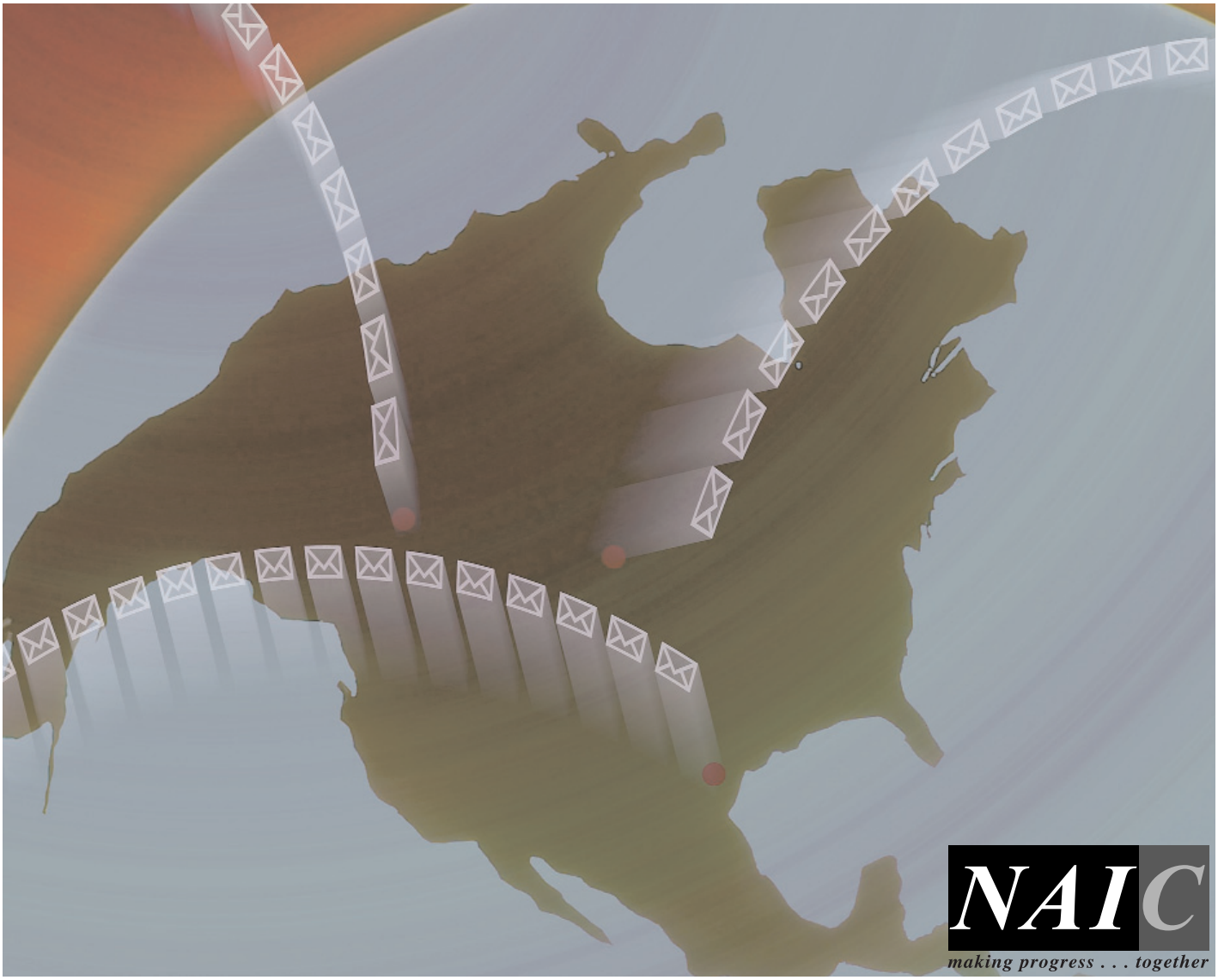

Communication and Coordination Among Regulators, Receivers, and Guaranty Associations: An Approach to a National State Based System

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Prepared by the

Receivership And Insolvency (E) Task Force

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Receivership And Insolvency Task Force
National Association Of Insurance Commissioners

"State guaranty funds, the safety net designed to protect consumers when insurance companies fail, could be facing their biggest challenges to date. A spate of high-profile insolvencies has left the property/casualty state funds to clean up $1.7 billion in claims for 2002, an all-time high…. Guaranty funds play the vital role of protecting consumers, which is necessary because some companies will always fail in a free market system driven by competition."

Excerpt from Best's Review, February 2004, "Clean-Up Operation" by Meg Green

Executive Summary: Purpose And Goal Of This White Paper

This report addresses the various issues relating to communication and coordination among the regulators, receivers, and guaranty associations[1], each of which is separately responsible for providing a national state based safety net for policyholders and claimants using different tools.

While historically there has been no clear consensus on when and how to involve guaranty associations in a troubled company[2] one developing shared assumption is that effective communication and coordination among state regulators, their receivership operations and the guaranty associations is critical in providing essential protections to consumers in the event that insolvency ensues. Guaranty association involvement should be early enough that the guaranty associations can immediately undertake their statutory duties upon liquidation. As a practical matter, this calls for involvement as soon as it appears that there is a significant possibility of liquidation. This point may be reached even before the insurer is under administrative supervision or in conservation or rehabilitation. The experience of Arkansas and Arizona, where the guaranty association and receivership functions are within the department of insurance, demonstrates the benefits of effective communication and coordination.

The genesis of this report is a concern over two overarching and crucial issues: (1) improving timeliness and effectiveness of consumer protection and (2) minimizing the ultimate costs of the insolvency (and thus the "hit" to guaranty system capacity).

Specifically, this report addresses the following questions regarding communication and coordination efforts among regulators, receivers and guaranty associations:

- Why should regulators want to involve guaranty associations?

- When should guaranty associations become involved in the process of a troubled company? Should it be as late as at the point of liquidation? Should it be prior to the entry of a liquidation order? Should it be during rehabilitation? Should it be when a company first appears to be at serious risk of becoming insolvent in the near future? Should it be when there is an insolvent run-off?

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[1]: "Guaranty association" is used to refer to both guaranty funds (as that term is frequently applied to the property and casualty guaranty entities) and guaranty associations (as that term is usually applied to the life and health guaranty entities).

[2] "Troubled Company" is used loosely here to refer to any situation in which a company is in administrative supervision, conservation, rehabilitation, or has been otherwise identified as a company for which there exists a significant possibility of liquidation in the near-to-intermediate term future.

- How should guaranty association involvement be structured? Should the type of involvement differ based on the status of the troubled company?

- What specific issues would be better addressed because of earlier communication and coordination among/between regulators, receivers and guaranty associations and their national associations – National Conference of Insurance Guaranty Funds ("NCIGF") and the National Organization of Life & Health Insurance Guaranty Association ("NOLHGA")?

- What are the potential challenges to consider in developing optimal structures for communication and coordination efforts and how can those challenges be met?

- In cases in which guaranty associations need not be involved pre-receivership, what are "best practices" for interaction between regulators and their receivership operations in planning and preparing for the potential insolvency of a troubled company?

INTRODUCTION: WHY NOW?

Business practices and coverage arrangements for many modern insurance companies are more complex than ever before.

Regulators, receivership offices, and guaranty associations currently face historically high levels of insolvency activity. The experience gained has not been without considerable difficulties. There is a need to memorialize problems encountered and lessons learned for the benefit of those who will have the responsibilities for administering future insolvencies and handling resulting claims. Further, the challenges that the insolvency of a complex company will bring about make it essential that all players in the liquidation of the company work together to resolve what are sure to be difficult issues – issues that must be dealt with to maximize protection of policy claimants.

Gramm Leach Bliley is now a reality. Many groups support federal chartering of insurance companies in one form or another. Alternatives to the current system of insolvency administration have been put forth. If we want the system of state-based insurance regulation to survive in something resembling its current form, we need to be able to demonstrate that it is efficient, businesslike, and most importantly, responsive to consumer needs.

Against this backdrop, regulators, receivers designated by regulators, and guaranty associations need to pursue actively the shared goal of protecting insureds and claimants of insurance companies in liquidation. To achieve this important goal, a high level of cooperation and coordination among regulators, receivers and guaranty associations is necessary when dealing with troubled companies before they are placed into liquidation.

This paper discusses how regulators, receivers and guaranty associations might better work together to protect consumers and create a seamless transition for troubled companies. It builds on the experience of Arkansas and Arizona, where having the guaranty association functions within the department of insurance has produced beneficial and effective communication and coordination.

be established. It may be that adjuster notes can be furnished in electronic format and will not need to be printed out by TPAs; however, if this is not possible, duplication of such is another labor/time intensive task that needs to be addressed pre-liquidation.

For any of the above to be accomplished effectively, lead time is essential.

IMPORTANT FACTORS IN ESTABLISHING EFFECTIVE COORDINATION

There are several important considerations in establishing effective coordination among regulators, receivers, and guaranty associations. These include data transfer issues, state deposits, guaranty association task forces and coordinating committees, reporting between parties, coordination in the transfer of policies and unearned premium calculations, early access payments to the guaranty associations, third party administrators, asset recovery and closing plans.

- Data Transfer Issues

In life and health liquidations, the need for good communication, coordination and cooperation in the transfer of policy data and files (including access to policy administration systems and policy records) is an issue of critical importance to policyholders. There often is a backlog of claims and that backlog will grow until the guaranty associations have a system in place to process and pay claims.

Similarly, in the property and casualty area, timely movement of data and files to the guaranty associations is critical in connection with claim payments, especially in cases where claimants are receiving periodic ongoing benefits, such as workers compensation or no fault benefits.

The data transfer issue should be addressed in advance of the entry of the liquidation order. An early meeting with the liquidator and guaranty associations to begin planning for the transfer is recommended. One consideration in this process is whether statutes in the state of domicile restrict the regulator's ability to share certain confidential information with the guaranty associations. This can be addressed by executing a confidentiality agreement with the guaranty associations if necessary. Also, state statutes should be adjusted to acknowledge the necessity of pre-liquidation information sharing and express provisions should be added, as needed, to permit the regulator and receiver to do so.

In property and casualty estates, usually it is advisable that guaranty association data consultants and company personal work side-by-side to put data into a format that will be usable by the guaranty associations. If the company is currently making use of two or more data systems, which would not be unheard of in a large insolvency, it is clear that this project becomes more complex and requires more time and financial resources. Test files can and should be forwarded to the NCIGF well in advance of the projected triggering date for the funds. In this way, conversion issues can be identified while there is still time to make appropriate adjustments. Often, data will be under the control of an outside vendor. Regulator or receiver staff should negotiate early on with these entities to ensure that the release of data by vendors or issues relating to system hardware do not become obstacles to the conversion process.

- State Deposits

There needs to be a mutual understanding between the regulator, liquidator and the guaranty associations as to how deposits will be treated. The regulator and liquidator can take the lead in arranging discussions with guaranty associations, possibly in conjunction with quarterly NAIC meetings.

- Working with Task Forces and Coordinating Committees

In the latter stages of liquidation proceedings, task forces and coordinating committees are the vehicles through which ongoing communications between liquidators and guaranty associations are maintained. Of critical importance is communications with respect to the financial condition of the estate because this will

reveal the possibilities for early access and enable guaranty associations to monitor and adjust ongoing assessment levels.

With respect to property and casualty insolvencies, task forces and coordinating committees can be of valuable assistance to the liquidator in crafting settlements with large insureds and with settlements that exceed the guaranty association's statutory cap. This can reduce costly litigation while crafting a prompt and fair settlement for the policyholder or claimant.

At the point where coordinating committees are established, it makes sense for a representative of the committee to contact the regulator and obtain the name of a contact person with whom the coordinating committee may interface.

- Reporting between guaranty associations and receivers using the UDS and other means of communications

Liquidators need the UDS to function efficiently to maximize estate assets. Liquidators that allow guaranty association staff to go on site to assess whether or not the companies data is usable and can be made available will significantly reduce unwanted and unneeded problems in connection with UDS reporting. This needs to be done pre-liquidation to avoid payment delays to claimants.

- Coordination in the Transfer of Policies

This issue is particularly important in life and health insolvencies because coordination in the transfer of policies directly impacts consumers and can reduce expenses of the estate while maximizing assets. Once again, this is an issue that can and should be addressed as early as possible in the receivership process.

- Unearned Premiums

The return of unearned premiums to policyholders is often delayed, causing consumer frustration and hampering the ability of the consumer to pay for replacement coverage. Data issues and the complexity of various state laws can cause these delays. However, these delays may be reduced by communication among liquidators and guaranty associations (especially their information technology personnel) in the pre-liquidation phase.

- Early Access

Early access is critical to the guaranty associations' ability to meet statutory obligations, especially in times of heavy activity. Timely and substantial early access should be a top priority for the liquidator. At least annually, receivers should provide reports on the status of available assets to make early access distribution. Such reports permit guaranty associations to determine their financial needs. This may help avoid unneeded assessments.

- Third Party Administrators

In life and health liquidations, liquidators and guaranty associations often use TPAs to tackle the large backlog of claims and to administer ongoing claims. If policy data is leased or sold by the liquidator without coordinating such transfer with the guaranty associations, the ability of the guaranty associations to transfer policy and claims administration can be impaired. Early and open communications between the liquidator and the guaranty associations regarding the selection of a TPA can result in more efficient claims handling, benefiting consumers and reducing estate expenses.

If possible before the entry of a liquidation order, guaranty associations and liquidators should work together to locate files, determine if data is in UDS format and appropriately instruct the TPAs with respect to the shipment of files and transfer of data.

- Asset Recovery

Liquidators are charged with maximizing the assets of the estate and, in some instances, are forced to pursue asset recovery in court. Guaranty associations may be able to help in litigation since their interests are aligned with, and sometimes identical to, that of the liquidator. The liquidator and guaranty associations should communicate with respect to potential litigation to determine if guaranty association participation would be helpful.

- Winding Up and Closing Plan Activities

Generally, the longer a receivership estate is open, the more costly it becomes. Ongoing administrative expenses reduce the assets of the estate and result in fewer assets with which to pay creditors. In some cases, however, it can be more costly to force early closure than to simply ensure that costs are minimized while the estate is in a phase of waiting for losses to develop or for litigation to conclude. Guaranty associations and liquidators should have open communications to develop a plan for closing out estates at the earliest possible opportunity.

CONCLUSION

This white paper while directed to the regulatory community and guaranty associations, is ultimately about policyholders, claimants and creditors. Accordingly, the document must be the beginning, not the end, of efforts to improve this component of the national system of state based regulation.

As a point of departure, two immediate steps should be taken. First, continued oversight of the improvements recommended by the white paper working group should be undertaken by the NAIC through the Insolvency Task Force. Second, the process of communication and collaboration should begin with the next impaired company. For example, if the entry of a liquidation order is contemplated, communication and coordination between the regulators and the guaranty associations should begin as early as possible prior to the entry of a liquidation order. In some cases there may be challenges in pursuing the goal of early communication and coordination, such as confidentiality issues, perception concerns, legal considerations and the need for an objective cost/benefit assessment. Where there is a significant possibility that a company will be liquidated, timely communication and coordination between regulators and guaranty associations can help create a more seamless, effective and efficient transition for all interested parties, which should expedite the handling of claims and payments for policyholders by guaranty associations.

- Next Steps: Areas For Further Analysis and Action

    - What statutory provisions in the different states apply to the sharing of pre-liquidation information with guaranty associations and how do these differ from state to state?

    - What kinds of costs and benefits are associated with early communication and coordination among regulators, receivers, and guaranty associations, and who bears the burden of paying for engaging – or not engaging – in such early communication and coordination?

    - What kind of framework should be in place for the regular briefing of guaranty associations by the state of domicile?

    - What changes are needed to the NAIC Model Laws to ensure adequate planning to accomplish a smooth transition to liquidation with minimal disruption of payments to policyholders?

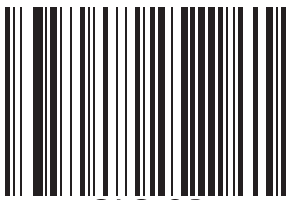
    - What changes are needed to NAIC publications such as the *Receivers* and *Troubled Company Handbooks* to address ideas presented in this report? Currently, the *Troubled*

Company Handbook section on pre-receivership consideration has very little on guaranty associations.

- What changes in the laws are necessary to allow more flexibility for regulators and receivers to communicate with guaranty associations pre-liquidation?

- What areas of potential conflict and divergent interests exist between guaranty associations and the statutory receiver as these address their respective statutory obligations? How can such potential conflicts be avoided or mitigated? What is the role of the regulator?

- Where can efficiencies be achieved in the operations of the guaranty associations as they coordinate their efforts with the court-appointed receiver within a national framework? In additional to resolving legal issues, practical issues such as minimizing expenses in claims handling and claims adjudication across the system should be considered.



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