Understanding the Safety Net Provided by Property and Casualty Insurance Guaranty Associations

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In today’s world, many types of property and casualty insurance coverages are considered a necessity rather than a luxury. State laws require owners of motor vehicles to procure liability insurance as a condition of licensure. Similarly, federal law requires interstate truckers to purchase substantial policies of liability insurance. Banks require homeowners to obtain property and liability insurance coverage as a condition of their mortgage obligations, and they require those who borrow to purchase cars to maintain both liability and physical damage insurance. Employers are required to maintain Workers’ Compensation insurance to protect their employees from the consequences of workplace accidents and occupational disease. Doctors are afraid to practice medicine without professional liability insurance to protect them from claims of actual and perceived medical malpractice. These types of insurance provide a financial safety net for insureds and those from whom they borrow money, those with whom they do business, and those who may have tort claims against them.

Most insureds are ill-equipped to make any sort of knowledgeable assessment of the financial strength of the insurers from which they purchase policies. Purchases of insurance policies are made on the strength of insurers’ advertising campaigns and personal relationships with producers rather than on the basis of any effective financial analysis of the health of the underwriting insurer. Even the experts—the insurance regulators charged with financial overview of insurers domiciled or doing business in their states—sometimes have trouble accurately determining the financial strength of individual insurers, and the financial decline of an insurer may not come to the attention of its regulator until far too late to take any effective remedial action. The financial rating agencies themselves appear to have been surprised by the insolvency proceedings that have been commenced against Reliance Insurance Company and several of the other large insurers that have ended up in liquidation. Thus, when an insurance company becomes insolvent, the protection and security it has provided disappears, and the financial assets of the insolvent insurer’s customers are exposed. To protect insureds and claimants from this type of contingency, state legislatures have established property and casualty insurance guaranty associations (IGAs). The protections provided, however, are restricted to those insureds and claimants possessing sufficient nexus to the establishing state.

How Are IGAs Established and Structured?

IGAs have been established under state laws as a safety net when insurers become insolvent and are placed in liquidation. While the exact terms of the IGA enabling legislation vary from state to state, the legislative structures in most states generally follow the template of the Post-Assessment Property and Liability Insurance Guaranty Association Model Act (Model Act), adopted and promulgated by the National Association of Insurance Commissioners. Accordingly, this article focuses on the provisions of the Model Act, though some variation in provisions of that Act or a variation thereof can arise in any given state.

New York is the only state that has adopted insolvency fund legislation on a preassessment basis, thus elements of New York’s protections differ substantially from the Model Act template.

Under the Model Act, IGAs are statutorily mandated, involuntary associations comprised of all of the insurers holding certificates of authority allowing them to write covered lines of insurance in a state. Insurers doing business in a state as surplus lines insurers or unauthorized insurers do not participate, although New Jersey has established a separate IGA for surplus lines carriers covering risks in that state. The member insurers participate in the costs of the IGA based upon their premium writings for the lines of business in the state.

There is no “free lunch” for the public, however, and the IGA system has a cost the public must pay. To the extent that the insurer members of an IGA pay net amounts to the IGA as assessments to cover their share of the IGA’s expenses for covered claims, claims expense, and administrative expense, the IGA’s members are entitled to include in their rates and premiums an amount sufficient to recoup those
payments. Some states allow IGA members to offset the amount of their assessments against premium taxes the insurers may owe arising from policies issued in the state.

Depending on the amount of assets marshalled and recouped by a liquidator for an insolvent insurer, the ultimate impact of the insolvency upon IGAs and their members may be lessened by recoveries that the IGAs make from the liquidation estate.

The Model Act offers alternative structures for allocation of the costs of IGAs. In one option, the IGA is deemed to be a single, unitary entity where the costs of all covered claims are spread over all of the member insurers. The other option provides for the establishment of individual “accounts” that split up the IGA’s claims expenses into separate accounts for Workers’ Compensation insurance, automobile insurance, and “the account for all other insurance to which the Model Act applies.” The theory behind this is that the costs of IGA payments for insolvencies in individual large lines of insurance would be paid by the solvent insurers writing those lines and, in turn, the insureds of the solvent insurers writing those lines. Thus, Workers’ Compensation insurers and their insureds would share the costs of an insolvency of a Workers’ Compensation insurer but would not bear responsibility for the insolvencies of an automobile liability insurer or a medical professional liability insurer. Assessments by the IGA on each of its insurer members are limited to “two percent (2%) of that member insurer’s net direct written premiums for the calendar year preceding the assessment.” Where separate accounts are used by an IGA, the 2 percent limitation applies to each account separately.

The structure of the Model Act contemplates that claimants will bear the risk of insufficient assessment capability by an IGA, which might result from the 2 percent assessment limitation. In situations where the IGA’s assets plus the maximum assessment for a year do not generate sufficient funds to pay the claims for that year, the claims may be paid on a pro rata basis with the balance to be paid in subsequent years as funds become available. The use of separate accounts has recently caused considerable difficulty where an individual IGA has an account with a too-small assessment base but large losses in the account. While the partial, pro rata payment option may be acceptable for claims arising out of many covered lines of insurance, there are some lines, such as Workers’ Compensation, where claims must be paid in a timely manner and in full. This has resulted in the need for the affected IGA to obtain bond or other financing to cover its claims obligations during the period of assessment inadequacy. Alternatively, some IGAs have resolved these issues by interaccount borrowing, to take care of cash flow needs. Many times, however, the normal development of claims involves a process that can take several years, thus enabling the IGA to make several annual assessments in order to accommodate the cash flow realities and generate the requisite funds. Moreover, the Model Act provides that an IGA can pay claims in any order that it may deem reasonable, including payment of claims “as they are received from the claimants or in groups or categories of claims,” thus giving additional flexibility to IGAs that may be suffering from cash flow difficulties.

**What Triggers Coverage?**

The Model Act requires an insurer to be an “insolvent insurer” before a state IGA can be activated. It defines insolvent insurer as

an insurer licensed to transact insurance in this State, either at the time the policy was issued or when the insured event occurred, and against whom a final order of liquidation has been entered after the effective date of this Act with a finding of insolvency by a court of competent jurisdiction in the insurer’s state of domicile.

This definition is designed to avoid activation of IGAs when an insurer has been placed in conservation or rehabilitation and is not yet in liquidation. A few states, however, do not include the entry of an order of liquidation as their trigger for IGA activation. In these states, the entry of an order containing a finding of insolvency is the prerequisite for activation; and the entry of an order of rehabilitation will cause the IGA to activate, assess its members, and undertake its claims-handling responsibilities.

**What Claims Are Covered?**

Since IGAs are creatures of statute, their obligations to stand in the shoes of an insolvent insurer to pay claims arise solely from statutory requirements. Under the Model Act, IGAs are responsible only for “covered claims.” The Model Act defines the term as follows:

“Covered claim” means an unpaid claim, including one for unearned premiums, submitted by a claimant, which
arises out of and is within the coverage and is subject to the applicable limits of an insurance policy to which this Act applies issued by an insurer, if the insurer becomes an insolvent insurer after the effective date of this Act and:

1. The claimant or insured is a resident of this state at the time of the insured event, provided that for entities other than an individual, the residence of a claimant, insured or policyholder is the State in which its principal place of business is located at the time of the insured event; or
2. The claim is a first party claim for damage to property with a permanent location in this state.17

Where potential for a claim could be filed against more than one IGA, recovery must first be sought from the IGA of the place of residence of the insured or, where the claim is a first-party claim involving property with a permanent location, from the IGA of the location of the property. Workers’ Compensation claims go first to the IGA of the residence of the claimant. Any recovery from an IGA reduces the amount of potential recovery against any other IGA or its equivalent.18 Where IGAs in more than one state have potential responsibility for a claim and the states afford different levels of protection under their respective statutory mandates, the IGA of the state with primary coverage will pay up to its limit. Then the IGA of the state with secondary responsibility will pay the unpaid balance up to its limit after taking a credit for all moneys paid by the first IGA. If both states have the same statutory limit, the offset of payments by the first IGA will exhaust any obligation of the secondary IGA.

The statutory responsibility for IGA claims can be confusing in operation. For example, consider ongoing litigation arising from a motor vehicle accident that is caused by Driver A, a resident of Maryland, who collides with and injures Driver B, a resident of Virginia, while driving in Virginia. Driver B sues Driver A in Virginia since that is Driver B’s residence and where the accident occurred, and Driver A’s insurer appoints Virginia defense counsel to represent him. Subsequently, Driver A’s insurer becomes insolvent and is placed in liquidation. At that point, the liquidator of Driver A’s insurer sends the file to an IGA. But which one? The liquidator may take a cursory look at the claim file, see that the case involves Virginia litigation and a Virginia claimant, and send the file to the IGA in Virginia. The Virginia IGA will not accept the file since the insured’s domicile is Maryland and proper IGA jurisdiction lies primarily with the state of residence of the insured. Then the file will be re-referred to the Maryland IGA, which will need to retain Virginia counsel to undertake and continue the defense of Driver A. This jurisdictional scenario may take several months or more to unfold and reach resolution.

There are specific exclusions to the definition of a covered claim. These provide that the IGA will not be responsible for any amount awarded as punitive or exemplary damages; any amount sought as a return of premium under any retrospective rating plan; or any amount due any reinsurer, insurer, insurance pool, or underwriting association as subrogation recoveries, reinsurance recoveries, contribution, indemnification, or otherwise.19 Additionally, to protect the insureds of the insolvent insurer, no claim for any amount due any reinsurer, insurer, insurance pool, or underwriting association may be asserted against a person insured under a policy issued by an insolvent insurer other than to the extent the claim exceeds the IGA’s obligation limitations as set forth in the statute.20

What Are the Restrictions on Coverage?
IGAs cover most types of property and casualty insurance, but a number of lines of insurance are specifically excluded. Under the Model Act, there are exclusions for life, annuity, health, and disability insurance; mortgage guaranty and similar types of insurance offering protection against investment risks; fidelity and surety bonds; credit insurance; insurance of warranties and service contracts; title insurance; ocean marine insurance; insurance covering transactions where there is a transfer of investment or credit risk but no transfer of insurance risk; and insurance provided by or guaranteed by government.21 Individual state exclusions vary. For instance, some states extend IGA protection to fidelity and surety bonds, and others cover title insurance. Exclusions must be examined on a state-by-state basis. Federal law precludes risk retention groups from being members of IGAs.

What Is the Scope of Claims Responsibility?
In many states, provisions restrict the protections afforded by IGAs to insureds of insolvent insurers that maintain a high net worth. On the theory that the claims of large, wealthy entities should not financially burden the insureds that bear the ultimate costs of supporting the IGA system, the Model Act provides a number of alternative provisions that preclude the IGA’s responsibility for any first-party claims by an insured whose net worth exceeds $25 million or $50 million on December 31 of the year prior to the year in
which the insurer becomes an insolvent insurer. The insured’s net worth on that date shall be deemed to include the aggregate net worth of the insured and all of its subsidiaries as calculated on a consolidated basis. As a variation on the net worth exclusion, the Model Act provides that an IGA will pay claims made against a high net worth insurer but will have the right to recoup all such payments by subrogation against the insurer. Other states have adopted a flat exclusion precluding IGA liability for these claims. To ensure that those affiliated with the insolvent insurer do not benefit from the insolvency at the expense of the insureds of other, solvent insurers, the Model Act precludes coverage for any first-party claim by an affiliate of the insolvent insurer. Similarly, if an affiliate of an insolvent insurer should benefit from payments made by an IGA, that IGA is granted the right to subrogate against the affiliate to recover the amount of any covered claim paid on behalf of the affiliate. 

The obligations of an IGA to pay covered claims on behalf of an insolvent insurer are not unlimited. The IGA only has responsibility for covered claims existing before the order of liquidation, arising within 30 days after the order of liquidation, or before the policy expiration date, if less than 30 days after the order of liquidation, or before the insured replaces the policy or causes its cancellation, if the insured does so within 30 days of the order of liquidation. Thus, insureds of insurers that are placed in liquidation must act promptly to replace the coverage with a new carrier if they wish to maintain their protection.

The IGA’s obligations with respect to individual claims are limited to those of the insolvent insurer under the policy or coverage from which the claim arises and to additional statutory limitations such as the full amount of a covered claim for benefits under a Workers’ Compensation insurance coverage, an amount not exceeding $10,000 per policy for a covered claim for the return of unearned premium, and an amount not exceeding $500,000 per claimant for all other covered claims. Some states have imposed different, lower caps. Some states also impose a small deductible on claims made against IGAs so that they may avoid the expense of handling de minimis claims. Covered claims must be filed promptly with the IGA. Under the Model Act, a covered claim must be filed before the final bar date set by the court for the filing of claims against the liquidator or receiver of an insolvent insurer. Some states establish bar dates for claims against the IGA that do not correspond with the bar dates for claims against the liquidation estate and may be shorter than the liquidation bar dates.

Because an IGA is deemed to be the insolvent insurer to the extent of its obligation on the covered claims, it is given the rights, duties, and obligations of the insolvent insurer as if the insurer had not become insolvent. These include the right to pursue and retain salvage and subrogation recoverable on covered claim obligations to the extent paid by the IGA.

The goals of the Model Act are to protect claimants and policyholders while, at the same time, attempting to minimize the financial imposition on the IGA’s member insurers and their policyholders. Thus it requires claimants to exhaust all coverage provided by any other insurance policy before proceeding against an IGA and, further, provides that any such recoveries are to be set off against and reduce the obligation of the IGA on the claim.

This setoff provision is the basis for requiring claimants in automobile accidents to seek recovery under the uninsured motorist or collision provisions in their own motor vehicle insurance policies before attempting to recover from an IGA. The setoff provision can also affect the IGA’s obligations when the insolvent insurer’s insured is one of several tortfeasors involved in a claim. In a multiple vehicle accident, any recovery by an injured party from the solvent insurer of another at-fault driver will reduce the obligation of the IGA to pay the same claim on behalf of the insured of the insolvent insurer. The setoff rights only apply to the same claim, and an IGA standing in for an insolvent insurer that has issued an excess insurance policy may not set off its obligations against the payments made by an underlying solvent primary insurer.

When an insurer becomes an insolvent insurer as defined by the Model Act, delays necessarily occur as the statutory liquidator, who is normally the insurance commissioner of the insolvent insurer’s domiciliary state, and the appointed special deputy receiver take over the insolvent insurer. The special deputy receiver must locate and assemble claims files and other claims information for transmittal to the appropriate IGAs. In some instances, this may require dealing with a substantial number of claims offices scattered across the country. In others, however, the claims information and files have been distributed amongst hundreds of, or even several thousand, unrelated third-party administrators. Thus the responsible IGAs cannot immediately step in for the insolvent insurer with respect to existing claims and ongoing litigation. The Model Act contemplates this situation by providing for a six-month stay of litigation in the IGA’s home state where the insolvent insurer was a party or was obligated to defend a party. The stay will permit the IGA to properly defend the causes of action for which it must assume responsibility.

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warranted, the court may extend the stay for an additional period.

Realizing that an insurer that is becoming insolvent may not properly defend itself or its insureds as insolvency proceedings approach and that its inaction may result in the entry of default judgments, orders, decisions, verdicts, or findings, the Model Act provides relief to the responsible IGA. It is allowed to apply to the same court or administrator that rendered the original default ruling and to have the default ruling set aside so that the IGA can defend the claim on its merits.34

Conclusion

The protections afforded to insureds and injured parties under the IGA system are not as complete as those provided by the original insurance policies in place before the issuing insurers became insolvent. Nonetheless, IGAs adequately protect the interests of most people who have the misfortune to become involved with an insolvent insurer in the prosecution or defense of a claim under an insurance policy.

Notes

1. I NAT’L ASS’N INS. COMM’RS, PROCEEDINGS 253–62 (1970), reprinted as amended in III NAT’L ASS’N INS. COMM’RS, MODEL LAWS, REGULATIONS AND GUIDELINES 540-1 to 540-26 (2009). For purposes of this article, the original 1970 Act will hereinafter be cited as the Model Act. In 2009, the Model Act was revised and renamed the Property and Casualty Insurance Guaranty Association Model Act; this revision will be cited as the New Model Act. The NAIC has also adopted the Life and Health Insurance Guaranty Association Model Act, I NAT’L ASS’N INS. COMM’RS, PROCEEDINGS 160–73 (1971), reprinted as amended in III NAT’L ASS’N INS. COMM’RS, MODEL LAWS, REGULATIONS AND GUIDELINES 520-1 to 520-45 (2009), which protects those dealing with life insurance, health insurance, and annuity products issued by insurers that become insolvent. It is beyond the scope of this article.


2. The New Model Act has only been enacted by Alabama and Iowa since NAIC adoption in 2009. Current IGA laws in other states are based upon earlier versions. The exceptions are California, Michigan, New York, and Wisconsin, which have adopted statutory frameworks that did not originate with the Model Act.

The Model Act does not exist in a vacuum. It is linked in its structure and operation with state-enacted insurance insolvency laws. Most states have enacted a form of the NAIC Insurers Rehabilitation and Liquidation Model Act; I NAT’L ASS’N INS. COMM’RS, PROCEEDINGS 242–75 (1978) (as amended). Several competing model acts for the conservation, rehabilitation, and liquidation of insolvent insurance companies have been proposed by various sectors of the insurance community. The Uniform Liquidation Act, UNIF. INSURERS LIQUIDATION ACT, 13 U.L.A. 429–31, has been proposed in conjunction with an interstate compact addressing insurer insolvencies, but it has not been adopted by any state. Similarly, the NAIC has recently developed the Insurance Receivership Model Act, See NAT’L ASS’N INS. COMM’RS, PROCEEDINGS 48–122 (2005), reprinted as amended in III NAT’L ASS’N INS. COMM’RS, MODEL LAWS, REGULATIONS AND GUIDELINES 555-01 to 555-98 (2007). Elements of this Act have met significant opposition from IGAs, insurance trade associations, insurers, and reinsurers. While it has been adopted by the NAIC, it has not yet been widely accepted at the state level.

3. See N.Y. INS. LAW §§ 7601–7614 (1989). The New York preassessment scheme is not addressed in this article. Generally the insurance industry has sought to establish IGAs on a postinsolvency assessment basis. Experience has shown that state legislatures, in times of financial crisis, will try to “borrow” from large, unused accumulations of moneys that have been collected on a preinsolvency basis without an imminent need for the funds, and such takings may not be repaid.

4. MODEL ACT § 8.A(3). Section 8.A(3) of the New Model Act provides a number of alternatives for states to select for allocation of costs.

5. MODEL ACT § 16; NEW MODEL ACT § 17, alternative 1. This Model Act provision is unusual insofar as it allows member insurers to base their future rates on past expenses so as to allow the recoupment of those expenses. Normal rate-making procedures do not allow insurers to recoup past loss payments from future policyholders. Future rates are generally based upon actuarial projections of future losses.

6. NEW MODEL ACT § 17, alternative 2.

7. The provisions of Model Act Section 11.C (or New Model Act Section 12.C) grant IGAs the right to stand in the shoes of the claimants they have paid for the purpose of recouping from the liquidation estate the moneys the IGAs paid out in claims. To the extent the liquidator can pay claimants (including IGAs) a high percentage of their allowed claims, the need for assessments by the IGAs will be lowered on a net basis.

8. MODEL ACT § 6; NEW MODEL ACT § 6.

9. MODEL ACT alternate § 6; NEW MODEL ACT alternate § 6.

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10. See Model Act alternate § 8.A(3); New Model Act § 8.A(3), alternatives 1b & 2b.
14. See the alternative financing provisions established under the Model Act’s Optional Section 8.C and the New Model Act’s Optional Section 8.D.
16. Model Act § 5.G. Section 5.1 of the New Model Act expands upon prior definitions of insolvent insurer to address assumed claims issues.
17. See Model Act § 5.F. Section 5.1H of the New Model Act has been amended from earlier versions to also apply to claims under assumed policies.
19. Model Act § 5.F(3)(a), (b) & (c). Subsection 5.F(3)(c) may cause some problems for insurers paying uninsured motorists or collision claims to their own insureds and seeking to obtain reimbursement. The IGA has no responsibility for such claims, and the paying carrier’s subrogation rights are limited to making a claim in the receivership proceedings of the liquidation estate.
20. Both Model Act Section 5.F(3)(c) and New Model Act Section 5.H(2)(c) place this substantive prohibition against pursuing the insureds of the insolvent insurer in a definitional provision.
21. Model Act § 3; New Model Act § 3. Some of the types of insurance excluded by these sections are covered by the Life and Health Insurance Guaranty Association Model Act. See note 1, supra.
23. Model Act § 11.B(1); New Model Act § 13 [Optional], alternatives 1 & 2 for Section 13.B. The application of the preclusion of IGA coverage for high net worth insureds is made more complicated by the writing of policies containing high deductibles or self-insured retentions.
25. Model Act § 11.B(2); New Model Act § 12.B.
27. Model Act § 8.A(1)(i), (ii) & (iii). Prior versions of the Model Act limited IGA responsibility for “all other” claims to $300,000.
28. Model Act § 8.A(1)(b); New Model Act § 8.A(1)(b). The recent insolvencies of several insurers that wrote claims-made coverage for long-tail lines of liability insurance, such as medical professional liability coverage, have created issues of when claims arise, both for purposes of satisfying the covered claim definition and for purposes of applying bar dates. This is made more complex when either the insurer or the liquidator has sold the insured an extended reporting period (ERP) within which to report claims. Such a purchase does not formally convert a claims-made policy to an occurrence policy, although the insured may consider the ERP endorsement to do just that. While parsing the terms of an ERP endorsement shows that the endorsement does not per se convert the claims-made policy to an occurrence policy, courts have generally assumed that an ERP endorsement does functionally convert the policy.
A similar issue involves the filing of “contingent proofs of claim,” also known as “policyholder protection claims.” These claims are filed by insureds trying to gain future protection from an IGA when a bar date approaches and the insured believes that some claims, from unknown claimants, may be made after the bar date has passed. While the filing of contingent claims may be allowed in individual liquidation estates under the provisions of the insurer liquidation acts, there are strong arguments against allowing such general, nonspecific claims to be made against IGAs. Indeed, the Model Act does not contemplate such claims. See Dist. Hosp. Partners, L.P. v. D.C. Ins. Guar. Ass’n, Civ. Action No. 05Ca4791 (D.C. Sup. Ct., Apr. 10, 2007); Union Gesellschaft fur Metal Industrie Co. v. Ill. Ins. Guar. Fund, 56 N.E.2d 1076 (III. App. Ct. 1989).
31. Model Act § 5.G; New Model Act § 5.I.
32. In the Reliance Insurance Company insolvency, the Pennsylvania liquidator found that claims files were scattered over more than 2,000 third-party administrators. In many instances, the claims department at Reliance had no information concerning the individual claims being handled by the third-party administrators, and reports concerning these claims often went directly to the insureds that paid and controlled the third-party administrators.
33. Model Act § 18; New Model Act § 19. The Model Act provision contemplates that the IGA will be litigating matters in the IGA’s home state. This is not always the case, however, as the IGA will have primary responsibility for litigation brought against the insured of an insolvent insurer domiciled in the IGA’s jurisdiction, but the litigation may be brought in another state where the plaintiff resides or the underlying accident occurred. In that event, the IGA’s enabling statute will not apply and the corresponding statute in the state where the litigation is located will only apply to the local IGA. In these situations, reasonable courts will usually stay the proceedings upon request, but it does not...
always happen.

34. MODEL ACT § 18; NEW MODEL ACT § 8.A(6). This situation is similar to that discussed in note 33. The Model Act is drafted as if the IGA would only be litigating in its home state, and the authority to have default judgments set aside would not extend to litigation in other states. Nonetheless, the conformity of language among the states usually causes courts to lift any defaults and allows the IGAs to defend.