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What Happens when an Insurer Fails

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Some businesses do well and last for years, while others do not. Retail stores that continue to fail will close shops, leaving thousands of employees without jobs. Closed operations will have enormous sales to get rid of inventory. Bon-Ton, Toys R Us, and Teavana are just a few of the businesses that have closed or are closing all shops, and many other retailers are closing specific numbers of underperforming stores. This is easy enough to do because tangible goods can readily be sold, and there are no obligations for previously sold goods. Insurance, however, is a different matter entirely.

When an insurance policy is sold, the insured receives a copy of the policy. However, what the insured is actually buying is a promise - a promise to make the insured whole in event of a loss. A loss may never happen, in which case the insured is spending money for something he will never receive. However, if a loss does occur, then the insured will be made whole for the loss. If the insured's house burns down, the insured has paid far less in premium than the value of the home, and it is likely that the insured did not have the cash on hand to replace the home and all its contents. This is a great relief to an insured who has sustained a loss, and why insurance works. Insurance provides coverage for financial losses an insured cannot readily absorb on her own. Even if the home is paid off and there is no longer a mortgage, the chances that an insured could pay to replace that home out of pocket are slim. This is fine as long as the insurance company has the funds to pay the losses. States regulate insurance to make sure that the company does have such funds and can pay its insureds if a loss occurs; certain levels of capital are required before a carrier can even operate in a state, and some states require an additional amount of surplus funds as well. So what happens if a carrier does become insolvent and is no longer able to pay claims?

The carrier may be declared insolvent and put into receivership, where the carrier's assets and operations are put under the control of a custodian. An insolvent company is one unable to pay its debts as they come due. A liquidation order will be put in force, and this requires the assets of the company to be distributed to claimants. Claimants may be creditors, insureds and others. With an insurer insolvency, insureds are not only left without a policy, but there can be insureds who have suffered losses who now have no way to make themselves whole from a loss. States do not want insureds to be left in this vulnerable position. Insurance runs a thin line between being for profit organizations and being social organizations for the good of the whole.

In order for insureds not to be left in the lurch if a carrier fails financially, states have developed guaranty funds in order to protect the insureds. Part of the requirements of state guaranty funds is that carriers must participate in the fund in order to be able to write policies in that state. All states, Puerto Rico and Washington D. C. have guaranty funds. A state may have multiple guaranty funds, one for auto insurance, one for workers compensation, and other lines. Carriers pay into the guaranty fund so that if a carrier becomes insolvent, funds are available to pay claims that the insolvent carrier is unable to pay. Carriers generally pay a percentage of their direct written premium, often one or two percent. Carriers are assessed for the funds, and the assessment is determined by the amount needed to supplement the existing funds. The guaranty fund will take the insolvent carrier's remaining assets, including reinsurance, and funds previously deposited with the guaranty fund. These funds are combined with the funds assessed from other carriers operating in the state, and insureds' losses are covered through these funds.

Access Insurance Company, a nonstandard carrier writing in 22 states, was placed into receivership on March 13 by a Texas district court. The court ruled that the liabilities exceeded its assets and that it could no longer cover future claims, thereby putting its policyholders at risk. The company failed to maintain sufficient loss reserves and failed to pay certain taxes in some states. The carrier will be allowed to operate in Massachusetts only.

Insureds were then notified that they would need to obtain coverage from another carrier by April 12, when the Access policies would expire. Since this is a nonstandard carrier, insureds could face difficulties in replacing coverage. Nonstandard carriers serve those with poor driving records, including multiple accidents or DUI violations. States often require those with DUIs, those who had an at-fault accident without auto insurance, those who have had a large number of offences in a short period of time, or those who were driving with a suspended or revoked license, to obtain SR-22 documents. An SR-22 shows that the person does have insurance. The department of motor vehicles will require this in order to reinstate suspended licenses. Generally, a driver must carry an SR-22 for three years, although some states require carrying one for two to five years. If the insurance is not kept in force, or if the SR-22 was for a suspended license, the license will be re-suspended.

As of November 30, California has taken expedited legal action in order to secure the assets and take control of Merced Property & Casualty Company. This is an effort to protect the policyholders affected by the recent Camp Fire. The company has been overwhelmed with claims from the fire and the carrier is at the point of insolvency. The legal action will trigger laws that allow the California Insurance Guarantee Association to begin assessing losses and paying claims. Policyholders are being advised to seek coverage elsewhere immediately, even though their policies are in-force for 30 days. Because of the severity of the recent California wildfires, the commissioner has directed the department to conduct detailed reviews of all property carriers domiciled in California to ensure solvency.

It is important to note that surplus lines carriers do not pay into the guaranty fund. Likewise, if a surplus carrier becomes insolvent then the insureds have no source of funds for losses on those policies. When a surplus lines policy is written, many states require the insured to be notified that the insurance policy written by a surplus lines insurer is not subject to the filing or approval requirements of the state insurance department, and that the policy may contain different conditions, limitations and provisions from carriers authorized to write in the state, and that policies are not protected by the state guaranty fund. A list of state guaranty fund contacts can be found here [Guaranty Fund Contact List].