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GOVERNMENT RELATIONS
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NAIC
National Association of Insurance Commissioners
The Center for Insurance Policy and Research

When an Insurance Company Fails

- *State insurance regulators subject companies to stringent solvency requirements including conservative risk-based capital (RBC) rules, investment limitations, and detailed reporting and analysis, which minimize the risk of insolvencies to policyholders.*

- *State regulators have a time-tested orderly process in the rare event that an insurer does become insolvent. This "receivership" process emphasizes and prioritizes the best interests of policyholders.*

- *Unlike a failing bank, which faces immediate customer withdrawals, an insurer does not typically face a "run-on-the-bank" scenario. This allows the process to be managed in an orderly manner over a longer period of time. In addition to insurer assets, states have guaranty funds to help make policyholders whole.*

Background

The fundamental tenet of state insurance regulation is to protect policyholders by ensuring the solvency of the insurer and its ability to pay claims. State regulators have broad authority and a variety of tools to spot troubled insurers before insolvency occurs. If a company becomes a concern, regulators in the company's home state take corrective action through a laddered regulatory intervention process and can step in and take control of the company, starting the receivership process. The first stage is "rehabilitation." The state insurance department attempts to stabilize and improve the company's financial status. A company under the control of the insurance department will continue to honor claims as long as premiums are paid or cash value exists.

If the financial difficulties are too great to overcome, the commissioner declares the company insolvent and the receivership process moves to the next stage: "liquidation." In liquidation, the receiver attempts to maximize the company's assets to pay creditor claims, prioritizing policyholders over most creditors. Where possible, the receiver will transfer policies to a stable insurer. Once liquidation is ordered, state guaranty associations, who back up policies much like the FDIC backs up bank deposits, may provide coverage to the company's policyholders (coverage is capped and varies based on the type of policy and residency of the policyholder). If the company does not have enough funds to meet its obligations to policyholders or the receiver cannot transfer policies, each state guaranty association assesses member insurers in its state a share of the amount required to meet the claims of resident policyholders.

Key Points

- ✓ Post-Dodd Frank Act, states remain empowered to resolve systemically important insurers, with the FDIC serving in a backup capacity.

- ✓ Insurance is a highly competitive business with several thousand companies in the marketplace. If a troubled insurer is identified and cannot be rehabilitated, policies can often be sold to other competitors while retaining all the protections in the policy.

- ✓ State guaranty funds serve as a backstop when an insurer's financial difficulties are too great to overcome.

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