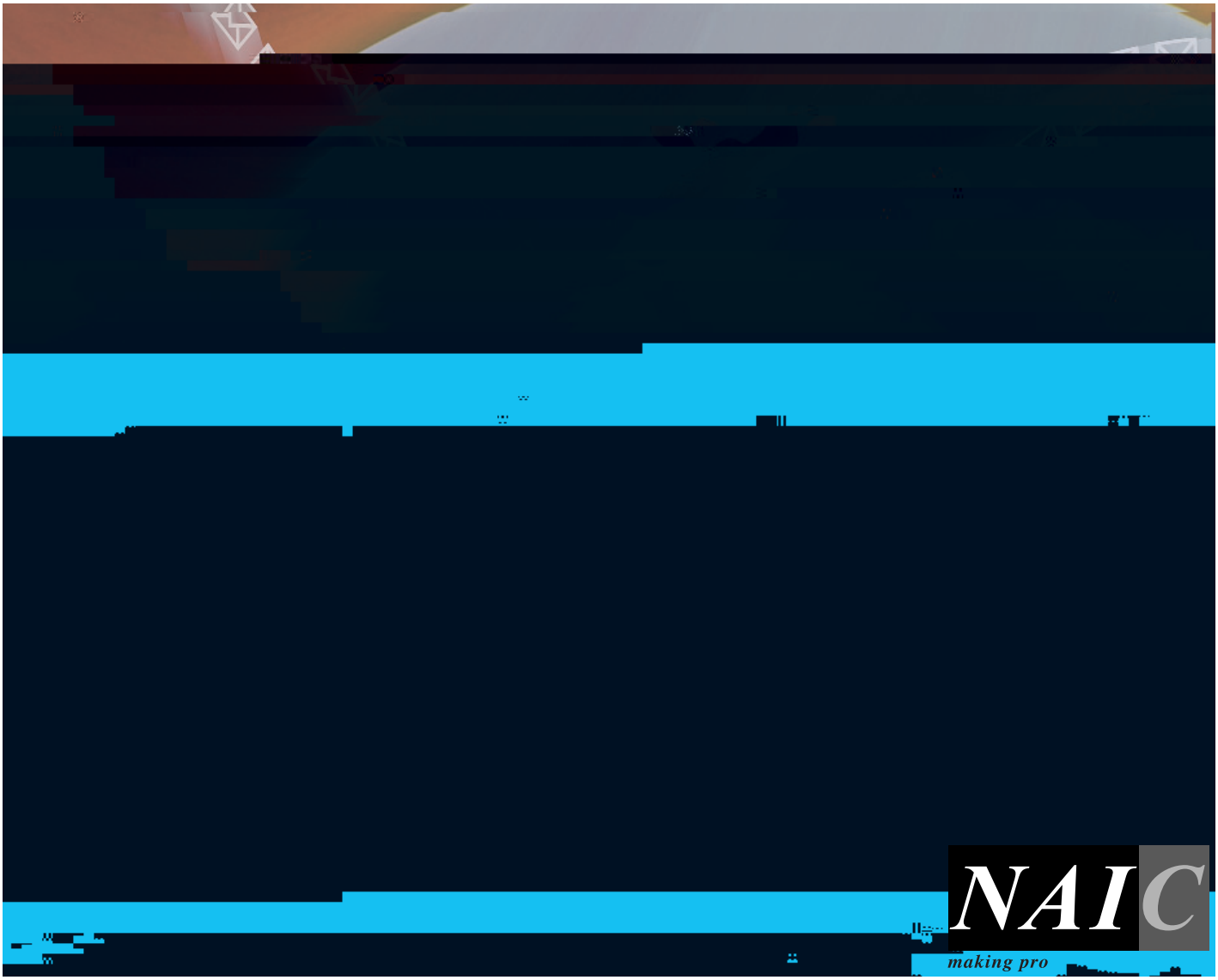

Communication and Coordination Among Regulators, Receivers, and Guaranty Associations: An Approach to a National State Based System

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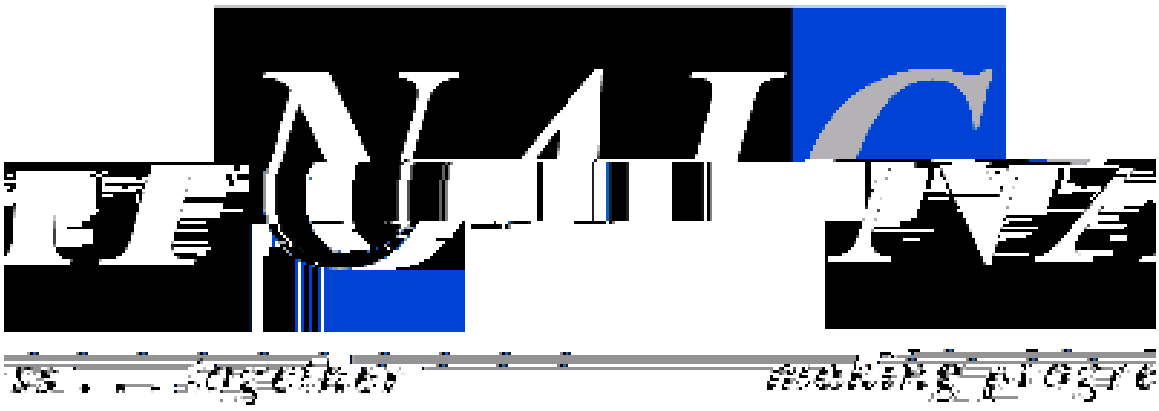

Prepared by the

Receivership An

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National Association of Insurance Commissioners
Insurance Products & Services Division
816-783-8300
Fax 816-460-7593
http://www.naic.org
prodserv@naic.org

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Executive Headquarters
2301 McGee Street, Suite 800
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Securities Valuation Office
48 Wall Street, 6th Floor
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Government Relations
Hall of States Bldg.
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Communication and Coordination

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

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

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

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

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,

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

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

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

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

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

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

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

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