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

**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 associations¹, 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 company² 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?

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.

NEW INDUSTRY TRENDS AND PRACTICES REQUIRE NEW APPROACHES TO TROUBLED COMPANY PROBLEMS

Business practices of insurance companies have changed much over the last several years. Regulators and guaranty associations may still encounter a company that conducts its business in what might be considered a “traditional” manner. They are just as likely to be confronted with a company having one or more of the following attributes:

- Services are “unbundled” – that is, claims administration may be turned over to third party administrators (“TPAs”)³, many of which may have more than a thousand physical locations. Data may be maintained by a separate entity that was a contractor of the insolvent company. Unlike the troubled company, these separate entities will not be liquidated or under the control of the domiciliary regulator. Moreover, underwriting functions may have been delegated to managing general agent (“MGAs”)⁴. The liquidating insurance company may have had very little day-to-day involvement in any of these “traditional” insurance company functions.
- The now insolvent company may have purchased blocks of business about which the remaining company staff has little understanding – these blocks may be extremely complex and may require that both the receiver and the guaranty associations get “up to speed” quickly in order to determine whether coverage exists and, if so, the extent of the coverage. Data for the different blocks of business may be maintained on several different systems, further complicating the transition to Uniform Data Standards (“UDS”) or other essential data storage systems.
- Insurance programs may be tailored to the needs and demands of various large insured entities. Resulting coverages may be one of a kind manuscript type of coverages. Further, a particular insured may have different coverage arrangements from one policy year to the next. In such situations the need for advance review of programs is necessary.
- “Alternative” coverage programs may have been written. These may involve large deductibles, self-insured retentions and policyholders without insurable interest in loss (e.g.: professional employer organizations, trade associations as policyholders). These require review early on to determine the parameters of guaranty association coverage and jurisdiction.
- Life and Health companies also have evolved substantially since the last significant wave of life/health insolvencies in the early 1990s. Health writers, like some property/casualty carriers, often have developed complex models of producing and servicing business through intricate TPA and MGA networks. Life carriers have dramatically increased the amount of annuity business written, and the annuity products themselves have become much more complex through the development of various guaranty features. In addition, the growth and development of holding company structures adds to potential receiverships complexities seldom seen in the past.

WHY SHOULD REGULATORS AND RECEIVERS INVOLVE GUARANTY ASSOCIATIONS?

Guaranty Associations share the common goal of consumer protection with regulators. In fact, guaranty associations provide the mechanism by which policy claimants with covered claims receive timely claim payments. In most cases, without guaranty associations, such payments would, at a minimum, be delayed for several years. Even at the point when payment could be made from an insolvent estate, such payment would likely only be a fraction of the benefit that would have been received from the insurer before

³ TPAs may mean slightly different things in different jurisdictions; in this paper we are using the phrase to refer to TPAs as defined in Section 1A in the NAIC Third Party Administrator Statute, in 1 *NAIC Model Laws, Regulations and Guidelines*, No. 90 (2002).

⁴ MGAs may mean slightly different things in different jurisdictions; in this paper we are using the phrase to refer to MGAs as defined in Section 2D in the NAIC Managing General Agents Act, in 1 *NAIC Model Laws, Regulations and Guidelines*, No. 225 (2002).

insolvency. This makes guaranty associations the primary source of policyholder protection. In the life company context, guaranty associations ensure the continuation of coverage under policies that would otherwise be expensive or impossible for consumers to replace. The following are just some of the receiver collaboration; and reasons for guaranty association:

- Guaranty associations need the information that is critical to their being able to prepare adequately to handle the claims against an insolvent insurer efficiently and effectively. Assuming that the size, complexity and type of business of any given company has a direct bearing on how much lead-time is needed by the guaranty associations, there is a minimum amount of time, prior to being triggered, in which guaranty associations need to receive information, including quantification of covered liabilities by state, claims system information, lines of business and product specifics, third party agreements, as well as any other arrangements. If adequate information is not gathered pre-liquidation, delays in payments to claimants will result. This creates unnecessary hardship for both the policyholder and claimant and raises questions regarding the efficiency of the insolvency system.
- Guaranty associations can often assist a regulator with formulating a plan for liquidation. Associations are frequently able to devote valuable resources, including legal, financial, actuarial, and other consulting services, in the design of a plan in circumstances in which budgetary or staffing constraints may pose challenges for regulators. If the plan relates to resolving the troubled company's circumstances (rather than liquidation), then guaranty association involvement may be less crucial, although even in such cases, communication with guaranty associations can clarify what guaranty associations can – and cannot – do in connection with such a plan.
- Early involvement of guaranty associations will reduce any delay in transitioning claims to guaranty associations. Protection of policyholders and other policy claimants should be the primary goal for both receivers and guaranty associations.
- Guaranty associations are usually the largest creditors in major insolvencies of insurance companies writing consumer lines of business. This results from their service to policyholders and third party claimants in handling and paying their covered claims.
- A smooth transition process will greatly accelerate reinsurance collections and commutations. The receiver needs usable data from the funds before billing reinsurance is possible. If data conversion is not successfully completed pre-liquidation, the guaranty association's ability to provide usable data to the receiver may be delayed. Reinsurance recoveries are the "bread and butter" of many estates. Not only does effective collection permit early access distributions in larger amounts earlier in the proceeding, it also provides the receiver with needed operating capital. Additionally, it is usual that the longer it takes to collect such reinsurance, the more difficult it becomes for several reasons, including insolvencies of the reinsurers.
- Life company receiverships usually involve a fairly complex transfer of consumers' policies (the in-force business) from the insolvent carrier to a healthy company. The transferred book of business is paid for by a combination of (i) assets transferred from the estate; and (ii) assets provided by the guaranty associations. The guaranty associations are typically parties to such a transfer. The speed at which such a transfer can be done and the costs of completing it can only be optimized if the guaranty associations are centrally involved in the planning process. Obviously, the earlier in the process-prior to commencement of formal insolvency proceedings-this occurs, the more quickly guaranty associations can respond at the appropriate time.

WHEN SHOULD COLLABORATION BETWEEN GUARANTY ASSOCIATIONS AND RECEIVERS BEGIN?

There are different perspectives about how early in the process guaranty associations should become involved. At one end, the perspective has been that they should only become involved after the entry of a liquidation order. At the other end, the perspective is that they may be involved as early as when the insurer is first identified as being a potentially troubled company. The approach will vary based on the

unique circumstances of each troubled company. There is general agreement that some lead time is essential for a successful transition to liquidation.

There are many complex issues to be dealt with pre-liquidation, and the days when guaranty associations first got involved only when a liquidation petition was filed are long past. The important decisions on how to dispose of in-force life policies or how to leverage assets to maximize benefits to both covered and uncovered policyholders while reducing the costs to guaranty associations (and protecting capacity for other cases) are decisions best made pre-liquidation.

In addition, guaranty associations are legally obligated to take over handling and payment of covered claims and, in the case of life and some health business, to provide continued coverage, upon the liquidation of an insurance company. While the amount of lead time needed may vary depending on the size and complexity of the insurance company to be liquidated, it is essential that all parties work together to ensure that the lead time is adequate. As a practical matter, guaranty associations should be involved no later than when a company is placed into rehabilitation, and in many cases, involvement even earlier will enhance consumers' protection and decrease the costs of the insolvency to all "stakeholders."

Of course, if liquidation with a finding of insolvency (both are usually prerequisite to guaranty association triggering) is unlikely, or if a particular company (e.g., a reinsurer with no consumer business) has no guaranty association covered products, then it is unlikely that guaranty associations would need to be involved in the process. Recent experience has shown however that a situation can change drastically with little or no notice. Regulators should immediately notify the appropriate guaranty association if liquidation becomes a realistic possibility and should commence appropriate planning with the guaranty associations.

Recent experience has also demonstrated that payment delays for ongoing benefits, such as workers compensation indemnity payments, can and do result from failure adequately to plan pre-liquidation for the triggering of the guaranty associations. Such delays are typically from two to three weeks. This is a considerable amount of time for a claimant dependent on these benefits for basic needs.

Problems are particularly pronounced when the company has multiple TPAs involved in handling its claims. Unlike the company itself, these TPAs are usually not under the control of the regulator. Securing needed electronic data and hard copy claim files becomes time-consuming and sometimes impossible post-liquidation. In some cases TPA locations close down after liquidation, making records that are in their control impossible to obtain.

Guaranty associations can usually act quickly to obtain a confirmation of coverage and other needed information by some means (sometimes by contact with claimant's defense counsel or the liquidating estate). If information is not available regarding the claim at the point of liquidation, then the guaranty associations in many cases will not know it exists until claim payments have been delayed for some time.

Payments to medical providers are also sometimes delayed in these situations. Handling these claims is often dependant on availability of closed files that may be very difficult, if not impossible, to obtain post-liquidation. When a claimant is no longer receiving regular benefits, then pre-liquidation claims handlers may close the file, sometimes prematurely, making it difficult to identify potential provider claims. While such payments may be regarded as less urgent than indemnity benefits, providers who have provided services will suffer from such delays, and the delays do not reflect well on the state-based system.

GUARANTY ASSOCIATION INVOLVEMENT AT FACT GATHERING AND PLANNING STAGES

The sharing of reliable information as early as practicable is the goal. Guaranty associations can assist with fact gathering, investigation and the identification of potential guaranty association-covered liabilities (in case of liquidation). In Arkansas and Arizona, for example, receivership and guaranty association representatives attend troubled company reviews where appropriate, and provide useful insights into problems encountered in similar companies.

Guaranty association participation would be useful in: (a) valuing assets and potential guaranty association-covered liabilities; (b) working out joint investigation/information sharing arrangements among the regulator, receivership office, and guaranty associations (including copies of all policy and contract forms, related financial/actuarial data, and information about any claim backlog); (c) finding ways to share financial analyses; (d) identifying assets and liabilities; (e) establishing appropriate guidelines for claim payments, temporary moratoria, and hardship payments so that preferences are avoided; and (f) gathering information regarding company data systems with a view to converting this data to UDS format.

GUARANTY ASSOCIATION INVOLVEMENT IN DETERMINING VIABILITY OF REHABILITATION

It is important that rehabilitators obtain the guaranty associations' perspective on the viability of the troubled company if rehabilitated. This requires guaranty association involvement early in the process. Guaranty associations and rehabilitators should work together to analyze some of the following key issues:

- What are the realistic chances of the company's survival under various interest rate and other business/economic scenarios?
- What would the policyholders receive if the court entered a liquidation order with a finding of insolvency and how does that compare with the anticipated recoveries in a rehabilitation?
- What economic benefits and costs, administrative or otherwise, are involved in the rehabilitation, in regard to both assets and liabilities?
- How would the plan be implemented, managed and monitored?
- What standby liquidation mechanisms should be put in place?
- How are factors for determining the viability of rehabilitation evaluated and weighed? These factors include assets, liabilities, nature of business operations, form of organization, domicile, accounting systems, management and employees, policyholder preference, company preference and commitment, viable alternatives, best interests of policyholders and creditors, and the relative hazard to the public of continuing insurer operations?
- Whether a particular guaranty association may/should lend money to or guarantee the performance of member insurers, such as guaranteeing appeal bonds issued to insureds etc.? (Many funds would lack the statutory authority to engage in such a transaction.)
- Whether statutory requirements for determining whether rehabilitation is a viable alternative are met?

CHALLENGES IN EARLY SHARING OF INFORMATION – WAYS THESE CAN BE MET

The challenges to the early sharing of information with guaranty associations involve confidentiality, perception, and legal and cost benefit challenges and considerations. These will be addressed in turn below, along with ways these challenges and considerations can be met or addressed.

- **Confidentiality Challenges**

There are some confidentiality issues that will need to be addressed in connection with guaranty association involvement prior to and during liquidation. Specific confidentiality and/or privacy requirements in applicable statutes must be honored, and where such requirements apply to guaranty association involvement, appropriate agreements or approvals from the company and/or court may need to be secured.

In some cases, there may also be “perception” concerns with sharing private company information with guaranty associations or any other third party. Some may contend that because guaranty association membership is composed of the troubled company’s competitors, sharing such information “with the competition” could be detrimental to any company that intends to contest any corrective order or receivership proceeding. These concerns can be addressed by confidentiality agreements used by the guaranty associations as part of the standard internal procedures. Regardless, it is clear that the regulator needs to be satisfied that there are satisfactory protective measures in place.

Even if the troubled company has no recognizable confidentiality concerns (or has waived confidentiality as to the guaranty associations), regulators and receivers still will wish to protect against inadvertent waiver of their own confidentiality rights or legal privileges when it comes to the Open Records Act or document discovery in litigation.

Treatment of different confidentiality and privilege issues may vary from state to state, and steps must be taken to try to ensure that confidential communications with a guaranty association do not inadvertently become a matter of public record.

Guaranty associations are statutorily created non-profit entities. As such, they are not the industry, nor are they competitors of troubled companies. Rather, they are created for the express purpose of working with regulators and receivers to protect consumers in the event of insurer insolvency. For that reason, many regulators and receivers have become comfortable with sharing information with guaranty associations in advance of insolvencies to effectuate the statutory purposes for which the guaranty associations were created (such as the “prevention and detection of insolvencies”).

Confidentiality agreements are commonly entered into among regulators, receivers representing regulators and guaranty associations for that purpose, and courts have respected the privileged nature of such communications under the “common interest doctrine.”⁵

Moreover, release of information can be structured such that only those directly involved in the guaranty association mechanism would be privy to sensitive information.

Statutory adjustments can be made as required to address the need to share information with guaranty associations. Issues relating to Open Records Acts, etc., can likewise be dealt with to the extent necessary through statutory change.

- **“Perception” Challenges**

In addition to confidentiality issues, there also are challenges relating to the potential negative perceptions of early communication and coordination with guaranty associations. Some are concerned that news of such communication and coordination prior to commencement of rehabilitation, if it becomes known outside of the regulator’s offices or the boardrooms of guaranty associations, may increase the chances of a “run on the bank.”

The troubled company may also perceive that a bias exists, namely that the outcome of the regulatory intervention is predetermined, since guaranty associations only become triggered after a liquidation order with a finding of insolvency.

Moreover, other creditors or even the court may perceive a similar bias. This may encourage other creditors to demand early involvement in the process.

⁵ It should be noted that not all courts recognize the “common interest doctrine” although the privilege is widely claimed. For example, the common interest privilege is routinely asserted in the insurance law field in very significant multi-insurer coverage disputes, and receivers and guaranty associations cooperating in litigation have used it successfully.

At the outset, it should be recognized that guaranty associations are fundamentally different from any other “stakeholder” in a potential insolvency. Like regulators and receivers, guaranty associations are creatures of statute that were established by state law for the primary purpose of protecting consumers in the event of insurer insolvency. While concerns may exist that early communication and coordination with guaranty associations may provoke a “run on the bank” or indicate a bias toward liquidation, such are not appropriate. First, guaranty associations never want to create any condition that might create a “run on the bank” since guaranty associations are the bank, and second, since there is no institutionalized current practice of, and no procedural framework for, regular and early guaranty association consultations the concern is purely speculation.

The NAIC has acknowledged that this concern can be minimized by institutionalizing a framework for regular, early and confidential consultations in a given troubled company situation. Once such a framework exists, discussions with guaranty associations regarding potential insolvencies would not be “news” other than in the positive sense, signaling that our coordinated national system of state-based insurance regulation routinely practices prudent contingency planning to permit protection of consumers, come what may.

- **Legal Considerations**

There may be special considerations bearing on potential guaranty association involvement that may differ from state to state. For example, in Illinois, corrective orders are confidential unless the company requests otherwise, and conservation proceedings are sequestered unless the company requests they be made public or the court decides they be made public after a hearing held privately in chambers. If a sequestration order is lifted during conservation, then it may be appropriate to involve the guaranty associations if the company is likely to end up in liquidation.

Steps can and should be taken to lift a sequestration order if such is necessary to allow for sharing of that information necessary for guaranty associations to prepare for an imminent insolvency. Also, some companies are likely to consent to guaranty association consultation, even during a sequestration period, particularly if an established framework for confidential discussions exists.

- **Cost/Benefit Considerations**

Along with the anticipated benefits of early communication and coordination among regulators, receivers and guaranty associations, there also may be unanticipated costs. For instance, in Illinois and other states, all costs attributed to a particular receivership are allocated only to that receivership. Costs and expenses incurred on behalf of or that benefit multiple receiverships can be allocated proportionately to them. Many guaranty associations have similar methods of covering direct and “allocable” expenses. If a receiver becomes involved early on with a troubled company and that company never results in receivership, however, there is an open question as to how such costs would be allocated. Similarly, how would guaranty associations fund this expense?

These costs may well be outweighed by the benefits to consumers and to the troubled company from early communication and coordination by the regulator, the receiver designated by the regulator, and guaranty associations. The relative costs and benefits of early communication and coordination must be considered in each case in determining the nature and timing of appropriate early involvement.

Regulators and receivers must consider how the costs of engaging in early communications and coordination can be handled and minimized. Ultimately, the overriding goal should be to protect policyholders. To the extent that there are some costs in doing so, the benefits should be assessed in comparison to the costs, and all responsible entities must bear an appropriate burden.

HOW SHOULD GUARANTY ASSOCIATIONS BECOME INVOLVED?

While there may be some debate on when guaranty associations should become involved once there is a significant possibility that liquidation may occur, it is generally agreed that stepped up communication and coordination between regulators and guaranty associations is advisable. Guaranty associations and regulators should consider:

- Regular briefings of the guaranty association by the state of domicile should be considered a best practice. The framework for a guaranty association briefing could be limited to the potential financial impact to guaranty associations without identifying the companies involved. The NAIC is increasingly taking an approach – in many areas – that all insurance related entities operate under a national system of state-based regulation. Interstate regulatory cooperation has evolved substantially on the monitoring and decision-making regarding large troubled companies operating in the national market.
- When a company writes business in 50 states, its problems are not only the issue of the domestic regulator and the domestic guaranty association, but of all regulators and all guaranty associations. The domestic regulator has a major role in the solvency monitoring process, but the role of the domestic guaranty association is not necessarily analogous. Where a national company's problems require early guaranty association involvement, the guaranty associations' national organizations also have to be involved in order for the system to operate as effectively and efficiently as possible.
- Guaranty associations should be notified when a petition for liquidation is being drafted. Copies of all petitions and orders should be provided to guaranty associations on a timely basis.
- Guaranty associations of the state of domicile should coordinate communications with other guaranty associations and with the NCIGF and NOLHGA.
- State regulators may want to provide, on an individual basis or through the NAIC, a restricted access website where additional information is available to guaranty associations and the NCIGF and NOLHGA.
- Guaranty associations should be provided reliable information about insureds' residency, any TPA, MGA, and trust arrangements, unearned premium data, policy limits applicable to multiple claims, and interest rate rollbacks and roll-forwards. Additionally, information about reinsurance may allow the guaranty associations to better report data to the receiver to aid in collections and commutations.
- Guaranty associations and the receiver can jointly create a bid process and reinsurance plan that can be implemented as soon as possible after the company has been placed into liquidation. Usually this is more applicable to life and health liquidations.
- Guaranty associations may assist the regulator or receivership office in regard to matters before the receivership court. They can often provide an avenue to illustrate the effects of the insolvency on consumers and the public. Legal arguments can be bolstered with, and related to, the real impacts the insolvency has had or will have on people.
- The parties can gather policy and other information regarding coverage arrangements and the book of business and put it into a form that can be used by both the liquidator and the guaranty association, e.g., electronic, and the cost of creating the database could be shared. Once this information is available it can be analyzed and coverage issues can be identified.
- Guaranty associations can provide data consultants who are familiar with the UDS data format to convert data and troubleshoot any problems with UDS conversion. It may also be possible in some situations to prepare electronic adjuster notes for transmission to the guaranty associations along with UDS data. This will reduce costs and time and may also aid with reinsurance collections and commutations.
- Guaranty associations can be provided with claim count and reserve information so they can start planning for staffing and office space needs. TPA locations can be identified and a transition process can

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.

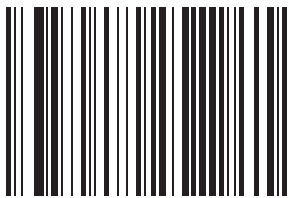
As a point of departure, two immediate steps should be taken. First, continued oversight of the improvements recommended by the white paper working group should be undertaken by the NAIC through the Insolvency Task Force. Second, the process of communication and collaboration should begin with the next 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*

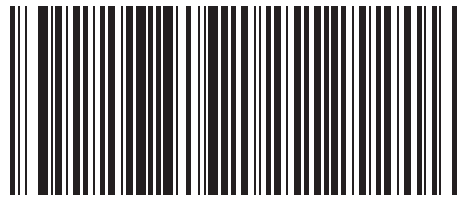
Company Handbook section on pre-receivership consideration has very little on guaranty associations.

- 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 addition 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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