RISK & INSURANCE
Date: Saturday, September 01, 2007
Location: HORSHAM, PA
Circulation (DMA): 47,183 (N/A)
Type (Frequency): Magazine (14Y)
Page: 66
Keyword: Guaranty Fund

The Guaranty Fund System: A Public Policy Success

Guaranty funds have met their obligations, to the tune of $21 billion in claims to policyholders whose carriers have become insolvent.

Perhaps nothing better reflects public policy's virtues and inherent challenges than the state property and casualty guaranty fund system. For nearly 40 years, guaranty funds have fulfilled their original public policy mandate: to protect policyholders and claimants.

It is a proven system, one that has met its statutory obligations by paying $21 billion in claims to policyholders, beneficiaries and claimants whose insurance company has become insolvent.

Property and casualty insurance is based on a delicate public policy balance that distributes the risk of property loss among millions of consumers under the watchful eye of state departments of insurance.

A key element of that balance is the low-cost structure of state-based guaranty funds that helps protect people and small businesses least able to absorb the impact of an uninsured loss related to a property and casualty insurer insolvency.

The success of the system has not gone unnoticed. Speaking in the summer of 2006, the Deputy Assistant Secretary of the U.S. Treasury for Financial Institutions, David G. Nason, said: "While there are passionate views on virtually all aspects of the [insurance] modernization debate—the viability and merit of the state guaranty system is rarely, if ever, called into question."

Of course, the opinion of the property/casualty guaranty fund system that matters most is that of the authors of each state's insolvency statutes that define the system and its mission.

The first priority of every state legislator is, or should be, the protection of his or her constituents, who could potentially be harmed by an insurer failure. As they evaluate the merits of policy options for the current guaranty fund system, lawmakers might well find guidance in the words of American economist Thomas Sowell.

As Sowell put it, anything under examination must "stand up to three questions: (1) Compared to what? (2) At what cost? and (3) What are the hard facts?"

As Sowell suggests, legislators are well-advised to make any review of state guaranty fund-related issues through the critical and objective prism of public policy because it is public policy that gave birth to the safety net in the first place.

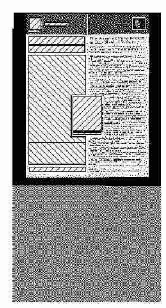
That is exactly what the state guaranty fund system is doing. The property-casualty guaranty funds are undertaking a thoughtful, candid and broad-based self-examination of the culture and process of the state system through a strategic planning initiative created by the NCIGF board of directors.

The initiative, begun in January 2006, has evolved into the most ambitious self-examination of the state guaranty fund system in its history.

GUARANTY FUNDS: A successful safety net for policyholders, or a frayed system about to snap?

The original system was intended to serve as a limited backstop to protect consumers from insurance company failures that inevitably arise in competitive markets.

Perhaps more importantly, it made a powerful public policy statement about the sanctity of the insurance contract. As statutory payment limits and other fail-safe methods added by state legislatures make clear, it was not planned for the guaranty



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fund system to become a source of funds from which broader relief can be drawn.

The insolvency burden for insurance consumers, taxpayers and solvent insurers has been considerable in recent years; yet insolvencies have been handled successfully in an established public policy structure designed to make property and casualty insurance available and dependable to consumers.

The guaranty funds have performed as an effective and proven system, one that has provided an essential safety net serving thousands of policyholders and claimants least able to deal with losses related to more than 600 insurance company failures.

We live in an era marked by meganatural catastrophes, terrorism risk and renewed political interest in the regulation of insurance markets; we must not take the proven performance of the guaranty fund system for granted. Guaranty fund public policy has been—and should be—accorded a higher profile on the policy landscape.

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POINT
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Account: 26319 (58)