auto	NJ only
First Commercial Insurance Co.	8/24/2009	FL	Workers' compensation, commercial, auto, general liab, commercial multiperil	FL, Georgia
First Commercial Transportation and Property Insurance Co.	8/24/2009	FL	Commercial auto	FL only
American Keystone Insurance Co.	10/9/2009	FL	Homeowners	FL only
Southeastern U.S. Insurance Inc.	10/27/2009	GA	Workers' compensation	Georga
Park Avenue Property and Casualty Insurance Co.	11/18/2009	OK	Workers' compensation	28 states (claims primarily in FL and GA)
Insurance Corporation of NY	3/10/2010	NY	Fire and casualty	26 states (all claims in NY)
Imperial Casualty and Indemnity Insurance Co.	3/18/2010	OK	Workers' compensation	All states except FL, ME, MA, NY
Magnolia Insurance Co.	4/20/2010	FL	Homeowners	FL only
Northern Capital Insurance Company	5/1/2010	FL	Homeowners, automobile and inland marine	FL only
Financial Advisors Assurance Select RRG	5/20/2010	NV	Errors and omissions	NV only
Gibraltar National Insurance Company	5/21/2010	AR	Workers' compensation	AR only
Titledge Insurance Company of New York	6/16/2010	NY	Title	NY only
Coral Insurance Co.	7/26/2010	FL	Homeowners	FL only
Pegasus Insurance Co.	8/12/2010	OK	Workers' compensation, minimal private passenger auto liability physical damage	27 states
Georgia Restaurant Mutual Captive Insurance Company	9/21/2010	GA	Workers' compensation	GA only
Colonial Cooperative Insurance Company	9/30/2010	NY	Fire	NY only
Constitutional Casualty Co.	1/3/2011	IL	Private passenger auto and homeowners multiple peril insurer; some commercial liability	IL only
Aequicap Insurance Co.	3/7/2011	FL	Commercial auto	FL, GA, OK, SC, TX
Seminole Casualty Insurance Company	3/15/2011	FL	Personal and commercial auto	8 states (claims primarily in FL and MD)
Atlantic Mutual Insurance Company	4/27/2011	NY	Workers' compensation, commercial multiperil, private passenger auto, homeowners, surety, aircraft	All states
Centennial Insurance Company	4/27/2011	NY	Workers' compensation, commercial multiperil, private passenger auto, homeowners, surety, aircraft	All states
Reinsurance Company of America	4/27/2011	IL	Workers' compensation, non-standard auto liability	20 states (all claims in TX)
Western Insurance Company	9/13/2011	UT	Surety	35 states
National Group Insurance Company	10/10/2011	FL	Commercial auto, commercial property	FL and GA (all claims are in FL)
National Insurance Company	10/25/2011	PR	Commercial auto	PR and FL
American Sterling Insurance Company	10/26/2011	CA	Private passenger auto, auto physical damage	AZ, NV, KS
Homewise Preferred Insurance Company	11/4/2011	FL	Primarily homeowners insurance	FL, TX, SC
Homewise Insurance Company	11/18/2011	FL	Primarily homeowners insurance	FL and LA
Southern Eagle Insurance Company	12/16/2011	FL	Workers' compensation	FL only
Autoglass Insurance Company	1/9/2012	NY	Private passenger auto	NY only
First Sealord Surety, Inc.	2/8/2012	PA	Bond and surety	38 states
Garden State Indemnity Company, Inc.	6/22/2012	NJ	Professional liability, surety	NJ only
Northern Plains Insurance Company, Inc.	9/18/2012	SD	Automobile	SD only
Frontier Insurance Company	11/9/12	NY	Fire, allied, homeowners and commercial multiperil, inland marine, medical malpractice, WC, other liability, product liability, private passenger auto liability, auto physical damage, fidelity, surety, burglary and theft, warranty	All states

Several of these companies were liquidated with little advance notice to the guaranty funds. They involved complex issues, and included claims of injured workers and other claimants whose periodic claims payments would be interrupted without the early intervention of the guaranty funds working in full cooperation with the estate receivers. That these insolvencies continue to occur demonstrates the continued need for a guaranty fund system that is prepared to handle covered claims of insurance consumers. Moreover, early coordination and cooperation between the guaranty funds, regulators, and the receivers of the insolvent insurance companies is critical to the continued ability of the system to protect policy claimants in a timely manner.

For comprehensive information on the companies the guaranty funds are handling with payout information, please see our Web site at www.ncigf.org.

Estate Distributions and Closing Efforts

A critical component of the guaranty funds' ability to pay claims of insolvent insurance companies in a timely matter are the distributions 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 2010, the most current year information is available, the guaranty funds recovered more than $1.3 billion from the insolvent companies' estate assets and statutory deposits.

Closing efforts continue in several jurisdictions. The liquidator for the two Credit General estates in Ohio (Credit General Insurance Company and Credit General Indemnity) expects to file motions by the end of 2013 to propose a plan for estate closure. American Mutual continues to work toward closing. In preparation, the liquidator has settled up with the guaranty funds for the values of their paid and unpaid workers' compensation liabilities and the court approved a distribution of $100 million to Class 2a creditors (predominantly guaranty associations) in April 2011. Another $50 million distribution is anticipated.

Transit Casualty Company

Transit Casualty Company was a Missouri domicile and was placed into liquidation in December 1985. The receiver for Transit Casualty Company filed a petition with the receivership court seeking approval to make a final distribution from the Transit estate. The guaranty associations and other policyholder-level claimants have received prior distributions of 86 percent of their allowed claims. Following approval of the liquidation court, the receiver made the final distribution to policy-level claimants, bringing the final dividend to 87.3 percent. A hearing on the receiver's petition to close the estate was held on December 20, 2012. The estate is closed; however, certain essential records will be held for a period of five years, after which they will be destroyed.

State Capital Insurance Company

State Capital Insurance Company, a North Carolina domicile, was ordered into liquidation in June 2004. In December 2011, at the prompting of state guaranty associations, the liquidator petitioned for closure of the estate and for authority to make a single distribution to policyholder-level claimants of 100 percent of approved claims. The petition was approved by the liquidation court, and the final distribution to policyholder-level claimants, primarily the state guaranty associations, was made in December 2011.

American Eagle Insurance Company

The deputy receiver for American Eagle Insurance Company filed an application with the District Court of Travis County, Texas, seeking to close the estate and discharge the receiver and deputy receiver. A final distribution to Class 2 creditors including the guaranty associations was made in December 2011. Following the approval of the final distribution order, the special deputy receiver collected an additional $101,675 that was distributed prorata to approved Class 2 creditors. Before it was placed into receivership in December 1997, American Eagle was licensed to write business in 45 states, and wrote coverage for aviation, transportation, construction and marine risks.

Reciprocal of America

Reciprocal of America (ROA) was placed into liquidaiton in June 2003 in Virginia. The company wrote workers' compensation, professional liability, and general commercial liability policies. As of 2012, the estate has made distributions of 95 percent to policyholder-level claimants, with an additional 5 percent to the guaranty associations as early access. In 2012, the receiver announced its intention to sell the estate's entire block of workers' compensation insurance to an outside insurer in an effort to accelerate closure of the estate. As of the end of 2012, the proposal had not yet been submitted to the court for approval.

Run-off Proposals

In some cases a state regulator will attempt to resolve a troubled company's claims by means other than a statutory liquidation. In these cases the guaranty funds are not activated. Proponents for alternative

approaches cite orderly claims processing, low cost, and greater flexibility to achieve commercially acceptable results. However, the efficiency and cost-effectiveness of an alternative – compared to a statutory – liquidation to our knowledge has never been established. In fact, there are many questions about how a prolonged run-off, versus a statutory liquidation, would impact the various stakeholders, including policy claimants.

Highlands

Highlands was placed into receivership in Travis County, Texas, in November 2003. In 2007 the court approved the Second Amended Plan of Rehabilitation. Under the terms of the plan, the receiver was ordered to administer a Monitoring Plan to ensure the estate will continue to have sufficient funds to pay the company's claims as they come due. As of September 30, 2012, the estate held total assets of $204 million against total liabilities of $373 million. A subcommittee of the Highlands Coordinating Committee met with the Special Deputy Receiver in March. The Highlands Coordinating Committee plans to meet with the Special Deputy Receiver via conference call for an estate update in January 2013.

Frontier Insurance Company

Frontier Insurance Company, a New York domestic, was placed into rehabilitation in October 2001. Following a court ruling that held that certain bond claims were entitled to the same priority as the company's other policy claims, thereby complicating the rehabilitation, the receiver decided to place the company into liquidation in October 2012.

Lumbermens

Three of the Lumbermens Companies (namely, Lumbermens Mutual Casualty Company (LMC), American Manufacturers Mutual Insurance Company (AMM), and American Motorist Insurance Company (AMICO)) were placed into rehabilitation in the summer of 2012. The Illinois Department of Insurance press release indicated this was done "to prepare for the orderly transition of claim-handling responsibilities to the State Guaranty Funds and Associations once an Order of Liquidation is entered." 4 The companies have been in run-off since 2003.

Lincoln General

On February 9, 2009, Lincoln General discontinued the writing of new business and began a process that would result in a voluntary, solvent run-off of all business. Third quarter 2012 financials indicate a policyholder surplus of approximately $1.7 million after augmentation for permitted practices, which increases reserves by a total of almost $10 million. The acquisition of control by Tawa plc ("Tawa") of Lincoln General Insurance Company was approved by the Pennsylvania Insurance Department on

[4] Illinois Department of Insurance Press Release dated July 3, 2012 "Lumbermens Mutual Casualty Company and American Manufacturers Mutual Insurance Company Agree to Being Placed into Rehabilitation."

October 5, 2011. Tawa is an entity that manages the run-off of non-life insurance companies and portfolios of policies.

Rhode Island Statute Used in GTE

Rhode Island is the only state to have a law in place regarding run-offs. For the first time, a proposal has been approved by the court for a commutation pursuant to the Rhode Island statute. This matter involves assumed reinsurance business written by GTE Reinsurance Company Limited. GTE novated remaining non-related business and re-domesticated its assumed reinsurance block to Rhode Island. A commutation plan was approved on June 25, 2010. There is no direct insurance business involved. Four hundred and forty cedants remained, and all had a vote on the commutation plan. The court in April 2012 ordered that the plan be implemented over the objection of several creditors.

Medicare Secondary Payer

The Medicare Secondary Payer provisions in Section 111 of the Medicare, Medicaid, and SCHIP Extension Act of 2007 impose information reporting requirements on insurance companies and other entities that provide payments pursuant to non-group health insurance plans, including liability insurance, self insurance, no fault insurance, and workers' compensation insurance plans. Failure to comply may result in a fine of $1,000 per day per file. Property and casualty guaranty funds are likewise adhering to these obligations.

The MARC (Medicare Advocacy Recovery Coalition) is a group formed to advocate for improvements in the Medicare Secondary Payer (MSP) system. MARC is made up of a group of entities affected by the Medicare reporting requirements; this includes attorneys, brokers, insureds, insurers, insurance and trade associations, self-insureds, and third party administrators. (Additional information is available on MARC's Web site at www.marccoalition.com.)

MARC organized support for HR 1063, federal legislation introduced in March 2011 to enhance efficiencies, add reasonable statutes of limitations and amend provisions relating to fines for compliance violations. This bill has now passed both houses of the U.S. Congress and awaits the President's signature.

TO LEARN MORE…

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

Look for a new issue of NCIGF's *Insolvency Trends* in July 2013.

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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