Keeping Insurance Promises: The Context &Operation of the U.S. Insurance Guaranty System

Presentation to U.S. Department of Labor

ERISA Advisory Council

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nolhga

Presenter

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Overview of Planned Presentation

- Basic Objective - Present an overview of the insurance guaranty system, the context in which it operates, and how core commitments to consumers are honored even in stressful economic circumstances.

Two Key Observations

- Historical performance of the current guaranty system in protecting consumers has been extremely positive and can be expected to be positive in the future.
- NOLHGA has provided extensive assistance to Congress and Federal agencies concerning the guaranty system and stands ready to do so today.

Outline

- Basic Aspects of U.S. Direct Insurance Industry
- Regulatory and Other Safeguards for Insurance Markets
- The Insurance Receivership Process
- The Guaranty System
- Experiences in Insurer Receiverships During Periods of Stress
- Keeping Core Commitments to Consumers, Even in Stressful Periods

Basic Aspects of U.S. Direct Insurance Industry

- Stability
- Long-Term, “Sticky” Liabilities
- Long-Term Investments, Matched to Liability Commitments
- Extensive Regulation Constraining Scope of Assets, Liabilities, and Operations
- Solid Performance Through Prior Financial Crises

Insurance Regulation and Other Safeguards

- Insurance Regulatory Balance of Responsibilities after Dodd-Frank
  - States remain primarily responsible for protecting insurance policyholders
    - Insurer SIFIs are subject to state regulation, liquidation, and guaranty laws.
    - FDIC resolves all other (non-insurer) SIFIs.
  - Federal Reserve has oversight of SIFI holding companies
    - Regulatory test factors suggest few insurers are systemically significant.
  - Federal Reserve oversight of insurance holding companies with bank or thrift subsidiaries
- State DOI Solvency Regulation
- Rating Agency Oversight
- Other Equity and Consumer Market Pressures

State Solvency Regulation of Insurers

- General Goals
- Statutory Accounting and Reserving Requirements
  - Statutory Accounting conservatively limits admissibility, valuations, and concentrations of assets.
  - Reserving employs conservative mortality and internal assumptions, plus cash flow testing.
  - Principles-based reserving captures life and annuity risks that may require reserve strengthening.
- RBC Rules (see next slide)
- Role of Domiciliary and Non-Domiciliary Regulators (FAWG Process)
- Regulatory Outcomes: Relatively Few - and Usually Mild - Insurer Receiverships
  - Recent Financial Crisis Experience
  - Great Depression

Solvency Standards – Risk-Based Capital

- Originally Developed by NAIC in Early 1990s
  - Response to insurer insolvencies in late 1980s and early 1990s.
  - Enhancement to fixed capital standards for monitoring insurers' financial health.
- RBC Calculations Specific to Type of Business
- RBC Establishes Minimum Capital Requirements
  - Focus is on: 1) Asset Risk; 2) Underwriting Risk; and 3) Other Risk
  - Unique to each company based on the types of risks to which a company is exposed
  - Generates the minimum amount of capital a company must maintain to avoid regulatory action—Baseline is "Authorized Control Level" (ACL)
- RBC Levels
  - Adjusted Capital > 200% of ACL: No Action (But DOI inquiries if < 250% ACL)
  - 200% of ACL > Adjusted Capital > 150% of ACL: Company Action Level
  - 150% of ACL > Adjusted Capital > 100% of ACL: Regulatory Action Level
  - 100% of ACL > Adjusted Capital > 70% of ACL: Authorized Control Level
  - 70% of ACL > Adjusted Capital: Mandatory Control Level

The Receivership Process for Operating Insurance Companies

- State Receivership Statute and Process—NOT Federal Bankruptcy
- Model Laws and “Bankruptcy-like” Process Establish a Comprehensive Statutory Framework, Including Supervision, Conservation, Rehabilitation, and Liquidation
- Key Role of Domiciliary Commissioner, Domiciliary Receivership Law, and Receivership Court
- Basic Mission of Receiver: Marshall “Estate” Assets, Evaluate Claims, and Distribute Assets to Creditors per Receivership Law
- Primary Goal of Receivership: Protecting Policyholders
  - Priority of Policy-level Claims

The State Insurance Guaranty System

- Consensus for System Essentially Developed in Late ’60s/Early ’70s
- NAIC Models – Separate L/H and P/C GAs and Systems
  - Different powers and duties
  - Different contractual promises and industry segments
- Core Mission: To work with receivers to deploy estate assets and GA funds to deliver to consumers a specified, guaranteed minimum level of financial protection against insurer insolvencies.
- NOT a Failed Insurer “Bailout” Mechanism
- To extent of GA coverage limits, GAs provide protection against both risks of inadequate credit (degree of insolvency) and liquidity (time it may take receiver to marshal assets of failed insurer).

Receivership, Distinguished from Guaranty System

- Receivership Process - essentially a single-state forum for determining the correct distribution of an insolvent insurer’s assets under a single set of rules
- Guaranty System Safety Net - applied by separate GAs in multiple states, ensuring floor levels of protection for state residents and funded in-state through legislatively prescribed practices

The Life & Health Insurance Guaranty System – Key Constituents

- State Insurance Guaranty Associations
  - Responsible for Providing Statutory Coverage to Resident Policyholders
- NOLHGA Performs Coordinating Role for Multi-State Insolvencies
  - MPC/Task Force Mechanisms Ensure System-Wide, Consistent Approaches
- Industry Representatives Serve on Boards and Provide Direction and Support
- State Insurance Commissioners Have Oversight Role

L&H Guaranty Associations: Coverage of Life Insurance, Annuities & Other Types of Contracts

- Contracts generally are long-term investments in substantial future financial benefits.
- Because of pricing structures, contracts generally cannot be replaced on same terms in marketplace after insurer liquidation.
  - Consumer aging and health changes may render consumer uninsurable–at minimum, cost of replacement coverage is higher.
- Safety net, to be effective, must respect and protect “equity” in contract by *continuing* the contract, thus providing prospective protection (applicable premiums also continue).

L&H Guaranty Associations: Coverage of Life Insurance, Annuities & Other Types of Contracts (cont'd)

- Model Act approach requires GAs to "guaranty, assume, or reinsure" the current covered contract.
- Accomplished by transferring "in force" contracts to a healthy carrier (supported by estate assets and GA coverage payments), by extended runoffs of the business, or a combination of both approaches.

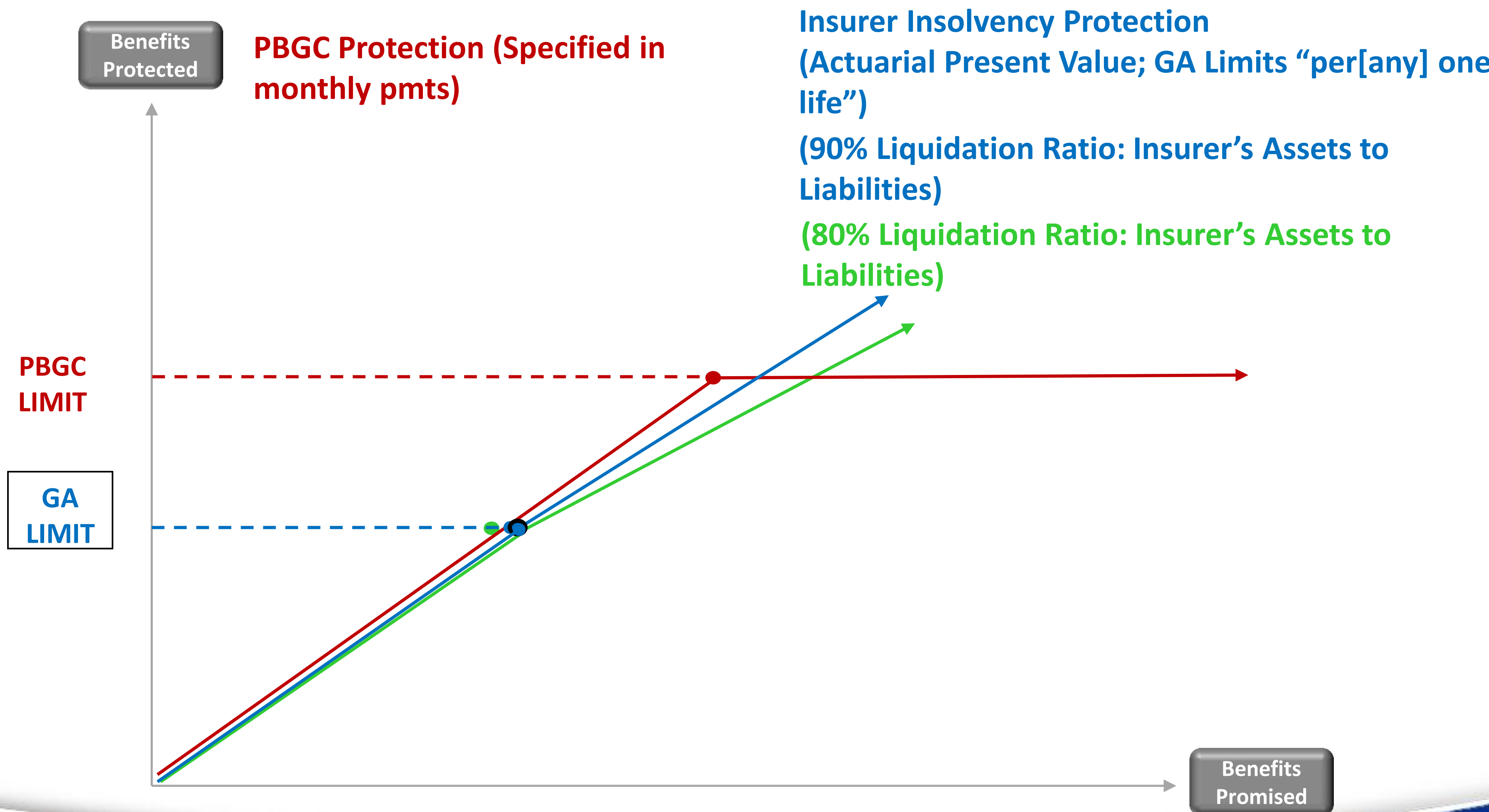
Coverage Benefit Limits

National Association of Insurance Commissioners Model Act

• Life Insurance	
– Death Benefits	$300,000
– Net Cash Surrender & Withdrawal	$100,000
• Annuities	$250,000
• Health Insurance	
– Major Medical	$500,000
– Disability	$300,000
– Other Health	$100,000
• Long-Term-Care Insurance	$300,000

PBGC & GA Protections Compared

Joint and 50% Survivor Benefits Assumed



Development of a Large Insurer Receivership

- Domiciliary Regulator (and/or FAWG) Identifies Financial Concerns
- Remedial Action Plan Considered/Attempted
- If Situation Not Improved, Supervision, Conservation, or Rehabilitation Attempted
- Legal Standards for Initiation of Liquidation
- Liquidation if Company Cannot Be Rehabilitated
- NAIC’s R-FAWG Process Provides Oversight and Peer Support in Multi-State Receiverships

Liquidation Process

- Receivership Team
- Analysis of Liabilities
- Analysis of Assets (Admitted, Non-admitted, Reinsurance, Claims against Third Parties)
- Cash Flow Projections/Liquidity Requirements Analysis
- Systems Needs
- Personnel Needs
- Operational/Administrative Requirements
- Special Issues Regarding Affiliated Companies, Unaffiliated Third-Party Vendors, and International Affiliates

Receiver/NOLHGA Cooperation

- Receiver Coordinates with GAs through NOLHGA to Develop Comprehensive Insolvency Resolution Plan
- Can Be and Often Is Accomplished as a "Pre-Packaged Liquidation Plan"
- Plan Often Includes Benefits in Excess of GA Coverage that Can Be Provided from Estate Assets Allocated to Policyholders' Equal-Priority Uncovered Claim Against Insurer

Guaranty System Analysis

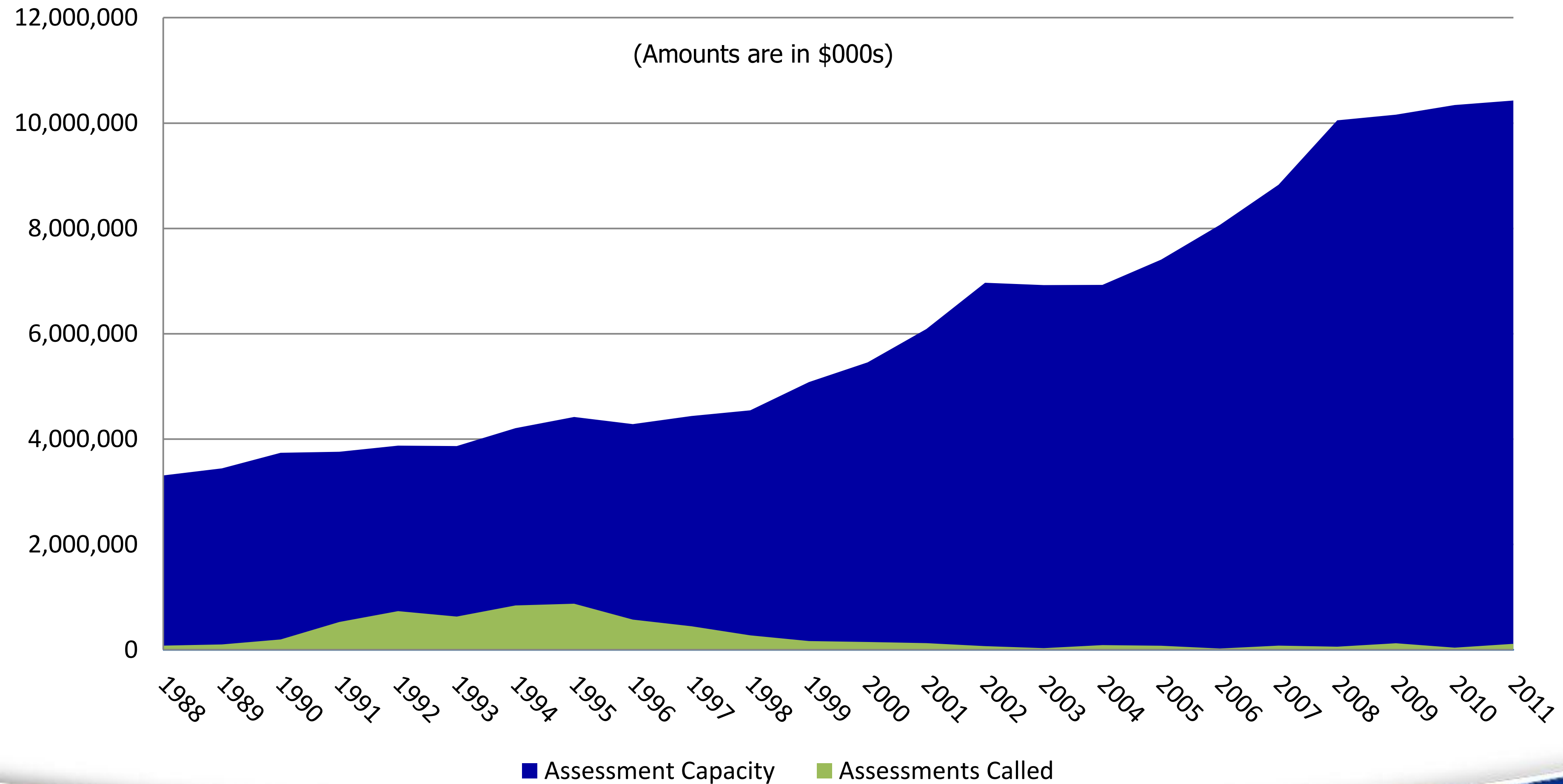
- National Coordination Teams
- Which GAs Cover Which Policies?
- Application of GA Coverage “Caps”

Common Misunderstandings about Insurer Receiverships

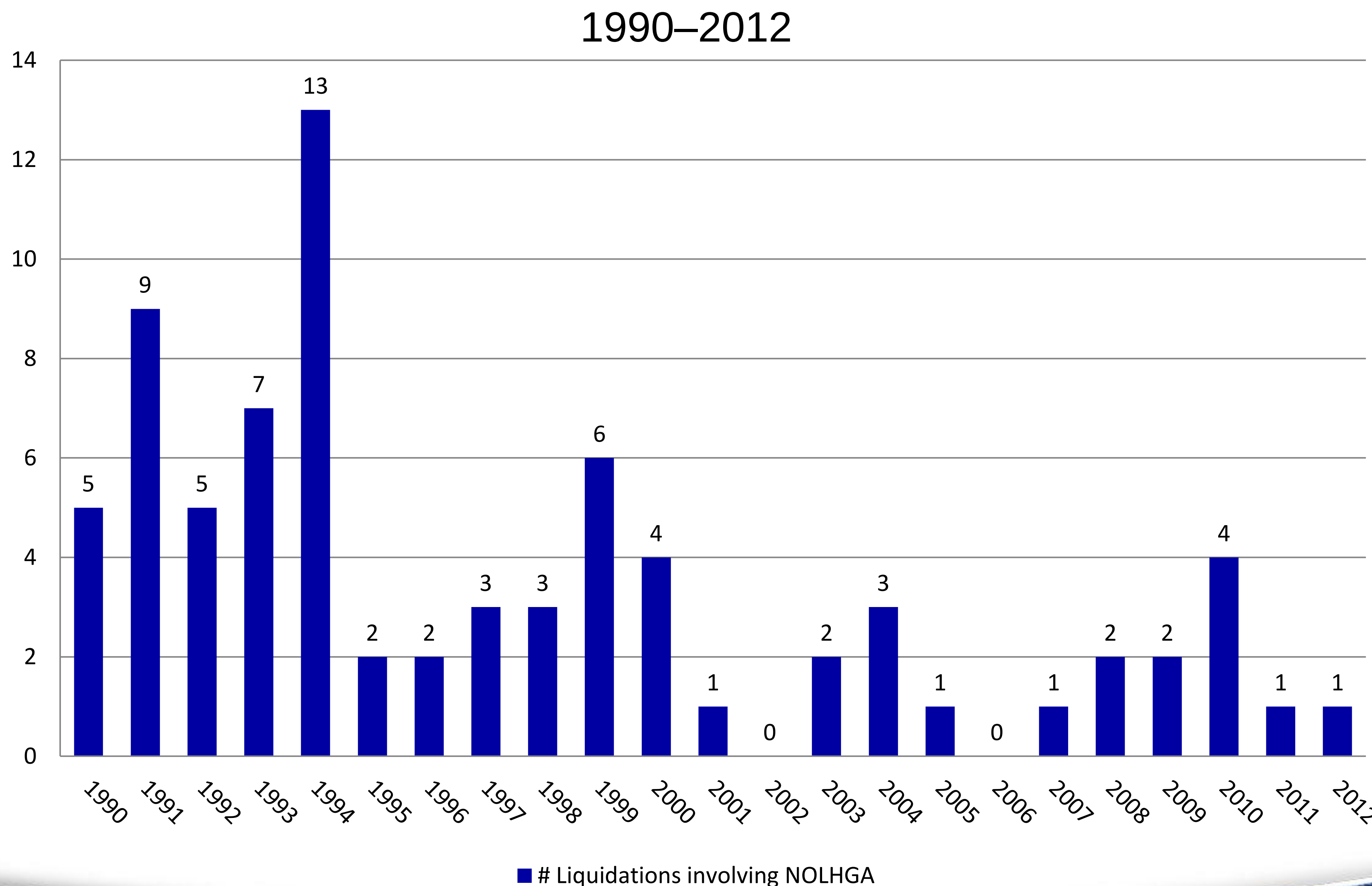
- Historical Frequency of Major Insurer Failures
- Consumers Commonly Engage in “Bank Run” Behavior at the Insolvent Insurer and at Other Similar Companies
- All Liabilities Come Due Upon Receivership Commencement
- Few if Any Insurer Assets Are Available to Respond to Failure
- Few if Any Operational Resources Are Available for Resolutions
- Receivership, Guaranty System, and Other Resources Inadequate

Assessment Capacity vs. Assessments Called: NOLHGA

1988 - 2011



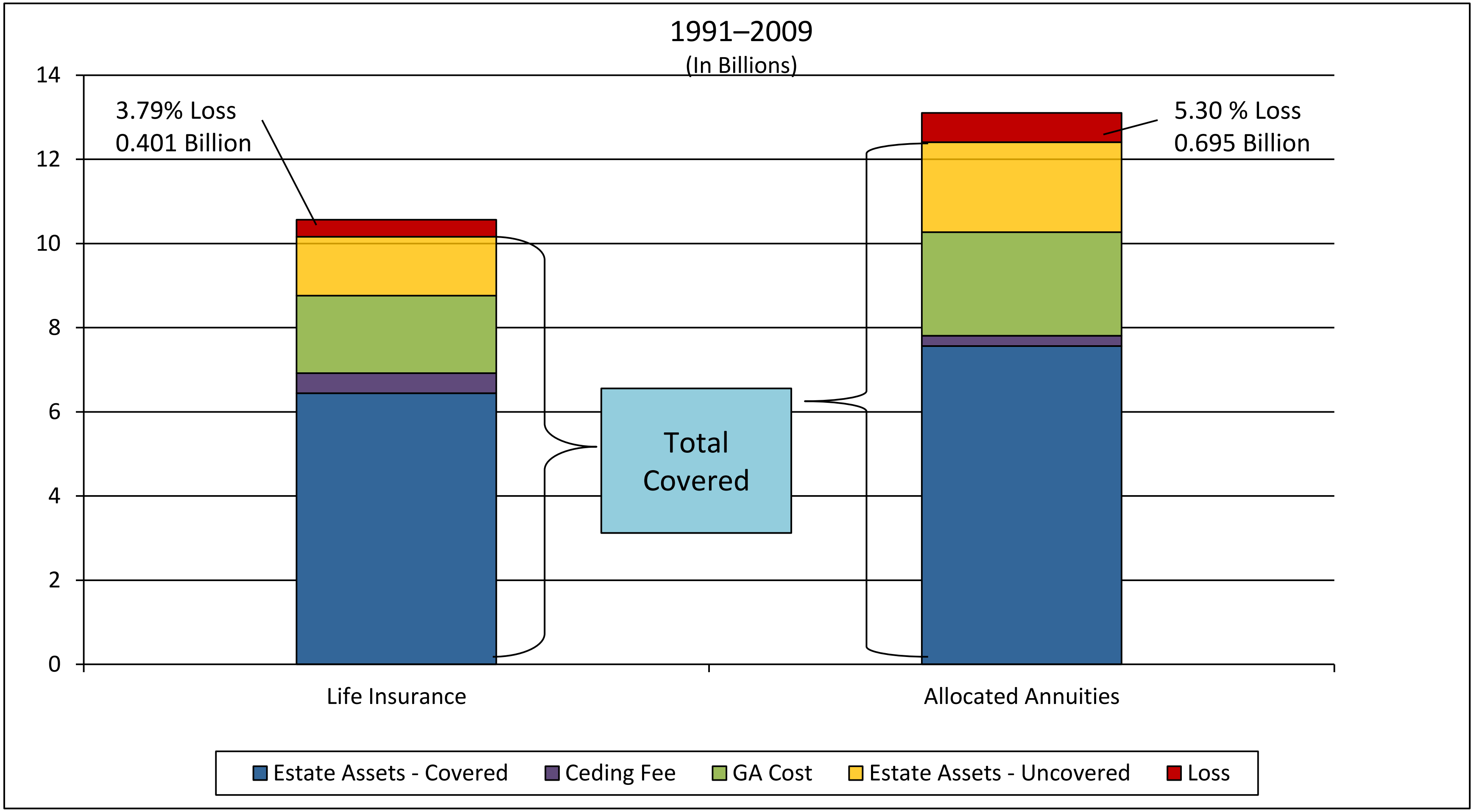
Number of Liquidations Involving NOLHGA



Insurer Promises Honored in Crisis

- Infrequency of Insurer Failures
- “Sticky Liabilities”/Long-Term Investments
- Powers of Receiver to Prevent Potential “Runs”
- Conservative Regulation and Related Oversight
- Typically Balance Sheet, Not Liquidity, Problems
- International Experience (esp. Japan)
- Guaranty System Capacity vs. Needs

Average Recoveries for Multi-State Insolvencies



* Graph does not reflect the time value of money.

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Questions?