

Revisions specific to the new NAIC Model Guideline discussed below were adopted subject to the NAIC's adoption of the Model Guideline, which will be considered at the 2021 NAIC Spring National Meeting

Chapter 5 – Claims

V. PAYMENT OF APPROVED CLAIMS

A. Priority of Distribution in Receiverships

5. Class 3 and 4 – Claims for Policy Benefits

a. Deductible and Limits

The policyholder's claim is for the amount that the insurer should have paid. The insurer's liability attaches after the deductible has been paid by the insured ("Non-Advancement Policies"). However, for some policies (e.g., some workers' compensation policies), the insurer is required to pay the claim and seek the deductible from the insured (thereafter, known as "Large Deductible Policies"). It is common for insureds to post collateral with the insurer for deductible payments that may be made by the insurer, for which the insurer then seeks reimbursement from the insureds. ~~With other policies, the insurer's liability attaches after the deductible has been paid by the insured ("Non-Advancement Policies"). There are three available Model alternatives that provide for the disposition of large deductible policy recoveries between receivers and guaranty associations: IRMA Section 712, the Guideline for Administration of Large Deductible Policies in Receivership (Guideline XXXX) and, National Conference of Insurance Guaranty Funds (NCIGF) Model Large Deductible Act (NCIGF Model) provides for the disposition of Large Deductible Policy recoveries between receivers and guaranty associations.~~ Individual state statutes ~~(see, for example, 40 PA §221.43a)~~ based on the NCIGF Model or Guideline XXXX may differ from IRMA Section 712 in certain respects.²²

IX. BEST PRACTICES FOR SUCCESSFUL BILLING AND COLLECTION OF LARGE DEDUCTIBLE PROGRAMS IN LIQUIDATION

A. Overview of Large Deductible Worker's Compensation

A large deductible worker's compensation policy or program is a method of insuring workers' compensation risk with the employer assuming some of that risk in a deductible of \$100,000, \$250,000, or even higher per claim ~~(varies by state)~~ and an insurer taking on the remaining risk. Large deductible programs for workers' compensation can be complex arrangements and depend on the employer's fulfillment of its obligation to reimburse all claims within the deductible. If the employer is unable to fulfill that obligation, the financial consequences to the employer could be catastrophic, and the employer's inability to pay could have a cascading impact on the financial health of the insurer. In order to manage this risk successfully, insurers and state insurance regulators must have a clear understanding of the nature and size of the insurer's exposure. Additionally, they must ensure that there are adequate measures in place to limit and mitigate the risk of the employer's failure to pay and ensure injured workers will receive benefits in compliance with state law.

~~In states that permit p~~Professional employer organizations (PEOs); ~~PEO's~~ often operate large deductible workers' compensation programs that are backed by large deductible policies. A PEO is an outsourcing firm which provides services to small and medium sized businesses. ~~The PEO enters into under~~ a contractual co-employment agreement with its clientele. Where permitted by state law, these services

~~generally include workers' compensation coverage obtained by the PEO in its own name. If the PEO assumes most of the risk of that program by purchasing a large deductible policy, it recovers the estimated cost through the fees it charges its clients. If those fees are inadequate to cover the actual costs of the claims, or if the employer or the PEO fails to pay for any other reason to reimburse its share of the claims, the insurer incurs an unexpected liability, and the~~The failure of the claim reimbursement mechanism has been a significant factor in a number of insurer insolvencies. For further information and guidance on high-deductible workers' compensation insurance and PEOs, refer to the NAIC's 2016 Workers' Compensation Large Deductible Study.

B. Administration of Large Deductible Plans

The administration of large deductible plans is impacted by entry of an order of liquidation. In such cases, ~~there are two options available regarding statutory authority concerning Large Deductible Worker's Compensation, namely:~~ there are three versions of applicable model legislation for states to consider. The most recent is Guideline ~~XXXX~~. The three Model alternatives are as follows:

- (a) *Insurer Receivership Model Act* (Model #555—IRMA) Section 712 Administration of Loss Reimbursement Policies; ~~or;~~
- (b) *Guideline for Administration of Large Deductible Policies in Receivership* (Guideline ~~XXXX~~); ~~or,~~
- (c) National Conference of Insurance Guaranty Funds (NCIGF) Model Large Deductible Act (NCIGF Model).

~~Both~~ Each of these three alternatives provide statutory guidance that articulates the respective rights and responsibilities of the various parties, ~~which would greatly enhance~~ the ability to manage complex large deductible programs post-liquidation. Generally, ~~both~~ all approaches provide for the collection of large deductible reimbursements from policyholders, clarify entitlement to reimbursement, and ensure that the claimants are paid. ~~The provisions in each of the two options generally complement each other except for conflicting provisions regarding the issue of the ultimate ownership of and entitlement to the deductible recoveries and collateral as between the estate and the guaranty fund. The most significant difference is the approach taken to address the ultimate ownership of and entitlement to the deductible recoveries paid by the employer or drawn from collateral as between the estate and the guaranty fund, and collateral as between the estate and the guaranty fund. IRMA § 712 generally treats these funds as general assets of the estate, while Guideline XXXX and the NCIGF Model apply them directly to the payment of claims. It should be noted that the NCIGF Model has evolved over time based on additional experiences from insolvencies and the NCIGF continues to modify its Model as warranted; as a result, states that have based their laws on the NCIGF Model have done so with varying language.~~

C. Communication and Reporting Between the Liquidator, Policyholders and Guaranty Associations, Including Administration of Self-Funded Policyholder Programs

1. Claim payment, reserve, and reimbursement reporting-

The administration of large deductible programs requires strong communication and reporting programs between the Liquidator, guaranty associations, and policyholders. Under ~~the both all three Model Acts~~ alternatives, the Liquidator is required to administer large deductible programs, and related collateral securing large deductible obligations, consistent with the policyholder's policy provisions and large deductible agreement ("LDA") ~~except where those provisions conflict with the statute, as amended by the provisions of the Model Act. Both All three Model Acts~~ alternatives make provision for two types of LDAs, those that permit self funding direct payment by the policyholder, and those that require initial payment by the

insurer or guaranty association with reimbursement by the policyholder. Both arrangements necessitate the reporting of claim payments and outstanding claim reserves to the Liquidator for billing, guaranty association reimbursement, and establishing collateral need requirements. The Liquidator's uniform data standard or UDS should be deployed as the reporting protocol for guaranty association claim payments and outstanding claim reserves. Policyholders that continue self-payment funding under their LDA will need to continue or establish a claim information reporting protocol with the Liquidator through the policyholder's third-party claim administrator or through a proprietary claim information aggregator. ~~Both~~ All three Model ~~Acts~~ alternatives require the Liquidator to form an independent opinion on outstanding claim reserves reported by policyholders and guaranty associations, including ~~a safety factor~~ an allowance for adverse development and incurred but not reported liability to ensure that collateral remains adequate throughout the administration of the program.

2. Agreements between Liquidator and guaranty associations-

~~An agreement between the Liquidator and the guaranty funds may be advisable. For~~ though it is less important in states that have enacted ~~the either of the two Model Acts~~ one of the three Model alternatives or other comprehensive similar statutory framework for the Liquidator's administration of large deductible programs, ~~an agreement between the Liquidator and the guaranty associations is not necessary. The Models provide a comprehensive framework for administration of the program. For states that have not enacted either Model, an agreement between the Liquidator and guaranty associations may be advisable.~~ The Model alternatives can serve as an outline for the issues that should be addressed in such an agreement in states that have not enacted pertinent legislation. Among other things, an agreement should address: whether large deductible recoveries are estate assets subject to the Liquidator's distribution regime or directly pass-through to the guaranty association on account of its prior claim payments; claim reporting protocols; frequency of collateral review and reimbursement activity; and administration of collateral for under collateralized non-performing policyholder accounts.

3. Converting policyholder accounts from an incurred to paid basis

~~Generally, LDAs are on a paid basis with collateral for the reserves. The NCIGF Model Act provides for the conversion of a policyholder's LDA at liquidation from an "incurred" to a "paid" basis. However, liquidators may encounter contractual arrangements where an LDA is constructed such that policyholders pay periodic large up-front payments that were accounted as premium based on losses incurred, as opposed to paid basis. After a certain number of years, the LDA provides policyholders with an opportunity to elect paid basis rather than incurred basis; which converts the incurred payments to collateral. The liquidator may wish to negotiate a conversion at the outset of liquidation. Conversion of a policyholder's LDA at liquidation from an "incurred" to a "paid" basis is beneficial to policyholders in several ways. Most importantly, conversion at liquidation treats pre-liquidation incurred loss payments made by the policyholder to the insurer as collateral, and thus property of the policyholder pledged to the insurer and restricted to the satisfaction of that policyholder's claims, rather than as a general asset of the liquidation estate. Conversion also offers flexibility to a policyholder as to the type of security provided to an insurer in satisfaction of the collateral requirement. Conversion affords policyholders the ability to utilize a letter of credit to secure an insurer for the outstanding portion of their loss, rather than payment of cash, since the outstanding bill after conversion is reflected in the Liquidator's collateral need analysis, rather than an incurred loss billing.~~

~~The NCIGF Model Act recognizes these important policyholder rights and provides incentive to policyholders to cooperate with the Liquidator's administration of large deductible programs and guaranty association reimbursement.~~ The Liquidator should consider notifying large deductible policyholders of these important policyholder rights at the inception of a liquidation proceeding and offer policyholders the opportunity to elect to convert their large deductible programs from an incurred to paid basis, ~~in accordance with the NCIGF Model Act,~~ memorializing any elections with an endorsement that otherwise follows and requires the policyholder to adhere to the provisions of the applicable law ~~the NCIGF Model Act~~.

4. Large deductible billing by Liquidator-

The Liquidator should establish a large deductible billing and collection program that bills policyholders on a periodic basis, e.g., quarterly, ~~that meets Liquidator and policyholder expectations for claim payments made by the estate prior to liquidation and by guaranty associations after liquidation.~~ The Liquidator's invoice to policyholders should communicate a claim payment summary that includes detail such as the insurer or guaranty association's check number, date of payment, payee, account year, and remaining large deductible limits. Large deductible programs that are ~~self-funded~~ paid directly by policyholders should also report their claim payments to the Liquidator on a similar periodic basis, so that the Liquidator can establish appropriate claim reserves, track the exhaustion of the policyholder's deductible limits, report to reinsurers and collect reinsurance. Consideration should be given to using one of many proprietary billing and collection software programs to automate the large deductible billing and collection process. Large deductible recoveries that are subject to guaranty association reimbursements should be aggregated and distributed on a quarterly or other periodic basis that balances the Liquidator's accounting requirements and the guaranty associations' reimbursement needs.

5. Annual collateral review by Liquidator-

~~The NCIGF Model Act Guideline XXXX and the NCIGF Model, consistent with the typical LDA,~~ requires the Liquidator to perform ~~an periodic-annual~~ collateral review for each policyholder account. Consistent with the typical LDA, this review should be performed annually, to ensure that the Liquidator holds adequate collateral to support a policyholder's large deductible obligations and to release any excess collateral held back to the policyholder. This review should include a report to the policyholder on total incurred claims, claims paid, outstanding reserves, including an appropriate allowance for adverse development and claims incurred but not reported, any additional safety factor and total collateral need. The Liquidator's collateral review should result in a report to the policyholder and an invoice for additional collateral need or a release and distribution of excess collateral. The Liquidator should consider whether any additional safety factor should be included for non-performing policyholder accounts. ~~The NCIGF Model Act Guideline XXXX~~ provides flexibility on the timing of the annual review, enabling the Liquidator to perform the annual review process throughout the calendar year so that all policyholder account reviews are not due at the same time.

D. Administration Fees

Section 712 (G) ~~OF~~ IRMA provides:

The receiver is entitled to recover through billings to the insured or from large deductible policy collateral all reasonable expenses that the receiver or guaranty associations incur in fulfilling their responsibilities under this Section. All such deductions or charges shall be in addition to the insured's obligation to reimburse claims and related expenses and shall not diminish the rights of claimants.

Further, Section 712(F) provides, in part:

The expenses incurred by a guaranty association in pursuing reimbursement shall not be permitted as a claim in the delinquency proceeding at any priority; however, a guaranty association may net the expenses incurred in collecting any reimbursement against that reimbursement.

Several states have adopted statutory provisions similar to the IRMA provisions regarding handling of large deductibles in an insolvency and provide for the Receiver to retain reasonable actual expenses incurred from the

reimbursement to the guaranty association(s). Similarly, statutes may provide for the guaranty association to net expenses incurred in collecting a reimbursement.

Guideline XXXX subsection (F) provides:

- (a) The receiver is entitled to recover through billings to the insured or from collateral all reasonable expenses that the receiver incurred in fulfilling its collection obligations under this section. All such deductions or charges shall be in addition to the insured's obligation to reimburse claims and related expenses and shall not diminish the rights of claimants or guaranty associations.
- (b) To the extent the receiver cannot collect such expenses pursuant to paragraph (1), the receiver is entitled to deduct from the collateral or from the deductible reimbursements reasonable and actual expenses incurred in connection with the collection of the collateral and deductible reimbursements.
- (c) To the extent such amounts are not available from reimbursements or collateral, the receiver, or guaranty associations if provided under an agreement with the receiver under subsection D(5), shall have a claim against the estate as provided pursuant to [insert state priority of claim statute].

When there is no statutory guidance, receivers should include a provision for reimbursement of reasonable actual expenses in an agreement with the guaranty associations regarding the collection and allocation of large deductibles.

E. Policy and Collateral Definitions

It is important that state laws define large deductible workers' compensation policies and large deductible collateral.—Defining the treatment of such policies and associated collateral is imperative for developing policies and processes for administering the collection of assets. The following definition is taken from Guideline XXXX. The definitions in the other Model Acts are similar; however, the term used in IRMA is “loss reimbursement policy”.

~~For purposes of this handbook,~~ “Large deductible policy” means any combination of one or more workers' compensation policies and endorsements ~~issued to an insured~~, and contracts or security agreements entered into between an insured and the insurer in which the insured has agreed with the insurer to:

- (a) Pay directly the initial portion of any claim covered under the policy up to a specified dollar amount, which the insurer would otherwise be obligated to pay, or the expenses related to any claim; or
- (b) Reimburse the insurer for its payment of any claim or related expenses under the policy up to the specified dollar amount of the deductible.

The term “large deductible policy” also includes policies which contain an aggregate limit on the insured's liability for all deductible claims, ~~in addition to~~ a per claim deductible limit or both. The primary purpose and distinguishing characteristic of a large deductible policy is the shifting of a portion of the ultimate financial responsibility under the large deductible policy to pay claims from the insurer to the insured, even though the obligation to initially pay claims may remain with the insurer, and the insurer remains liable to claimants in the event the insured fails to fulfill its payment or reimbursement obligations.

The dollar amount of “large” will vary by state law. While many states might associate a minimum financial threshold, it is more important to consider the administration of the policy compared to a traditional policy. Deductible amounts can include claim-related payments by the insurer for medical and indemnity benefits, allocated loss adjustment expenses, such as medical case management expenses, legal defense fees, and independent medical exam expenses.—It is critical that the policy specify the claim-related payments that are the responsibility of the policyholder and not be inside agreements or other agreements outside of the policy.

Collateral held by the insurer should be defined as amounts held as security for the insured's obligations under the large deductible policy. The policy should ~~provide-specify~~ acceptable financial instruments that can be held for the large deductible policy. Typical collateral requirements include: cash, letters of credit, surety bonds, or other liquid financial means held for the benefit of the insurer.

Guideline XXXX defines "large deductible collateral" to mean "any cash, letters of credit, surety bond, or any other form of security posted by the insured, or by a captive insurer or reinsurer, to secure the insured's obligation under the large deductible policy to pay deductible claims or to reimburse the insurer for deductible claim payments. Collateral may also secure an insured's obligation to reimburse or pay to the insurer as may be required for other secured obligations."

F. Responsible Party ~~F~~for Collection of Large Deductible Reimbursements

It is critical to immediately establish the party responsible for billing and collecting large deductible payments or reimbursements. While some states might have specific statutory language that specifies the entity responsible, some statutes might be silent. In the case where the statutes do not specify responsibility, it is recommended that the receivers and guaranty associations enter into an agreement that allows for the most efficient administration of the large deductible collections.

Specific consideration should be given to large deductible policies that provide coverage in multiple states and have claimants subject to the jurisdiction of multiple guaranty funds.—If feasible, the most efficient approach for such policies would likely be for the receiver to administer the deductible billing and collection process. Throughout the life of the estate, claimants continue to incur benefit payments and expenses and deductible collection efforts may last beyond the life of the estate. The party responsible for collections needs the ability to compromise and settle the future obligations.

The receiver should make provisions in its discharge motion and Court order, to the extent possible, regarding the transition of ongoing deductible collections to the guaranty association as well as the disposition of any collateral being held by the receiver.

G. Treatment of Collateral in Receivership

When collateral has been posted by or on behalf of a large deductible policyholder, what does the receivership estate actually own?—The answer is generally found in the documents pledging the collateral to the insurer.

~~The Insurance Receivership Model Act, NAIC Model Law # 555 ("IRMA")~~ defines "property of the estate" to include "all right, title and interest in property ... includ[ing] choses in action, contract rights, and any other interest recognized under the laws of this state."¹—In states without an explicit statutory definition, the common-law definition is substantially similar.

This means that the insurer's right to draw on the collateral automatically becomes an asset of the receivership estate, but the collateral itself is not an estate asset unless and until it is drawn.—In the first instance, the conditions and procedures for drawing the collateral should be spelled out in the relevant contract documents (which could include third-party instruments such as letters of credit or surety bonds), but state law could provide

¹ IRMA § 104(V)(1).

additional rights,² and will specify what the receiver may do when the documents are silent, incomplete, or missing.

Possession and control over the collateral are distinct from ownership.—The insurer could already be in possession of the collateral before the receivership, or the receiver might act to take possession by enforcing applicable contract rights or by negotiating an agreement.—Nevertheless, this does not immediately give the receiver the right to use the collateral to pay claims.—The defining characteristic of collateral is that it is intended to serve as a backstop in case the policyholder does not meet its obligations to pay all reimbursements promptly and in full.—Commonly, the right to draw on collateral only attaches after the policyholder has defaulted or has consented to a draw, or, if the collateral is a letter of credit (LOC), after the issuer has given notice of nonrenewal (in which case the receiver must act promptly to call the LOC or obtain replacement collateral).—There could also be the opportunity to negotiate an agreement under which the policyholder turns over the collateral and makes a lump-sum payment to commute any further reimbursement obligations, or the collateral might have been structured from the outset as a “working” loss fund from which the insurer was expected to pay claims in the ordinary course of business.

In any case, while it is essential for the receiver to preserve and exercise the right to access the collateral as needed, it is also essential to ensure that collateral is not dissipated to pay claims that the policyholder should be funding.—Special consideration needs to be given in situations where the policyholder is at risk of being or becoming judgment-proof, or where rights to the collateral are shared with other creditors of the policyholder and prompt action is necessary to preserve the receiver’s priority.

When the guaranty association is paying the claims, it is generally entitled to receive the proceeds of any policyholder reimbursements, including draws on the collateral.—Under laws substantially similar to IRMA, these payments are considered early access distributions (but without the necessity for court approval) which may be subject to subsequent clawback, while Guideline XXXX and ~~laws substantially similar to~~ the NCIGF Model treat them as the ultimate source of funding for the underlying claims, so that they belong unconditionally to the guaranty association.³—Either way, however, it is the receiver rather than the guaranty association that has the right and obligation to draw on the collateral,⁴ unless there is a formal written agreement assigning that right to the guaranty association.

Finally, there is always the hope that the policyholder’s reimbursement obligations will be oversecured or will become oversecured as claims are run off.—In that case, any excess collateral will revert to the policyholder or the policyholder’s guarantor.—State law might expressly provide a process for determining when excess collateral is being held by or on behalf of the receiver,⁵ or the ability to return collateral before the estate is closed might be part of the general powers of the receiver.—However, because workers’ compensation is a long-tail exposure with significant risk of adverse reserve development, receivers must take great care not to make premature or excessive return distributions.

H. Issues Raised by Net Worth Exclusions and Deductible Exclusions

Unlike other lines of insurance, workers’ compensation insurance is generally exempt from the statutory caps on guaranty association coverage, so that the guaranty fund is usually obligated to pay workers’ compensation claims

² For example, IRMA § 712(D) specifically provides that the relevant provisions of the policy are not controlling “where the loss reimbursement policy conflicts with this section.”

³ Compare IRMA § 712(C)(3) with Guideline XXXX § (C) and NCIGF ModelA § 712(C).

⁴ See Guideline XXXX § (E)(3) and NCIGF ModelA § 712(E)(3).

⁵ See, e.g., Guideline XXXX § (E)(4) and NCIGF ModelA § 712(E)(5).

in full. However individual states may have adopted caps on guaranty association coverage.⁶—States have created this exception to honor their state’s promise that injured workers will be paid the full benefits to which they are entitled.—The general purpose of these exclusions is to avoid any obligation for the guaranty association to pay losses that can and should be borne by the policyholder.—Net worth exclusions make guaranty association protection unavailable to policyholders with net worth above a specified threshold, while deductible exclusions expressly prohibit guaranty association coverage for amounts within a policy deductible.

Unless these exclusions are drafted and implemented carefully, there is a risk that they could result in delays in claims payments or even a complete loss of coverage.—In some states, claimants might be protected by an uninsured employer fund, but that is not the purpose of those funds, so even if such a fund exists in your state, it should be a priority to ensure that however it is done, the estate, employer, or guaranty association will provide for payment in full of all benefits due under the state’s workers’ compensation laws.—If this is not possible under current law, regulators should advocate for a change in the law.—A variety of successful approaches are available; there is not a single one-size-fits-all solution that is best for every state.

1. Net Worth Exclusions:

The ~~PC-GA Act~~ *Property and Casualty Insurance Guaranty Association Model Act (#540)* contains an optional section, with a variety of alternative provisions states can select, excluding coverage for high-net-worth insureds, whether they are individuals or business entities.⁷—The base version sets the threshold at \$50 million, while one of the alternatives sets the threshold at \$25 million.—Many states have enacted some version of this clause or some comparable net worth exclusion.

The impact on workers’ compensation coverage depends on how the exclusion is structured.—In states with provisions substantially similar to any of the three alternatives under the ~~PC-GA Act~~ *Model 540*, coverage is excluded completely for first-party claims by high-net-worth insureds, but workers’ compensation claims against high-net-worth policyholders are administered by the guaranty association on a “pay-and-recover” basis: that is, the guaranty association has the obligation to pay the claim in the first instance, and the right to be reimbursed by the policyholder.⁸—Thus, claimants are fully protected, and for large deductible policies, this mirrors the structure of the policy for claims within the deductible.—In states with guaranty association laws similar to Guideline XXXX or the NCIGF Model, this is the same reimbursement right the guaranty association would have ~~in the absence of the exclusion~~ as the insurer’s successor: in the absence of the exclusion.

If the policyholder is cooperative, the guaranty association has the option of negotiating an agreement where the policyholder advances funding for claims within the deductible.—However, if the policyholder is not cooperative, guaranty associations have expressed concern that the pay-and-recover framework is burdensome and gives the policyholder too much leverage to avoid or delay paying its obligations in full.—If ~~PC-GA Act~~ *Model 540*’s Alternative 2 is modified to treat workers’ compensation claims the same as other third-party claims, then the guaranty association has no obligation unless the formerly high-net-worth

⁶ See *Property and Casualty Insurance Guaranty Association Model Act*, ~~NAIC Model Law~~ (#-540 (“PC-GA Act”), § 8(A)(1)(a)(i).—Almost all states have some provision requiring payment in full of workers’ compensation claims, but some states might have caps or other limitations on coverage.

⁷ ~~PC-GA Act~~ *Model 540*, § 13.

⁸ Alternative 1 applies the pay-and-recover obligation to all third-party claims.—Alternative 2 excludes most third-party claims as well as all first-party claims, but requires the guaranty association to pay workers’ compensation claims, statutory automobile insurance claims, and other claims for ongoing medical payments.—Alternative 3 excludes only first-party claims and claims by out-of-state claimants that are subject to a net worth exclusion in the claimant’s home state; this alternative does not create any statutory right of recovery when the guaranty association is obligated to pay a third-party claim.

policyholder has become insolvent.⁹—Otherwise, the claimant’s only recourse is against the policyholder or the insured’s estate.—As stated above, the injured worker should be protected by some means in these cases.

When a guaranty association net worth exclusion and a large deductible both come in to play on the same claim, it is imperative that the receiver and guaranty association stay in close communication in order to avoid any confusion regarding which entity is responsible for the collection.—In ~~both~~ IRMA §712, Guideline XXXX and the NCIGF Model large deductible model statute, the guaranty fund is entitled to collect net worth reimbursements.—Coordination of these collections with receiver efforts to collect on high deductible will do much to avoid duplication of billings and potential resulting collection delays.

2. Deductible Exclusions:

~~The PC GA Aet Model 540~~ does not contain any explicit deductible exclusion.—Instead, it simply provides that “In no event shall the association be obligated to pay a claimant an amount in excess of the obligation of the insolvent insurer under the policy or coverage from which the claim arises.”¹⁰—However, some states have enacted explicit language further clarifying that there is no guaranty association coverage for amounts within a policy’s deductible or self-insured retention.¹¹ For example, Minnesota law excludes “any claims under a policy written by an insolvent insurer with a deductible or self-insured retention of \$300,000 or more, nor that portion of a claim that is within an insured’s deductible or self-insured retention” from coverage by the property and casualty guaranty association.¹²—A Minnesota employer entered into an employee leasing arrangement with a PEO, which obtained a workers’ compensation policy with a \$1 million deductible.—Both the PEO and the insurer became insolvent, and the Minnesota Court of Appeals held that there was no guaranty association coverage for workers’ compensation claims against the client employer because of the statutory deductible exclusion.¹³—The court observed that the Legislature deliberately chose to protect the guaranty association from unlimited exposure, without mentioning that the Legislature also deliberately created an exception making the cap on coverage inapplicable to workers’ compensation claims (which strongly suggests that the statute in question, which is tied to the statutory \$300,000 cap on coverage, was not written with workers’ compensation in mind).¹⁴—Likewise, the court took for granted that the statute’s undefined term “deductible” included the contract provision at issue in the case, even though the insurer had assumed the unconditional liability to pay all claims in full.—The opinion did not consider the possibility that the Legislature’s intent was simply to clarify that the guaranty association has no obligation to drop down and pay claims from the first dollar if the insurer would have had no obligation to pay those claims.

Therefore, if states determine that there is a need to include express provisions addressing deductibles and self-insured retentions in their guaranty association laws, it is essential to avoid unintended consequences.—In particular, the key terms should not be left undefined.—For this reason, IRMA coined the term “loss reimbursement policy” in its section addressing these types of policies, to distinguish them from true

⁹ ~~PC GA Aet Model 540~~, § 13(B)(2) Alternative 2.

¹⁰ ~~PC GA Aet Model 540~~, § 8(A)(1)(b).—Compare ~~LH GA Aet Life and Health Insurance Guaranty Association Model Act (#520)~~, § 3(B)(2)(a), expressly excluding from life and health guaranty association coverage “A portion of a policy or contract not guaranteed by the member insurer, or under which the risk is borne by the policy or contract owner.”

¹¹ Currently, the only states with language specifically excluding claims within policy “deductibles” are Iowa, Louisiana, Minnesota, Missouri, and Nevada.—Louisiana’s exclusion applies only to policies issued to group self-insurance funds, and Missouri’s does not apply to workers’ compensation claims.

¹² Minn. Stat. § 60C.09(2)(4).

¹³ *Terminal Transport v. Minnesota Ins. Guar. Ass’n*, 862 N.W.2d 487 (Minn. App. 2015), *review denied* June 30, 2015.

¹⁴ Minn. Stat. § 60C.09(3).

deductibles, where the insurer has no obligation to pay anything except the portion of the loss that exceeds the deductible.¹⁵

This is the crucial difference between a “large deductible” workers’ compensation policy and an excess policy.—Although “large deductible” policies transfer a significant amount of risk back to the policyholder, they do not extinguish the insurer’s liability.—That is why “large deductible” policies, in states that allow them, are accepted as a mechanism for satisfying the policyholder’s compulsory coverage obligations, while excess policies generally are not.—Usually, excess workers’ compensation policies may only be issued to self-insurers that have been approved by the state.—It is the approved self-insurance program, not the excess policy, that satisfies the employer’s compulsory coverage obligation, and the insurer has no liability for any portion of a claim that falls within the employer’s self-insured retention.¹⁶—Thus, despite the terminology that is commonly used, it is the excess policy, not the large deductible policy, that functions as a “deductible” in the traditional sense of the term.

It is worth noting, however, that commercial self-insured retention and large deductible policies can vary widely in policy terms and sometimes “side agreements” supplement the policies.—Arrangements can contain aggregate limits, can vary on the obligation for defense cost and expenses and, in some cases permit the insured to “self-fund” its claims with an account in the possession of the TPA which is handling the claims. Because of these complexities, policy terms and any related endorsements and side agreements should be carefully reviewed.—Whether such side agreements are legally enforceable requires a thorough case-by-case analysis in light of applicable state laws.

Chapter 6 – Guaranty Funds/Associations

II. PROPERTY AND CASUALTY GUARANTY FUNDS

J. Large Deductible Policies

In ~~March of 2006~~2016, the NAIC adopted a white paper titled *Workers’ Compensation Large Deductible Study*. ~~The paper revisits and reconsiders issues raised in an earlier 2006 Workers’ Compensation Large Deductible Study.~~ ~~—The 2016 study provides valuable information about how large deductible policies work and special issues that can arise with their use.~~

As used in workers’ compensation coverages, large deductible policies allow employers to retain a certain amount of claims risk, thereby reducing the cost of their workers’ compensation coverage. Typically, these policies are administered by the insurer or a third-party administrator paying claims within the deductible and obtaining reimbursement from the insured employer. In the receivership context, where guaranty funds pay claims within the deductible, there is an issue as to the handling of the insured employer’s reimbursement of payments within the deductible. That is, should the reimbursement be paid to the guaranty fund outside the receivership distribution scheme, or should the reimbursement be treated as an asset of the receivership estate subject to the claims of all creditors? ~~At the time the NAIC white paper was adopted, four states, Pennsylvania, Illinois, California and Texas had~~Several states have provisions in place in their respective receivership liquidation statutes which provided that large

¹⁵ For example, if a consumer has an auto policy with a collision deductible of \$1,000, and the repair costs \$5,000, the insurer’s liability is limited to \$4,000.—“Self-insured retentions” (SIRs) in commercial excess policies are designed to function the same way on a larger scale.—If a business is found liable (or a third-party claim is settled) for \$500,000, and its liability policy has an SIR of \$300,000, the insurer is never responsible for more than the remaining \$200,000, even if the policyholder is bankrupt.

¹⁶ In many states, a separate self-insurance guaranty fund protects claimants if a self-insured employer becomes insolvent. Those funds typically operate entirely under the state’s workers’ compensation laws, not the state’s insurance receivership or insurance guaranty fund laws.

deductible reimbursements should be paid directly to the guaranty fund outside the receivership distribution scheme.⁴⁷

~~Subsequently, Michigan and Utah have also amended their liquidation statutes to deal with the issue of large deductible reimbursements, both of which call for the assets to flow at 100% to the guaranty associations and not be treated as general assets of the estate.⁴⁸~~

~~Legislation continues to be proposed on this issue and receivers should consult their state's laws. (The New Jersey Workers' Compensation Guaranty Fund act has also been amended to address this issue.)⁴⁹ Among the findings and recommendations contained in the NAIC white paper is: "Guaranty fund laws should be changed or clarified to assure that reimbursements by employers for claims paid by guaranty funds under deductible plans go to the guaranty fund instead of simply becoming assets of the estate." As mentioned above, this can also be accomplished by amending receivership/liquidation statutes and this has been the most typical approach in state legislatures thus far. For examples of state codes, see Exhibit 6-4.~~

Where the insolvent insurer wrote large deductible policies, the receiver should be mindful of this issue and should consult with the affected guaranty associations as soon as possible. The receiver should also review those states' guaranty fund statutes where the claims will be processed to determine whether claims within large deductibles are "covered claims" as defined in the appropriate guaranty fund act. Typically, claims under workers compensation policies will be covered. However, claims under policies for other lines of business may not be covered. The availability of guaranty fund coverage is to some extent dependent upon the specific language of the policy involved.

IRMA provides for a different treatment of large deductible collections. Under IRMA [§ 712](#), payments of such monies to the guaranty funds are treated as early access. ~~See IRMA [§ 712](#).~~

~~Under the *Guideline for Administration of Large Deductible Policies in Receivership* (Guideline [XXXX](#)) subsection B, "Unless otherwise agreed by the responsible guaranty association, all large deductible claims that are also "covered claims" as defined by the applicable guaranty association law, including those that may have been funded by an insured before liquidation, shall be turned over to the guaranty association for handling." Refer to the Guideline subsection B for further discussion of deductible claims paid.~~

Chapter 9 – Legal Considerations

III. CLAIMS

I. Large Deductibles

The purpose of these large deductible amounts is to reduce premiums for the insured while permitting the insured to meet statutory or regulatory insurance requirements. Large deductible policies are most common in the workers compensation area but may be found in other types of liability insurance.

Typically, a large deductible policy provides that the insurer will pay claims in full and then collect the deductible amount from the insured. Conversely, first party claims against an auto policy with a deductible are paid minus the amount of the deductible. To ensure that the deductible will be paid, most insurers that write this type of policy will require the insured to post some form of security. This can be a

⁴⁷ 40 P.S. § 221.23a (PA); 215 ILCS 5/205.1; Cal. Ins. Code §1033.5; Tex. Ins. CODE §21A.213.

⁴⁸ MCL 500.8133a; UT 31A-27a-612(6)

⁴⁹ N.J.S.A. 34:15-111.

letter of credit, securities placed in a trust or escrow account for the benefit of the insurer, or some other form of a third-party commitment to reimburse for claims within the large deductible, such as a bond or large deductible reimbursement insurance policy. When the insurer pays a claim, depending on the agreement with the insured, the insurer may either submit a bill to the insured for the amount of the claim paid within the deductible or collect directly from the collateral.

As long as the insurer and the insured remain solvent, there are seldom any difficulties with large deductible arrangements. If the insured becomes insolvent and stops paying the deductible billings and if the collateral held is insufficient to pay current and future billings, the insurer's ability to collect the amounts due will be adversely affected.

If the insurer becomes insolvent and is placed into liquidation, the property and casualty and workers compensation guaranty associations will be triggered to begin paying claims. Just like the insurer, the guaranty association will be responsible for first dollar coverage of the claims. After the guaranty association pays the claim, the liquidator can then collect the amount of the claim within the deductible from the insured or the collateral. ~~Historically, receivers and the guaranty associations disagreed on the disposition of these proceeds has become a very contentious issue between the receivers and the guaranty associations. Some Receivers believe that the proceeds are claims based assets, similar to reinsurance recoverables, which should go into the general assets of the estates and be distributed pro rata to all claimants. The guaranty associations believe that, to the extent that the claim payment is within the deductible, they are not paying a claim on behalf of the insolvent insurer but rather on behalf of the insured and therefore, they should receive the reimbursement directly.~~

The first significant incidence of large deductible policies in a receivership occurred in the administration of the Reliance Insurance Co. Estate. During the early years of this receivership, the guaranty associations paid several hundred million dollars of claims within large deductible limits. After extensive unsuccessful negotiations between the Pennsylvania liquidator and the guaranty associations, a suit was filed in the Commonwealth Court of Pennsylvania asking the Court to determine entitlement to the large deductible recoveries. The suit was rendered moot by passage of Act 46 of 2004 by the Pennsylvania General Assembly. Act 46 provided that the liquidator would collect the deductible reimbursements and deliver them to the guaranty associations that had paid the claims. The Act allows the liquidator to retain part of the reimbursements to offset the expense of collection.

Subsequently, several other states ~~including Texas, Illinois, Michigan, Utah and California~~ have enacted legislation addressing this issue modeled after the National Conference of Insurance Guaranty Funds (NCIGF) Model Large Deductible Act (NCIGF Model). On [date], the NAIC adopted Guideline for Administration of Large Deductible Policies in Receivership (Guideline XXXX) that also addresses this issue. ~~As this area is constantly evolving, a newly appointed Statutes vary by state, therefore, the receiver for a property and casualty large deductible insolvency should insurer must consult local counsel and review the applicable statutes of the domiciliary state and states where the claims will be processed.~~

- § 712 of IRMA requires the receiver to collect the deductible reimbursements as a general asset of the estate, but the amount collected is to be distributed to the guaranty associations that have paid claims within the deductible amount as early access subject to claw-back if the amount distributed ultimately exceeds the amount to which the receiving guaranty association would be entitled from the final estate distribution.
- Under Guideline XXXX subsection B, "Unless otherwise agreed by the responsible guaranty association, all large deductible claims that are also "covered claims" as defined by the applicable guaranty association law, including those that may have been funded by an insured before

liquidation, shall be turned over to the guaranty association for handling.” Refer to the Guideline subsection B for further discussion of deductible claims paid.