

## When an Insurance Company Fails

- *State insurance regulators subject companies to stringent solvency requirements including conservative risk-based capital (RBC) rules, investment limitations, and detailed reporting and analysis, which minimize the risk of insolvencies to policyholders.*
- *The state insurance solvency regime also provides for an orderly process in the rare event that an insurer does become insolvent. This “receivership” process emphasizes the best interests of policyholders.*
- *Unlike a failing bank, which faces immediate customer withdrawals, a failing insurer does not typically face such a “run-on-the-bank” scenario allowing the process to be managed in an orderly manner over a longer period of time.*

### Background

The fundamental tenet of State based insurance regulation is to protect policyholders by ensuring the solvency of the insurer and its ability to pay claims, and states have broad authority and a variety of tools to spot troubled insurers before an insolvency occurs. If a company becomes a concern, regulators take corrective action through a laddered regulatory intervention process. In the unlikely event an insurance company is found to be financially unstable, the insurance department in its home state can use its broad powers to step in and take control of the company, starting the receivership process. The first stage is “rehabilitation.” The state insurance department attempts to stabilize and improve the company’s financial status. A company under the control of the insurance department will continue to honor claims as long as premiums are paid or cash value exists.

If the financial difficulties are too great to overcome, the commissioner declares the company insolvent and the receivership process moves to the next stage: “liquidation.” In liquidation, the receiver attempts to maximize the company’s assets to pay creditor claims. Policyholders have priority over most creditors. Where possible, the receiver will transfer policies to a stable insurer. Once liquidation is ordered, state guaranty associations, who back up policies much like the FDIC backs up bank deposits, will provide coverage to the company’s policyholders who are state residents (coverage is capped and varies based on the type of policy). If the company does not have enough funds to meet its obligations to policyholders or the receiver cannot transfer policies, each state guaranty association assesses member insurers in its state a share of the amount required to meet the claims of resident policyholders. The amount assessed is based on the amount of premiums each company collects in that state on the kind of business for which benefits are required.

### Key Points

- State insurance regulators protect policyholders from insolvencies by subjecting insurers to strict ongoing regulatory requirements, as well as through the orderly receivership process.
- Insurance is a highly competitive business with several thousand companies in the marketplace. If a troubled insurer is identified and cannot be rehabilitated, policies can often be sold to other competitors while retaining all the protections in the policy.
- State guaranty funds serve as a backstop when an insurer’s financial difficulties are too great to overcome.