Oh, No! My Insurer Has Gone Bust!

Can an Insurance Guaranty Association Help Me?

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In today's world, many types of property and casualty insurance coverages are considered to be a necessity, not a luxury. State laws require motor vehicle insurance and workers' compensation coverage. Lenders and other contracting parties require property and liability insurance. These coverages provide a financial safety net for insureds, those from whom they borrow money, 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. Even the experts, the insurance regulators charged with financial overview of insurers, sometimes have trouble accurately determining an insurer's financial strength; and the financial decline of an insurer may not come to the attention of its regulator until far too late for effective remedial action. When an insurance company becomes insolvent, the protection and security it provided disappears, and the financial assets of the insolvent insurer's customers are exposed. To protect insureds from this type of contingency, state legislatures established property and casualty insurance guaranty associations (IGAs). (Similar entities that protect customers of insolvent life and health insurers are beyond the scope of this article.)

Although 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 National Association of Insurance Commissioners Post-Assessment Property and Liability Insurance Guaranty Association Model Act (Model Act), as does this article (although variations in provisions will occur in any given state). New York is the only state to adopt insolvency fund legislation on a pre-assessment basis; elements of New York's protections differ substantially from the Model Act template.

Under the Model Act, IGAs are statutorily mandated, involuntary associations made up of all of the insurers holding certificates of authority allowing them to write covered lines of insurance business in a state; insurers doing business in a state as surplus lines insurers or unauthorized insurers do not participate (although New Jersey established a separate insurance guaranty association for surplus lines carriers covering risks within the state). The member insurers participate in the costs of the association based upon their premium writings for the subject lines of business in the state.

The Model Act requires an insurer to be an "insolvent insurer" before the IGA can be activated in a state, and defines the term 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 but is not yet in liquidation. A small number of states, however, trigger the activation of their IGAs solely on a finding of insolvency and do not require the entry of a liquidation order.

Because 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 for "covered claims," which are defined 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.

Where there is potential for a claim to 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 association of the residence of the claimant. Any recovery from an IGA reduces the amount of potential recovery against any other IGA or its equivalent.

There are specific exclusions to the definition of covered claim: 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. Additionally, in order 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.

IGAs cover most types of property and casualty insurance, but a number of lines of insurance are specifically excluded. The Model Act excludes 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. Individual states have adopted variations on these exclusions; for instance, some states extend IGA protection to fidelity and surety bonds, and others cover title insurance. Federal law precludes risk-retention groups from being members of IGAs.

In many states, provisions restrict the IGA protections afforded to high-net worth insureds of insolvent insurers. Under the theory that large, wealthy entities do not need to burden the IGA system with their own claims, the Model Act precludes the IGA's responsibility for any first-party claims by an insured whose net worth exceeds $25 million. As a variation on the net worth exclusion, some states provide that the IGA will pay claims made against a high-net worth insured but will have the right to recoup all such payments by subrogation against the insured; other states have adopted a flat exclusion precluding IGA liability for such claims.

The obligations of an IGA to pay covered claims on behalf of an insolvent insurer are not unlimited. The IGA has responsibility only for covered claims existing prior to 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 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, with additional statutory limitations as follows: 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 $300,000 per claimant for all other covered claims. Some states have imposed higher or lower caps. Some states also impose a small deductible on claims made against IGAs so they may avoid the expense of handling of *de minimus* claims.

The goal of the Model Act is to protect claimants and policyholders while at the same time trying to minimize the financial imposition on the IGA's member insurers and their policyholders. Thus, it provides for setoffs against the IGA's obligations as follows:

> Any person having a claim against an insurer whether or not the insurer is a member insurer under any provision in an insurance policy other than a policy of an insolvent insurer which is also a covered claim, shall be required to exhaust first his or her right under the policy. An amount payable on a covered claim under this Act shall be reduced by the amount of recovery under the insurance policy.

This setoff provision is the basis for requiring claimants in automobile accidents to seek recovery under the Uninsured Motorist provisions in their own policies before attempting to recover from an IGA.

The protections afforded to insureds and injured parties under the IGA system are not as complete as those provided by the original insurance policies 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. ❖

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