The Property Casualty Insurance Guaranty Funds and the NCIGF:
Keeping the Insurance Promise for 25 Years.

The P&C Guaranty Funds:
How the National System Works Today and the Potential Impact of a Fluid Global Regulatory Environment

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National Conference of Insurance Guaranty Funds NCIGF

Goals Of This Presentation

1. High level exposure to P&C guaranty fund system

2. Brief explanation of "new" responsibilities under Dodd-Frank

3. Challenges to U.S. guaranty fund system

P&C Guaranty Funds At A Glance

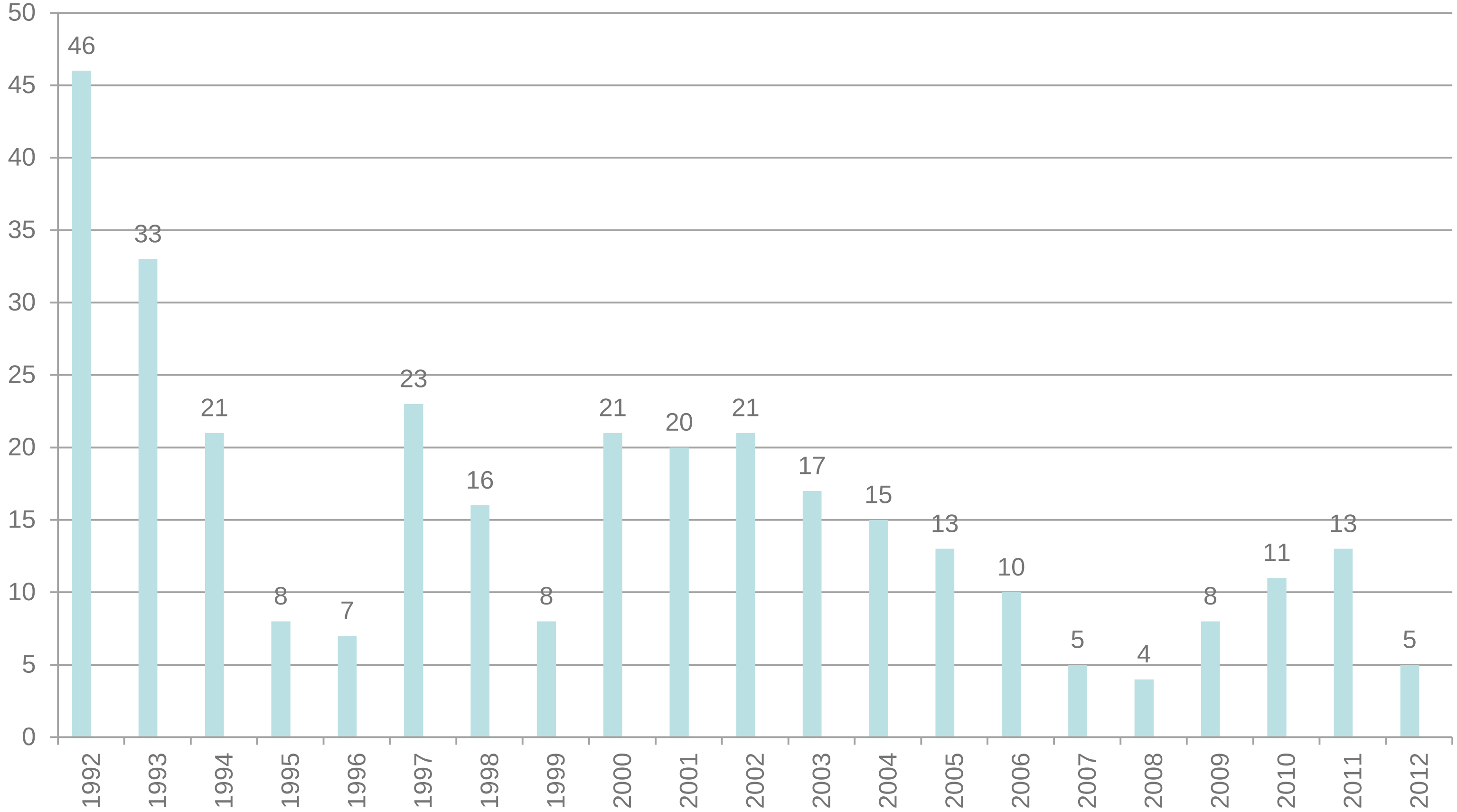
1. A backstop for policy holders (not insurance companies)
2. Created as a <u>state remedy</u> for consumers whose insurance companies have failed
   - + $27 Billion paid out since inception
3. If a policy holder has no claim, they have no problem; they simply buy new insurance
4. GFs pay claims promptly with minimal loss to claimants or policy holders
5. GFs assess healthy industry when needed
6. GFs are a reputational safeguard for the P/C industry
   - Existence helps p/c industry make its case against systemic risk

Cost Effective By Any Measure

- Nationally, the Property and Casualty state Guaranty Fund system costs about $66 million per year, and employs fewer than 650 people

- Costs of adjusting and paying claims are no more than those of industry.

Property & Casualty Insurance Guaranty Fund System
Number of Insolvencies
1992-2012



Biggest Criticism: Capacity Issues

Tailored solutions have been implemented. There is no “one size fits all” in these situations

Large states have borrowed through a bond issue – this is now part of the NAIC model

Smaller states – accelerated early access, inter-account borrowing, bank lines of credit.

GUARANTY FUNDS WORK

in partnership with insurance regulators to protect policyholders

How the Guaranty Fund System is Funded

RECOVERIES

To the extent possible to fulfill guaranty fund statutory duties, monies are obtained from remaining estate assets.

- The insurance company's remaining assets (including reinsurance).
- Funds deposited with state regulators in certain states while the company is still writing business.

ASSESSMENTS FROM INSURERS

Charged to insurance companies licensed to write business in a state.

- Typical cap is 2% of "net direct written premium".
- Assessment is determined by the amount of money needed by the guaranty fund to supplement the funding pool described above.
- Some guaranty funds have separate "assessment accounts" allowing them to segregate assessment billing and payments into various lines of business—a typical structure would be workers' compensation, auto, and all other property and casualty lines covered by the funds.

A state court finds an insurance company insolvent and orders it liquidated.

Policyholder claims files are transferred to the guaranty funds for servicing.

Covered claims are paid from a pool of money drawn from three sources made available at the time of the insolvency: a) the insolvent insurance company's remaining assets, b) cash already on deposit with state regulators and c) assessments on insurers licensed to write business in a state.

Payments are made promptly.

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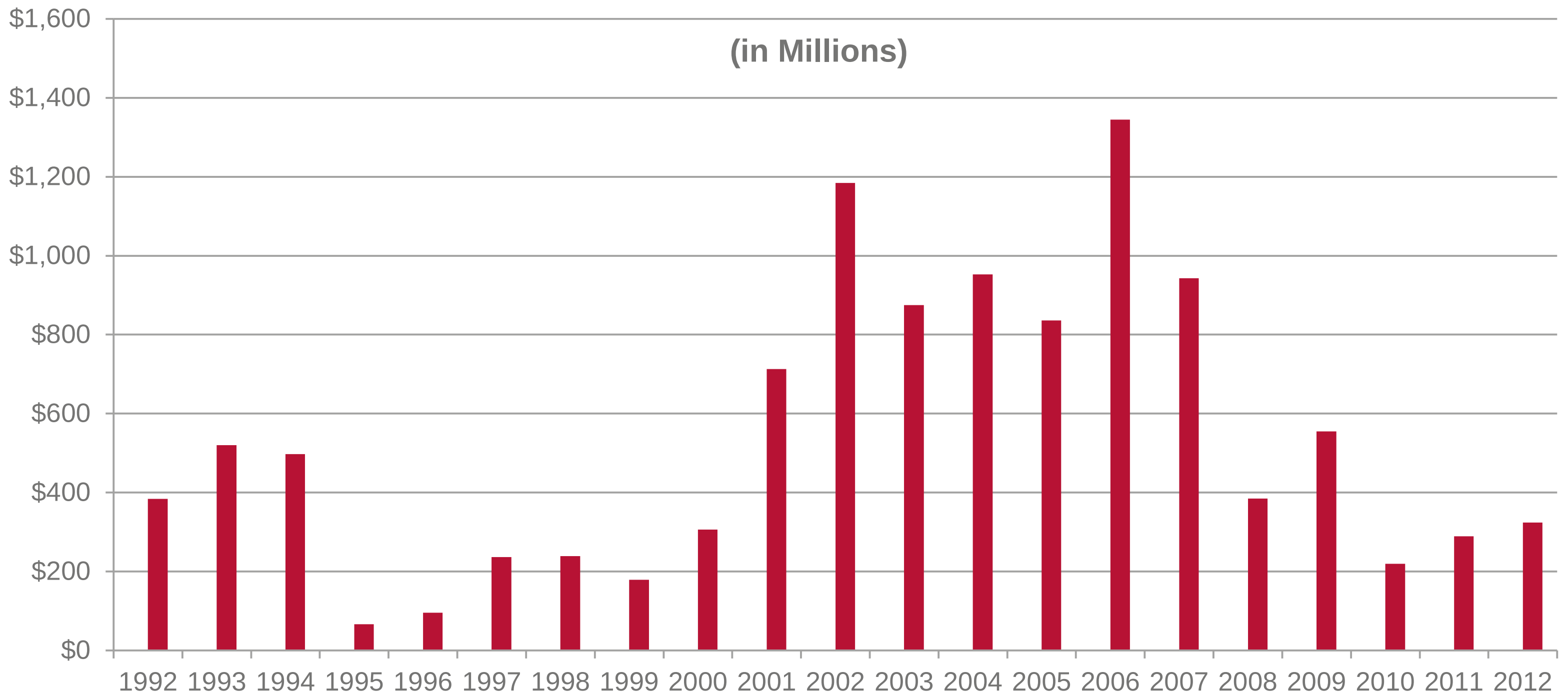
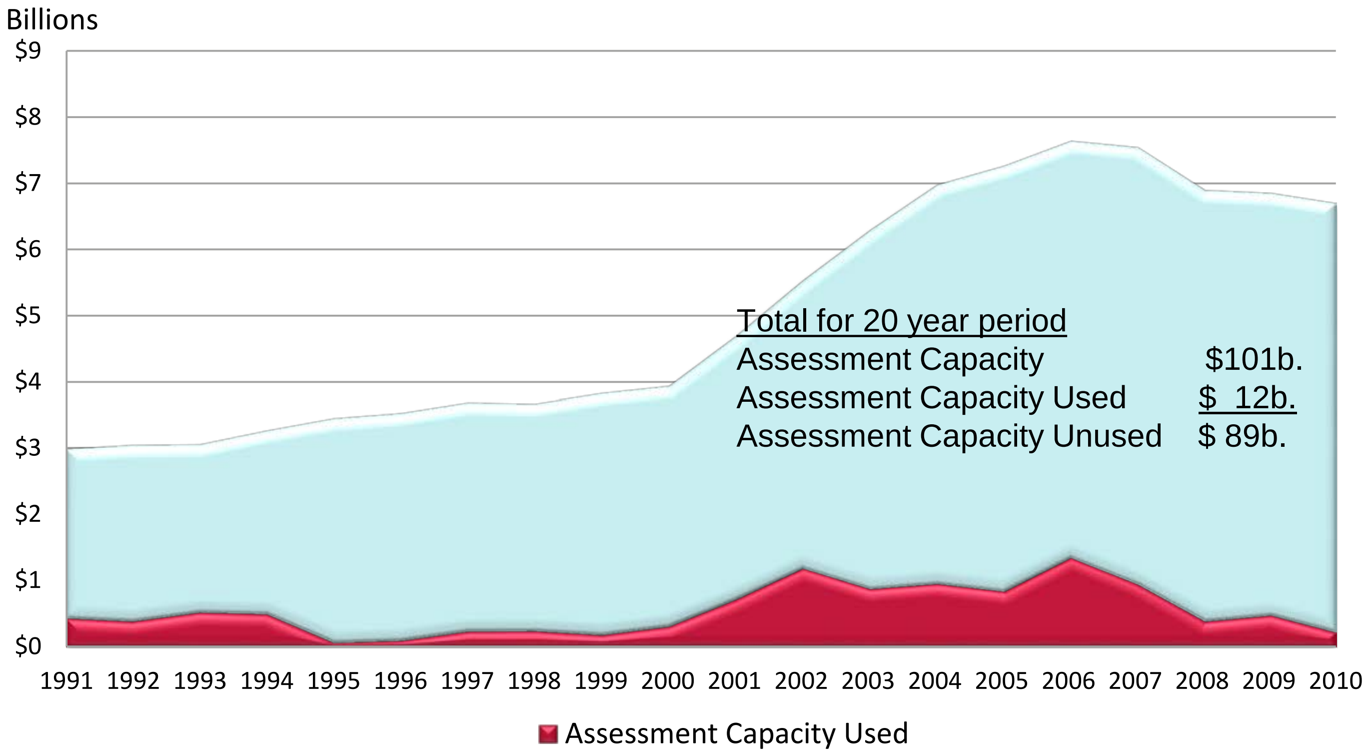
Property & Casualty Insurance Guaranty Fund System Assessments 1992-2012

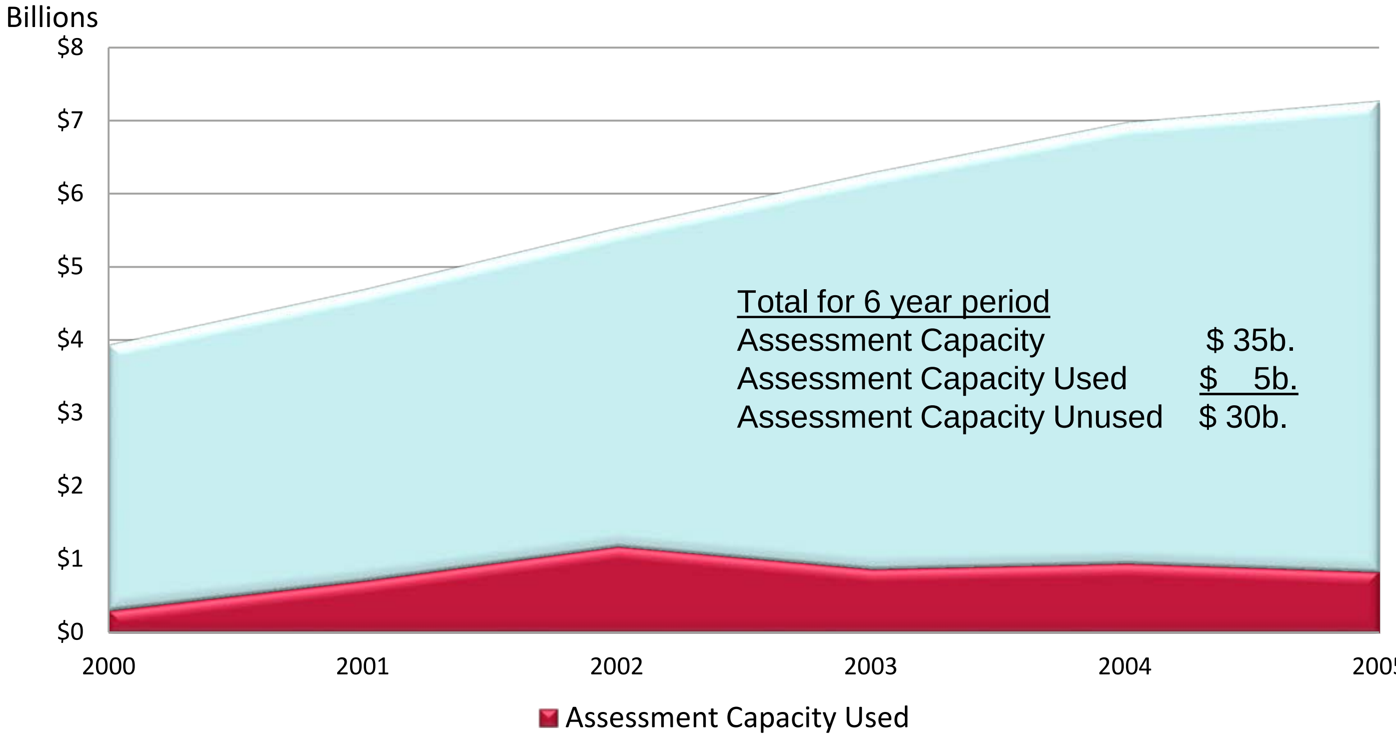


Assessment Capacity and Assessment Capacity Used 20 years - 1991-2010



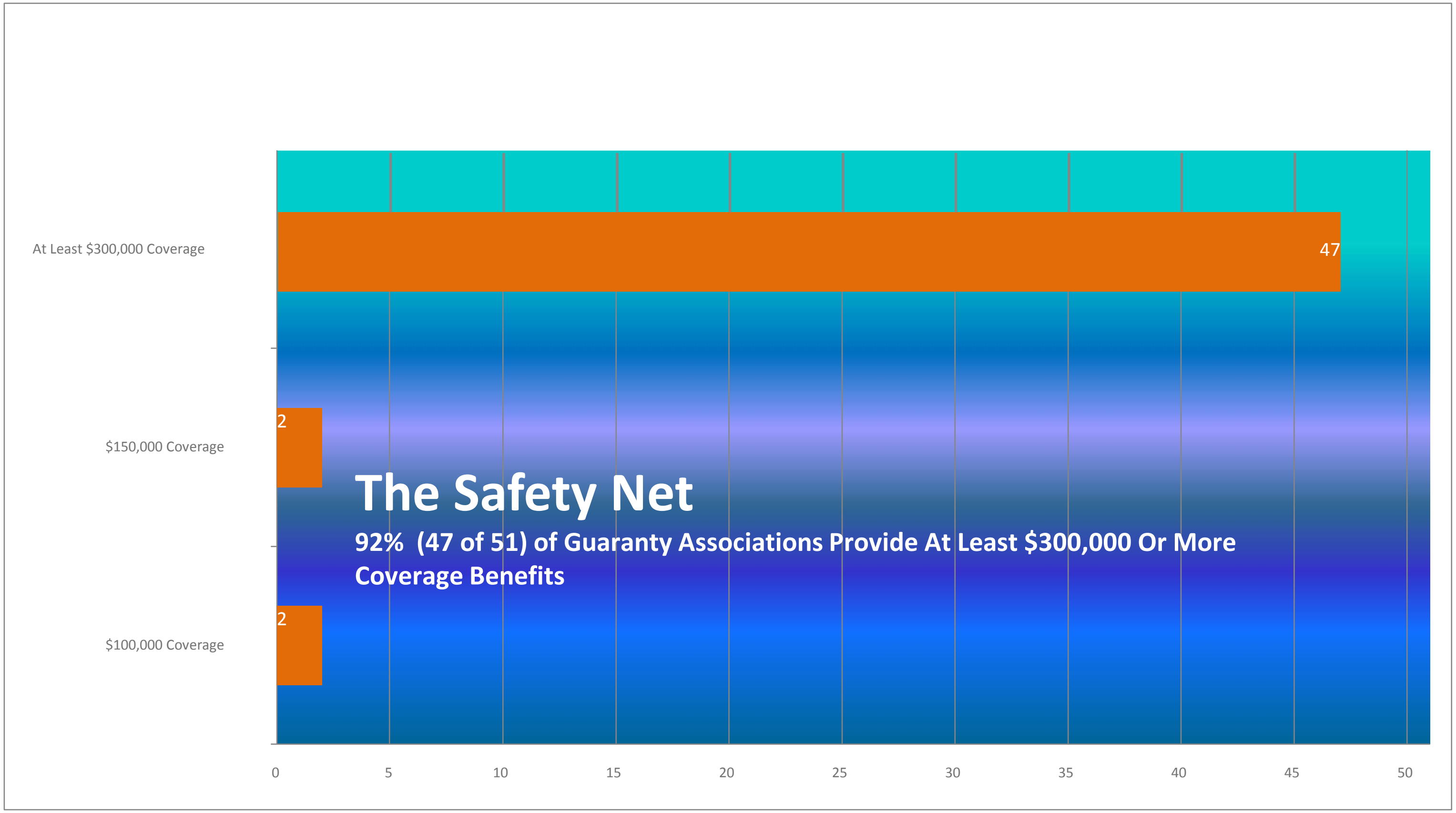
Property & Casualty Insurance Guaranty Association System Assessment Capacity and Assessment Capacity Used Period of Heavy Insolvency 2000-2005

(System paid during period over 40% of all payments since inception)



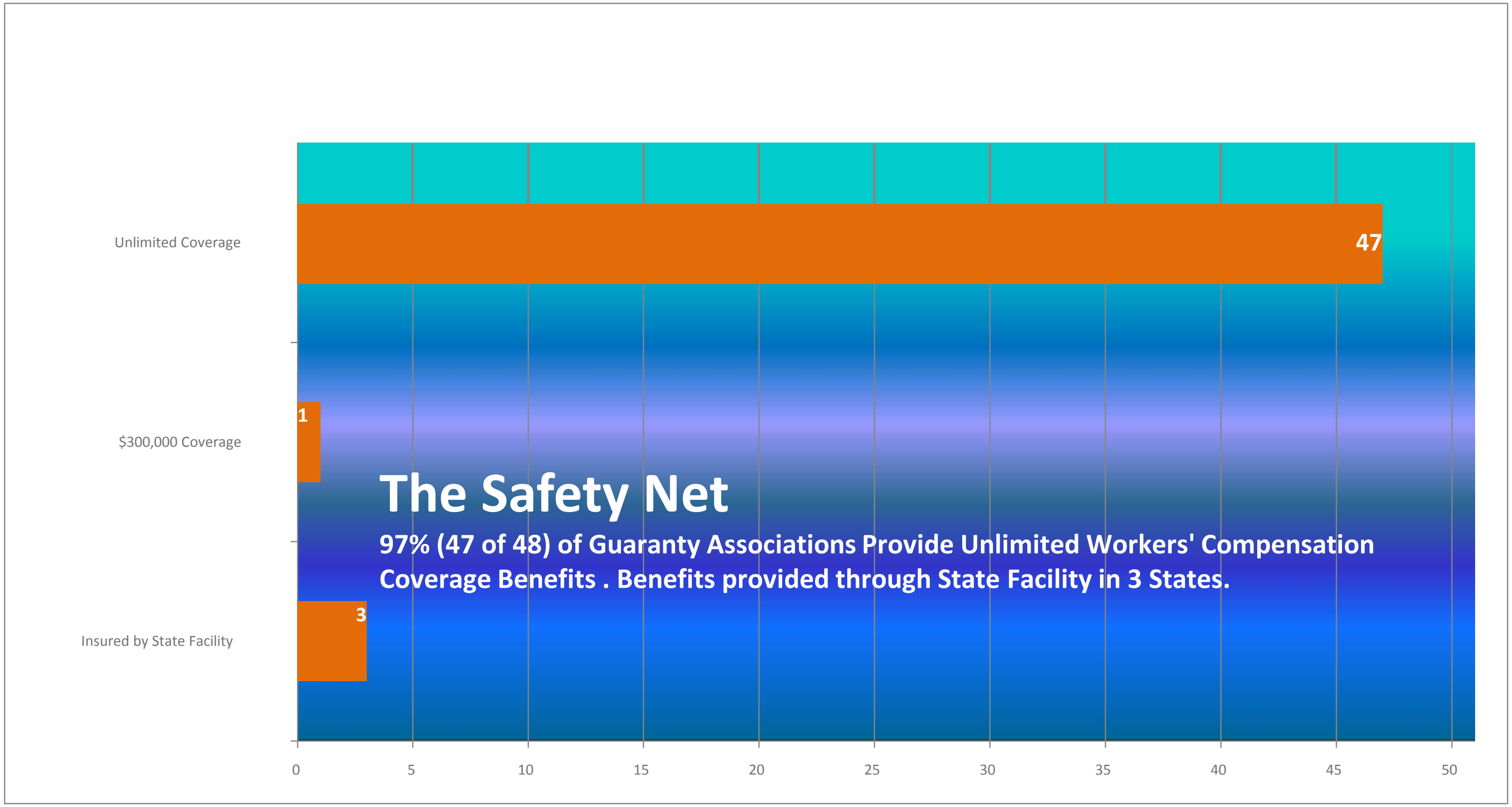
Policyholder Protection:

Property & Casualty Guaranty Association Benefits for All Lines of Business (Except Workers' Compensation)

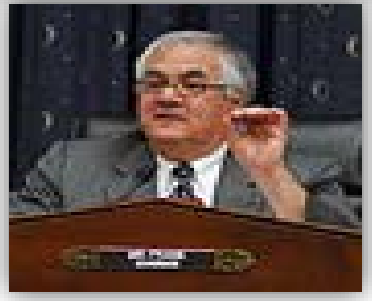


Policyholder Protection:

Property & Casualty Guaranty Association Benefits for Workers' Compensation



Key Elements of Dodd-Frank Act



Two big things for guaranty funds**:**

Title II resolution mechanism for liquidating systemically important financial institutions

- All insolvent insurers remain subject to state receivership and GF processes (Even SIFIs)

Federal Insurance Office

- Insurance Modernization Report released Nov., 2013.
- Relatively light touch on guaranty funds
- Recommended that NCIGF and NOLHGA stress their respective systems

Bottom Line For The Receivership and Guaranty Systems Post-DFA

- Existing role in protecting insurance policy holders remains intact

- Federal Reserve regulates SIFIs and now insurance, even though most don't believe insurers are systematically significant
    - LIVING WILLS

NCIGF/NOLHGA Education Project

- In effect since 2003
- Supported and depended upon by industry
- More than 600 briefings
- Instrumental in FDIC & DFA rulemaking
- Working closely with NAIC

Our Messages

- Constructive Communications: Protecting Insurance Company Assets, Consumers, & Guaranty Coverage under any regulatory structure
- Capacity & Stress: We Are Up to Dealing with Possible Gigantic Failures and Must Prove It
- FDIC → Bank Products → Cash → Over a Weekend
  GAs → Insurance Policies → Promises → Decades
- Consistency/Uniformity Nationally
- Stick to Our Knitting and Educating
  - Battle Tested – 40 Years
  - Well Prepared
  - Consumers First
  - Economically Efficient
- Keeping Regulators and the Industry Advised and Happy

NCIGF Strategic Focus

- Data Access Management
- Operational Readiness
- Financial Readiness
- Outreach

P&C Guaranty Funds - 101

- Triggered by a judicial finding of insolvency
- GF personnel "steps into the shoes" of insolvent insurer
  - Review and adjust claims
  - Policy limits and state law controls
- Post-Insolvency Assessments (except NY)
  - Emphasis on estate assets to mitigate costs– reinsurance is largest asset of the estate

P&C Guaranty Funds – 101 (continued)

- Most property and casualty lines of business are covered.
- Much of the book inherited by the guaranty funds is Workers' Compensation – WC is paid without limit in most states.
- Otherwise, $300,000 cap in most states.

Typical Guaranty Fund Governance

State GF Governing Boards:

- Made up primarily of industry representatives
- Board hires GF staff
- Board decides when to assess state GF members

NCIGF SERVICES OF INTEREST TO INDUSTRY

- Assessment and Financial Data for GF System: Assessment Liability Reports save insurers from the need to call guaranty funds to obtain the information. This saves time for both insurers and members

- SSAP 35: realistic and accurate reporting of GF assessments

- Coordinating Committees: collection of estate assets, resolution of file issues that delay payment of claims. $8B collected 04-14.

- Public Policy-Analysis, Representation and Education
  - Congressional Education
  - Representation @ NAIC and NCOIL
  - NCIGF Model Act
  - Training

COORDINATION OF MULTI-STATE INSOLVENCY MATTERS

•Services provided to NCIGF members, increasing efficiency and reducing costs:

- Estate distributions
- Public policy changes
- Complex coverage in a liquidation context
- Data support
- Execution of guaranty fund system strategic plan

P&C GF SUMMARY

- Guaranty funds “keep the promise”
- Integrity of the insurance product
- Proven and tested system: $27B in claims paid since 1968
- Bottom line impact is retrospective not prospective (like banking model)
- Responsive to conditions in the states
- Flexible and Low-cost
- **BUILT TO WORK**

Federal and International Insurance Issues: Why Should We Care?

"The changes underway will alter the basis for much of your world in ways that are not yet clear."

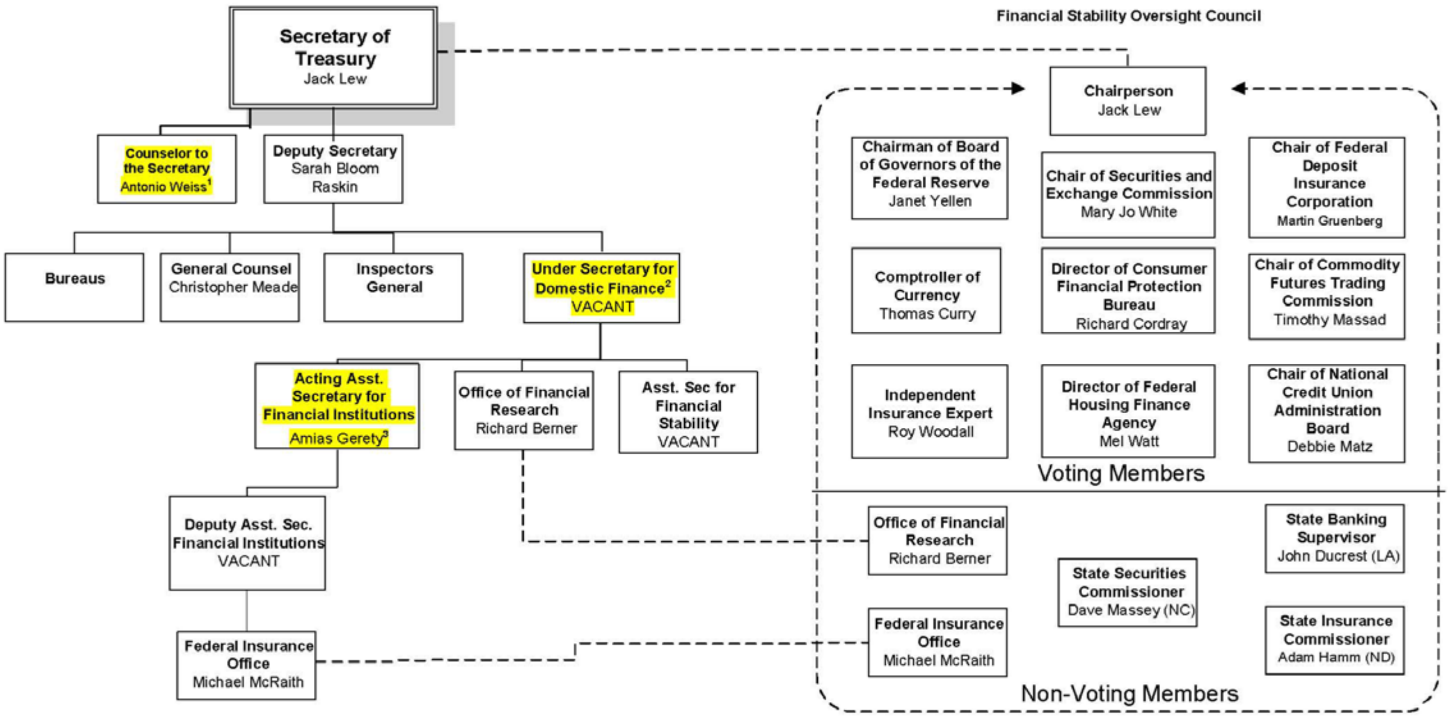
William P. White, former Commissioner,

DC Department of Banking and Insurance

October, 2013

United States Department of Treasury Organization Chart and Relationships to Dodd-Frank Act Entities and Other Agencies

As of June 2015



1. Weiss nomination for Undersecretary was blocked; then appointed to position not requiring Senate confirmation
2. Key vacancy after failed Weiss nomination; Matthew Rutherford stepped down early 2015
3. Appointed early 2015

Spanning the Globe:

The Rise of International Insurance Regulation

(Also a Big Deal For Guaranty Funds)

IAIS devising **International Capital Standards** @ FSB direction: Significance to Resolution

- ***Capital standards*** **are intended to** ***lessen the chances*** **that an entity will fail**
- ***Resolution strategies*** **are intended to** ***ensure that a failure won't destabilize*** **the economy**
- **How much capital an entity needs is, in part, driven by how it would be resolved. And how an entity can be resolved depends, in part, on how much capital it has.**

In a nutshell, some of the decisions that are being made with respect to capital standards could impact the guaranty system – because they will dictate what resolution strategies are possible.

Some Concerns About Insurance Capital Standards

- No relation between capital standards and the actual operation of insurance business
- No consideration of how risk is measured and how insurance products are priced in response
- Eventually applicable to insurers of all size

What are the Capital Standards Trying to Accomplish?

"One of the questions I have is whether we are trying to prevent company failures or control the effects?"

William P. White, former Commissioner D.C. Department of Banking and Insurance

October, 2013

The Goal of Insurance Regulation Has Already Changed

Move from singular focus on policyholder protection to dual focus on policyholder protection and financial stability

- **Capital standards and resolution strategies aimed at minimizing the impact of a company's failure on the broader financial system**
- **Federal Reserve Insurance Advisor Tom Sullivan's primary focus is not policyholder protection--he has to focus on financial stability first**
- **IMF Financial Sector Assessment Program (FSAP) raises questions about the guaranty system's inability to provide bail-out funding to troubled companies**

What's driving these changes?

- Insurance growth is in emerging markets
- U.S. regulators see AIG as success story because no policyholders were hurt. International regulators see it as a failure.
- Different mindset to regulatory approach
- U.S.= policyholder protection
- International = Counterparties
- Possibly a different concept of "insurance?"
- Is risk sharing still a valid business model? How about in 5 years or 10?

Well-known but don't forget

Prominent role being played by bank regulators, who have bank-centric experience, perspectives and anxieties

- FSOC is convinced that insurers are subject to a run on the bank scenario, in which policyholders concerned about their insurer's financial condition will surrender their products and demand their money all at the same time
- FSOC fears that if one insurer fails, policyholders of other insurers will engage in the same type of surrender activity, possibly leading to a wave of failures
- These bank-centric fears provided a basis for designating Prudential and Met as SIFIs

IMF Financial Sector Assessment Program

- Compared the U.S. insurance insolvency system to the Financial Stability Board's Key Attributes of Effective Resolution Regimes

  Initial findings:

IMF assessors rigidly applied the bank-centric Key Attributes of Effective Resolution Regimes without regard for the insurance-specific annexto the Key Attributes

Criticism that U.S. system prioritizes policyholder protection over financial stability

July 7, 2015: IMF Releases its Technical Review of How the U.S. Insolvency System Compares to the Key Attributes of Effective Resolution Regimes for the Banking and Insurance Sectors

- Although, the U.S. resolution regime for financial institutions has been significantly enhanced since the financial crisis, important gaps in the insurance resolution framework remain that could undermine the regime's ability to deal effectively with systemically important insurance companies

- State resolution frameworks are directed primarily towards the protection of policy holders and provide for a largely court-driven, receivership process which may lead to delays.

- Where an insurance company comes under a holding company, which can be resolved under federal law, an additional issue relates to the manner in which state resolution authorities would coordinate with each other and with the federal authorities.

- State frameworks do vary and such variance could hinder the prompt resolution of a systemically important insurance group.

And that's not all…

- Guaranty funds are legally required to protect policy holders in the event of insolvency, but they are not required to do so prior to insolvency (IMF thinks they should be).

- The funds are authorized to borrow from commercial banks or issue bonds, but not from the public sector.

- The liabilities of the failed insurance company are generally paid out over an extended period and are typically funded from the assets of the estate

- However, it is unclear whether the financial capacity of the funds would be sufficient to address a systemically important insurer.

- **Primary Recommendation:** The U.S. resolution regime, as enshrined in the [Dodd-Frank Act], should apply also to systemic insurance companies. (Requires an Act of Congress)

Reactions

- No statutory movement to change the guaranty system trigger.

- Troubled company bailout runs counter to the whole public policy purpose of the guaranty system and the stated goals of Dodd-Frank (AIG/Greenburg decision seems to support this policy).

- GFs are collaborative and coordinated through NCIGF and NOLHGA. That's why they were established!

Leading Indicators of GF System

- Dodd-Frank Title II
- IMF
- FSOC Designations
- FDIC SPOE
- NCIGF Trusted Expertise
- MetLife v. FSOC: ACLI amicus cites GF system's protection, coordination and "vast assessment capacity."

The Worry Room

- Ongoing federal skepticism/premature capitulation
- Changes to/replacement of system, at least for SIFIs, to meet international expectations
- Trickle down effect: Rating agencies may incorporate capital standards into rating criteria = competitive stress
- Capital standards will drive insurers to take greater risks/GF preparation?
- No more liquidations/impact on consumers/GFs?

Questions

ADDITIONAL RESOURCES

- NCIGF Laws and Law Summaries:
- ncigf.org/GF-laws-and-summaries-by-state

- NCIGF Insolvency Trends Whitepaper:
- ncigf.org/public-publications

- Financial History and Assessment Liability Information
- ncigf.org/Industry

- The NCIGF Website:
- ncigf.org

Thank You!

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