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Report to the Chairwoman, Subcommittee on Commerce, Consumer Protection, and Competitiveness, Committee on Energy and Commerce, House of Representatives

May 1991

INSURANCE REGULATION

State Handling of Financially Troubled Property/Casualty Insurers

GAO/GGD-91-92

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GAO
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May 21, 1991

The Honorable Cardiss Collins
Chairwoman, Subcommittee on Commerce,
Consumer Protection, and Competitiveness
Committee on Energy and Commerce
House of Representatives

Dear Madam Chairwoman:

This report responds to the Subcommittee's request that we examine how states deal with financially troubled property/casualty insurers. At your request, we did not obtain written comments on this report.

As agreed with the Subcommittee, unless you publicly announce its contents earlier, we plan no further distribution of this report until May 22, 1991. At that time, we will send copies to interested parties and make copies available to others upon request.

Major contributors to this report are listed in appendix III. Please contact me on (202) 275-8678 if you or your staff have any questions concerning this report.

Sincerely yours,

Craig A. Simmons

Craig A. Simmons
Director, Financial Institutions
and Markets Issues

Executive Summary

Purpose

The savings and loan and banking failures of the 1980s brought attention to the need for strong, reliable solvency regulation of financial institutions. GAO recently recommended that banking regulators take prompt actions to resolve bank problems when they first are evident and to ensure that all failed institutions are closed promptly. The same basic principles, if applied to the regulation of insurance companies, would help protect state guaranty funds against large losses.

At the request of James Florio, then Chairman of the Subcommittee on Commerce, Consumer Protection, and Competitiveness, House Committee on Energy and Commerce, GAO examined the type and amount of regulatory attention financially troubled property/casualty insurance companies received and at what point states took them over.

GAO's objectives were to

- determine what tools were available to state regulators in dealing with financially troubled property/casualty insurers, how and why those tools were used, and the consequences of their use;
- determine the speed with which state regulators dealt with financially troubled or insolvent property/casualty insurers; and
- review the methods and criteria used by state regulators to identify financially troubled property/casualty insurers.

Background

The insurance industry is regulated by individual states. State insurance departments, using various means of monitoring insurer solvency, may decide that an insurer is financially troubled, meaning that policyholders are subject to greater than normal financial risk, or that it is insolvent, which means that assets are less than liabilities plus capital and surplus.

Insurance departments often attempt initially to deal with a troubled property/casualty insurer by informal means such as consultations or correspondence with management. Regulators can also use formal written actions or take over an insurer through the process of rehabilitation. The final option available is a court order for liquidation of an insolvent company.

Once an insurer is placed in liquidation, state guaranty funds will pay some policyholder claims. These funds assess other insurers licensed in the state to pay these claims. These insurers can, depending on what the guaranty fund law in each state provides, either increase premiums or reduce their state premium tax liability to recover the cost of assessment. Thus, a liquidation ultimately results in higher costs to policyholders of other companies or reduced state revenue.

GAO reviewed state insurance department actions from detection of a financially troubled property/casualty insurer through the decision to place an insurer in liquidation. GAO obtained aggregate data from 44 states and the District of Columbia on 198 companies that were subjected to formal regulatory actions from 1980 through 1989. GAO also obtained company-by-company data from 46 states and the District of Columbia on 215 companies that were placed in rehabilitation or liquidation during that period. GAO also interviewed regulators in 5 states and examined 16 case studies of failed insurers from those states.

Since GAO does not have statutory access to state insurance department records, it could not review the use of informal actions by insurance regulators in dealing with financially troubled insurers.

Results in Brief

Although regulation of insurer solvency has been delegated to the states, the federal government retains power to regulate insurance. There is a federal interest in insurer solvency because (1) insurer failures affect other parts of the financial system; (2) policyholders of a failed insurer may have claims delayed in payment, partially paid, or not paid at all; and (3) failure of a very large insurer could lead to calls for direct federal intervention.

Insurance regulators were typically late in taking formal action against financially troubled companies. State regulators did not take formal action in 71 percent of failed insurer cases for which data were available until the insurers became insolvent or later. In at least 36 failed insurer cases, insurers continued to write policies after regulators identified them as financially troubled.

There are many possible reasons for regulatory delay. Among them are reliance on untimely or unverified information, lack of legal or regulatory standards for defining a troubled insurer, and a vague and unspecific statutory definition of insolvency.

Measures such as more frequent submission of independently certified financial information, a uniform standard for determining if an insurer is financially troubled, and a uniform legal definition of insolvency would represent a step forward in helping to protect policyholders and state guaranty funds.

GAO's Analysis

Federal Authority and Interest in Insurer Solvency

Monitoring of insurer solvency and dealing with financially troubled or insolvent insurers is the responsibility of state governments only because it has been delegated from the federal level. Even though Congress in 1945 chose to delegate insurance regulation to the states, overriding federal legislative authority still exists. Since the states exercise direct regulatory powers, federal involvement has been primarily through oversight of state regulation in the form of congressional hearings and studies. (See p. 10.)

There are three primary reasons for a federal interest in the solvency of property/casualty insurers. First, a property/casualty insurer failure can affect other parts of the financial system. In the mid-1980s, the failure of TMIC Insurance Company, a California mortgage insurer, affected the mortgage holdings of several savings institutions as well as some holdings of the Federal National Mortgage Association and the Federal Home Loan Mortgage Association. Second, the failure of even a medium or small insurer can result in nonpayment, delayed payment, or partial payment of claims for hundreds or thousands of policyholders, which may lead to calls for federal protection for such policyholders. Finally, there is also a federal interest in the general economic effect of a large insurer failure. The 10 largest insurance companies in terms of volume of property/casualty business range from $9 to $36 billion in assets. The failure of one of these insurers could produce substantial adverse economic consequences, and though Congress has no direct obligation to intervene, examples such as the Chrysler intervention illustrate the possibility of such intervention. (See pp. 10-11.)

State Delays in Taking Action Led to Increased Costs and Delayed Claim Payments

State regulators reported to GAO that in 71 percent of failed insurer cases for which data were available, they did not take formal action until or after the insurers became insolvent because they did not know at the time that the insurer was insolvent or because they decided to delay action. In at least 36 failed insurer cases, the company continued to write new and renewal policies after being identified as financially troubled. Such new and renewed policies create more claims to be paid by guaranty funds if the company fails. (See pp. 21-25.)

Of the 127 property/casualty insurers that states reported to GAO as having been placed in liquidation during the 1980s, and for which actual insolvency dates were provided by state regulators, 56 percent were not placed in liquidation until 7 months or more after they were insolvent. Almost all liquidated insurers were placed in rehabilitation prior to liquidation.

In some cases, regulators deferred or suspended the claim payments of companies under rehabilitation in an effort to preserve assets or improve the company's cash flow. GAO's questionnaire results showed that at least 47 companies that insurance departments reported placing in rehabilitation in the 1980s suspended claim payments for a period of time. For 12 companies, claim payments were suspended for 1 year or more. (See pp. 25-26.)

There Are Several Possible Reasons for Regulatory Delay

A number of factors accounted for delays in regulatory action. While many of these varied from state to state, some related to common problems of identifying and designating troubled or insolvent companies.

Insurance departments in the five states GAO visited relied primarily on insurer-submitted financial statements and field examinations to aid them in detecting companies that were financially troubled. In a 1989 report, GAO found that both of these sources were subject to significant time lags and that financial statements were used by many states without verification. (See pp. 27-28.)

Five states have statutory or regulatory standards for deciding when an insurer is financially troubled. These standards, however, are generally qualitative in nature even when dealing with quantifiable conditions and may be applied differently by different regulators. Also, while many states have adopted basically uniform statutory language on the definition of insurer insolvency, that language is vague and unspecific and relates only in general terms to the adequacy of loss reserves, a critical factor in determining property/casualty insurer solvency. (See pp. 29-31.)

GAO believes that the following measures, though not likely to totally eliminate regulatory delays, would represent a step forward in protecting policyholders and state guaranty funds:

- more frequent submission of financial information from insurers to regulators, with independent certification of the information submitted;
- a uniform standard for determining whether an insurer is financially troubled, including requirements that specified actions be taken when certain conditions are present; and
- a uniform legal definition of insolvency that takes into account the adequacy of loss reserves to meet future claims and the sufficiency of capital to replenish inadequate loss reserves. (See pp. 34-35.)

Recommendations

GAO is making no recommendations.

Agency Comments

At the request of the Subcommittee, GAO did not obtain comments on this report.

Contents

Abbreviations

IRIS	Insurance Regulatory Information System
NAIC	National Association of Insurance Commissioners

Introduction

Property/casualty insurance is the primary means by which individuals and corporations protect themselves from the possibility of economic loss resulting from damage to property or injuries to other people. Since an insurance policy is a contract for payment if the event insured against occurs at an unspecified time in the future, an insurance company must remain solvent if its customers are to get what they paid for.

Federal Authority and Interest in Insurer Solvency

Regulation of the insurance industry and administration of insurance company receiverships and liquidations are state responsibilities. In general, state legislatures set the rules under which insurance companies must operate, and each state has a state insurance department to administer these rules. This regulatory responsibility has been delegated from the federal level. The federal government retains authority in this area, and the consequences of insolvency, both actual and possible, justify a continuing federal interest in insurer solvency.

In 1868, the Supreme Court held that the insurance business was not commerce subject to federal regulation under the Commerce Clause of the Constitution.[1] In 1944, however, the Court abandoned the proposition that insurance is not commerce and upheld the application of federal antitrust laws to the insurance industry.[2] In 1945, Congress enacted the McCarran-Ferguson Act, which strictly limited the extent to which federal law, including federal antitrust law, preempted state insurance law, as long as the states themselves regulated the insurance business.[3]

Despite the choice made by Congress in 1945 to delegate regulation of the insurance business to the states, the 1944 decision still stands; thus, the overriding federal legislative authority granted by the Commerce Clause still exists. Although the states exercise direct regulatory powers, federal authority has been exercised through oversight of state regulation in the form of congressional hearings and studies.

There are three reasons for a federal interest in the solvency of property/casualty insurers. First, a property/casualty insurer failure can affect other parts of the financial system. A major example of this is mortgage guaranty insurance, which is not covered by state guaranty

[1]Paul v. Virginia, 75 U.S. 168 (1868).

[2]United States v. South-Eastern Underwriters Association, et al., 322 U.S. 533 (1944).

[3]15 U.S.C. sections 1011-1015.

funds except in Michigan. In the mid-1980s, the failure of TMIC Insurance Company, a California mortgage insurer, affected the mortgage holdings of several savings institutions as well as some holdings of the Federal National Mortgage Association and the Federal Home Loan Mortgage Association. Also, insurance on collateral held by banks and savings and loans may not be fully paid by guaranty funds in the event of an insurer failure.

Second, a failure of even a medium or small insurer will have a direct effect on hundreds or thousands of individual policyholders who, depending on the nature of their coverage, the regulatory disposition of the failed insurer, and the provisions of the state guaranty fund law, may have claim payments delayed, paid only in part, or not paid at all. Policyholders who encounter such difficulties may call upon Congress to extend to them protection similar to that currently enjoyed by depositors at federally insured financial institutions.

Finally, there is also a federal interest in the general economic effect of a large insurer failure. The 10 largest American property/casualty insurers ranged in 1989 from $9 to $36 billion in assets. The failure of one of these insurers would produce substantial adverse economic consequences, and Congress might decide, as it did in the Chrysler situation, to intervene to prevent such failure.

Monitoring and Handling of Insurer Solvency Problems

As we discussed in a previous report, insurance departments keep track of the financial condition of companies licensed to operate in the respective states through statements submitted by each company, usually on an annual basis.[4] Most states also do on-site field examinations at 3- to 5-year intervals, or more frequently if the company's financial statement seems to warrant it or if the regulator receives other information indicating a possible solvency problem. Regulators may also use the Insurance Regulatory Information System (IRIS), which has been designed by the National Association of Insurance Commissioners (NAIC), to alert regulators of companies that may require attention.[5]

[4] Insurance Regulation: Problems in the State Monitoring of Property/Casualty Insurer Solvency (GAO/GGD-89-129, Sept. 29, 1989).

[5] IRIS involves calculations of statistical ratios from financial statements and review of selected companies by a team of financial examiners. See chapter 4 and Insurance Regulation: The Insurance Regulatory Information System Needs Improvement (GAO/GGD-91-20, Nov. 21, 1990).

On the basis of these sources, the regulator may decide that an insurer is financially troubled, which NAIC defines as a company moving toward a position that would indicate that policyholders, claimants, and other creditors, are subject to greater than normal financial risk. The regulator may also decide that a company is actually insolvent; NAIC defines insolvency as when assets are less than liabilities plus the greater of legally required minimum capital and surplus or the total par or stated value of its stock. NAIC defines liabilities as including reserves against future losses.

As an initial step, a regulator can employ informal means of dealing with a financially troubled company, attempting to work with company management to deal with the sources of trouble. The success of such actions is entirely dependent on the voluntary cooperation of the insurer. The regulator can also employ formal written regulatory actions. These range from voluntary arrangements such as consent orders to such mandatory orders as to increase capital, cease and desist certain business practices, or obtain state approval before making certain transactions. The regulator may also revoke a company's license to write new policies or renew old ones. In the state in which the company is headquartered, the regulator may formally assume control of a company's management and assets. This action is called rehabilitation and generally requires an order from a court.[6]

The final action a state regulator can take concerning an insolvent insurer is liquidation. In a liquidation, the court-appointed liquidator marshals the company's assets and prepares for asset distribution and the company's dissolution, and state guaranty funds are activated. These funds are activated in each state in which a liquidated company was licensed. Except in New York State, there is no standing fund; instead, the fund assesses insurers in the state as much as is needed when a company is liquidated. These assessments are then used to pay policyholders residing within the state, subject to certain limitations such as a cap on the overall amount of a claim payout. In 31 states and the District of Columbia, insurance companies can recover their assessments by increasing premiums paid by policyholders or by imposing a policyholder surcharge; in 17 states, they can do so by reducing the premium tax they pay to the state. In one state, the options of both a rate increase and a tax offset are available, and in one other, no recovery

[6]Some state statutes provide that, if a regulator determines that a company is insolvent and immediate takeover is necessary to preserve assets, the regulator may take over an insurer on its own authority without obtaining prior permission from a court. Such "quick-take" orders are subject to subsequent judicial review.

method is available. Thus, the end result of an assessment by a state guaranty fund is higher premium rates for policyholders of the insurers that were assessed or a reduction in premium tax revenue to the state government.[7]

Concerns About Handling of Troubled Insurers

In the past several years, a number of persons with some degree of expertise concerning the insurance regulatory structure have expressed concern about how states are handling financially troubled property/casualty insurers.

In November 1988, former New York State Superintendent of Insurance Richard Stewart et al. issued a report, Managing Insurer Insolvency, published by the National Association of Insurance Brokers. According to the report, the strategy of most state insurance departments for dealing with potential insolvencies has been to delay recognizing insolvency for as long as possible. States view insolvency as indicative of regulatory failure and conceive their mission as rescuing companies in trouble. As a result, liquidation is postponed for a time. When it does occur, however, it is made more severe by the additional business taken on during the period of delay. This increased business adds to the size and complexity of the insolvency and creates more eventual claims on the guaranty funds.

The concerns expressed in Managing Insurer Insolvency have been raised by others. In September 1989, a special investigator reported that the Texas Insurance Department had been lax and negligent in its handling of the failed National County Mutual Fire Insurance Company, Inc. A February 1990 report by the Southern Finance Project (an independent research unit sponsored by the nonprofit Institute for Southern Studies) also cited "regulatory laxity and inattention" as a factor in the rising number of liquidations and guaranty fund assessments in 15 Southern states and the District of Columbia since 1985. And, during 1990, NAIC held hearings on the examination process. At these hearings, a representative of corporate, governmental, and institutional risk managers stated that by allowing financially troubled insurers to continue doing business "too many regulators are acting in a way which can only serve to make insolvencies worse than they need to be."

[7] For further information on guaranty funds, see Insurer Failures: Property/Casualty Insurer Insolvencies and State Guaranty Funds (GAO/GGD-87-100, July 28, 1987).

Objectives, Scope, and Methodology

This is our second report examining the role of state insurance departments in dealing with property/casualty insurer solvency. Our previous report (see footnote 4) concerned state insurance department activities before identification of a troubled insurer. This report concerns state handling of financially troubled insurers from initial detection to the point at which a company is placed in liquidation. We did this report and the previous one at the request of the Chairman of the Subcommittee on Commerce, Consumer Protection, and Competitiveness, House Committee on Energy and Commerce. At the Subcommittee's request, we did not obtain comments on this report.

Our basic goal for this report was to evaluate state insurance department actions concerning financially troubled property/casualty insurance companies. We approached this goal by attempting to

- determine what tools are available to state regulators in dealing with financially troubled property/casualty insurers and when they are used,
- determine the speed with which state regulators deal with financially troubled or insolvent property/casualty insurers, and
- review the methods and criteria used to identify financially troubled property/casualty insurers.

We did initial fieldwork in two states, California and Illinois. Based on this fieldwork and survey interviews with experts on insurer insolvency, we prepared a two-part questionnaire that we sent to insurance departments in all 50 states and the District of Columbia. This questionnaire asked for the number of formal written actions concerning domestic insurers from 1980 through 1989, and also for information on each company placed in rehabilitation or liquidation during this period. All but four states (New Jersey, Indiana, West Virginia, and Louisiana) returned the questionnaire to us; however, not all of these states filled out both parts of the questionnaire.

The first part of the questionnaire asked for information on individual insurers that had been placed in rehabilitation or liquidation from 1980 through 1989, including the date on which each insurer became insolvent (the actual insolvency date), the date on which the regulator was able to prove that the insurer was insolvent (the verified insolvency date), and the dates of all formal department actions concerning each insurer. Forty-six states and the District of Columbia returned this part of the questionnaire and gave us information on 215 individual failed insurers. The regulator supplied the verified insolvency date for 177 insurers. For 140 of these, the regulator also supplied the actual date (which was determined after the fact for 104 insurers).

The second part of the questionnaire asked for aggregate information on the number of insurers subject to formal actions other than rehabilitation or liquidation during the 1980s. The information we received indicated that, in the 44 states and the District of Columbia that responded to our questionnaire, 198 property/casualty insurers were subjected to formal actions from 1980 through 1989.

We cross-checked some of the information on the returned questionnaires with information available to us from other sources, such as data from rating services and independent listings of insurer failures prepared by others. However, we were unable to verify all information given to us on the questionnaires, as such verification would have involved on-site checking at insurance department offices. A sample questionnaire appears in appendix I.

We then visited three additional states: New York, Oklahoma, and Washington. These states, and the two we visited earlier, were selected to provide variation in size and geographic location. During the course of our work in all five states, we selected 16 failed insurers as case studies for review. We selected these case studies on the basis of variety in size and type of insurance written. They were not intended to be a representative sample of all failed insurers but to be examples of insurer failures.

We examined insurance department files on each case study and prepared summaries of what had taken place in each case along with a chronology of events. We spoke to insurance department officials in the states we visited about the case studies as well as about general policies and practices regarding financially troubled property/casualty insurers.

Although insurance regulators were generally cooperative in filling out our questionnaire and providing requested information, we were denied full access to insurance department records. Specifically, state regulators did not allow us to examine files of cases in which only informal actions were taken, nor would they provide aggregate data on the number of times informal actions were successful. As a result, we were limited in our ability to review the use of informal actions by insurance regulators in dealing with financially troubled insurers.

We did our work from October 1989 to April 1991 in accordance with generally accepted government auditing standards.

State Options in Troubled Company Situations

After identifying a property/casualty insurer as financially troubled, state regulators tried to correct problems using informal actions, formal regulatory actions, or rehabilitation. Under informal actions, regulators request that companies take certain steps to correct problems. Under formal regulatory actions, states can use statutory authority to require that companies implement corrective measures. A rehabilitation, or state takeover, means that an insurance department will assume control of an insurer from company management.

State Use of Informal Actions

Regulators in four of five states we visited, as well as regulators from another state that we spoke with said that their first responses to troubled company situations were always informal. They said they may, for example, ask a troubled company to come up with a plan to resolve its financial problems or request that it voluntarily cease writing new business.

We were unable to determine the extent to which informal actions were effective in correcting the problems of troubled companies because we do not have access to insurance department records. As a result, states did not allow us to examine files of cases in which informal actions successfully resolved problems nor would they provide aggregate data on the number of times informal actions were successful.

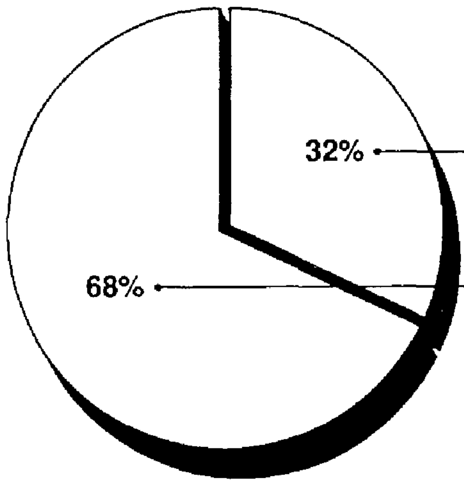
State Use of Formal Actions

States also have the option of using formal actions against financially troubled companies. Formal actions vary by state, but normally consist of written directives requiring an insurer to do one or more of the following: (1) obtain state approval before undertaking certain transactions, (2) limit the amount of policies it writes, (3) infuse capital, or (4) cease certain business practices. Such actions generally can be taken against any company licensed in a state and may be subject to court review.

The 45 insurance departments that responded to our questionnaire reported taking formal action against 198 property/casualty insurers headquartered in the state from 1980 through 1989. Figure 2.1 shows that, of these 198 insurers, 32 percent were eventually released from formal action and allowed to operate without further constraints.[1]

[1] Presentation of this and similar data in this chapter should not be taken to mean that such release constitutes "success" on the part of a regulator or that liquidation of an insurer constitutes "failure." In some cases, swift removal of companies from the market is warranted to prevent further costs to taxpayers and/or policyholders.

Figure 2.1: Outcome of Companies Subject to Formal Actions, 1980-1989

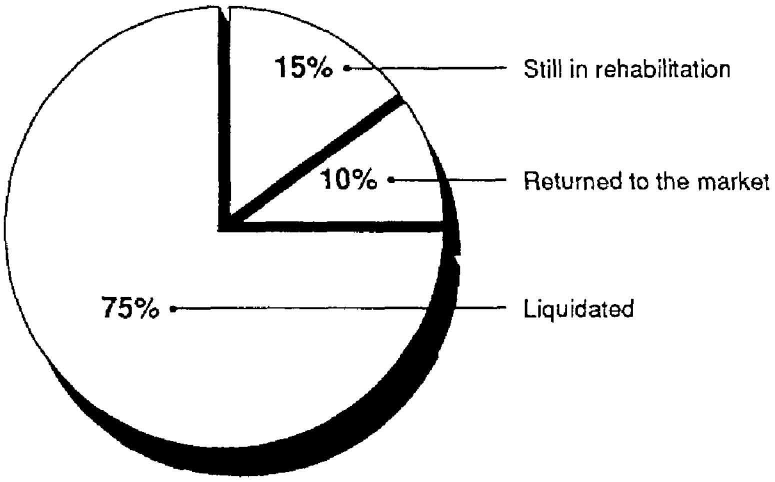


State Rehabilitation of Troubled Insurers

As discussed in chapter 1, all states have the statutory authority to take insurers over and run their operations in the process of rehabilitation. State insurance regulators told us that, generally, they do not use rehabilitation when they believe recovery is likely but instead use it as an intermediate step before moving insolvent insurers into liquidation in order to avoid publicity and a possible mass withdrawal of business. Some regulators also told us that they use rehabilitation because they believe that it will facilitate the dissolution of the company because of the perception that a court is more willing to grant a liquidation order after a rehabilitation attempt has failed. A state regulator may also choose to keep a company in rehabilitation indefinitely without either liquidating it or returning it to the market. In these situations, the company would not write business, but claims would be paid off, and the company would be dissolved without a formal court order of liquidation after all coverages have expired. One of the failed companies we studied is currently in such indefinite rehabilitation status.

From data provided by the states responding to our questionnaire or reported to NAIC, 163 companies were placed into rehabilitation from 1980 through 1989. This total includes 97 of the 198 companies subject to formal regulatory actions other than rehabilitation, as reported above, plus 66 others that were placed in rehabilitation without having been subject to formal regulatory actions. Figure 2.2 shows that the majority of companies placed under rehabilitation during the 1980s were later liquidated while 10 percent were returned to the market. The remaining 15 percent were still in rehabilitation at the time the states returned the questionnaires to us. These companies were placed into rehabilitation between January 1984 and December 1989.

Figure 2.2: Outcome of Companies Subject to Rehabilitation, 1980-1989



Liquidation of Insurers

The final option for state insurance regulators in dealing with a financially troubled insurer is liquidation. An order of liquidation must usually be obtained from a state court; it places an insurer in receivership. The receiver/liquidator musters the assets of the company and prepares for their distribution to policyholders, creditors, and possibly to shareholders. During this process, policyholders will have claims paid by state guaranty funds unless the policy was for a type of coverage excluded by state law from payment by the guaranty fund. However, the guaranty funds have caps, or maximum payment limits, for most types of insurance. The 47 insurance departments responding to our questionnaire reported placing 174 property/casualty insurers in liquidation from 1980 through 1989.

Conclusions

State regulators have four options to choose from in dealing with a financially troubled property/casualty insurer. They can work informally with an insurer's management, or they can exercise the option of issuing formal actions. If the situation appears to warrant it, they can institute proceedings to take over a company through rehabilitation or place it in liquidation. The timing of regulatory decisions to issue formal orders or to place a company in rehabilitation or liquidation are discussed in the following chapters.

State Delays in Taking Action Led to Increased Costs and Delayed Claim Payments

Formal regulatory actions are intended to prevent troubled companies from becoming insolvent by rectifying problems and stemming financial deterioration. Insurance department responses to our questionnaire showed that, in a significant number of cases, state insurance regulators did not take formal action against troubled companies until or after they were insolvent. Delays in taking formal action allowed companies to continue to operate and sometimes even expand business. Delays in moving insurers from rehabilitation to liquidation postponed claim payments and increased the ultimate cost of liquidation.

Criteria for Evaluating State Actions

In a recent report, we reviewed the deposit insurance system for banks and how the system could be preserved and strengthened.[1] In that report, we recommended that supervision and financial reporting requirements be strengthened so that regulators would have the information and resources needed to protect the deposit insurance system from losses. We also said that regulators must take prompt actions to resolve problems in all banks when they first are evident and to ensure that all insolvent institutions are closed promptly. We believe that these principles, if applied to improvement of the property/casualty regulatory system, would help protect against large losses to guaranty funds.

In a regulatory system that incorporated these principles, regulators would receive accurate and up-to-date information about financial conditions in insurance companies. This information would not be limited to data from financial statements but would also include information about the full range of company operations and management, including items such as frequency of problems in handling claims, management's plans for future growth and expansion, and whether any persons or groups outside the company had authority to commit the company to provide insurance coverage. Once received, the information would be evaluated in accordance with specific, uniform, and clearly understood guidelines as to what conditions constitute troubled company status or insolvency.

Also, regulators would take action concerning a troubled company soon after learning of the situation. Regulators might wish to pursue informal actions before resorting to formal ones, even though informal actions may be less effective since they depend on the cooperation of insurer management. The point at which formal actions should be employed in any particular case is difficult to determine. However, formal actions to compel management to correct problems would be undertaken well

[1] Deposit Insurance: A Strategy for Reform (GAO/GGD-91-26, Mar. 4, 1991).

before insolvency. Since it is generally difficult to restore insolvent financial institutions to financial health, early corrective action is needed.

If a company is allowed to issue or renew policies while insolvent or nearing insolvency, there will be more policyholder claims on the guaranty funds in the event of liquidation. In addition, to the extent that management of a nearly insolvent company lowers underwriting standards to generate short-term cash flow, the future claims burden will be even worse. At the same time, the assets on which the company's ability to pay claims rest may have deteriorated because of management's incentive to look for high-return, high-risk investments. Thus, a regulator's belief that a company may be unable to pay future claims on the business it already has written should trigger immediate action to limit harm to unsuspecting policyholders and to state guaranty funds. Regulators should either strengthen the company or take it out of the market.

In an ideal situation, companies should be liquidated when it becomes impossible to restore them to financial health. Regulators dealing with a troubled company would constantly reevaluate the company's financial condition and their own course of action to analyze the latter's effectiveness in returning the company to the insurance market in healthy condition.

Finally, in an optimal regulatory structure, rigorous and well-defined policies and guidelines for determining the status of an insurer and actions to take would be codified in law or regulation. This codification would make it easier for both regulators and those responsible for overseeing the regulators to ascertain whether these policies and guidelines are in fact being adhered to, and for regulated companies to know, in advance, the effects and consequences of their decisions and actions.

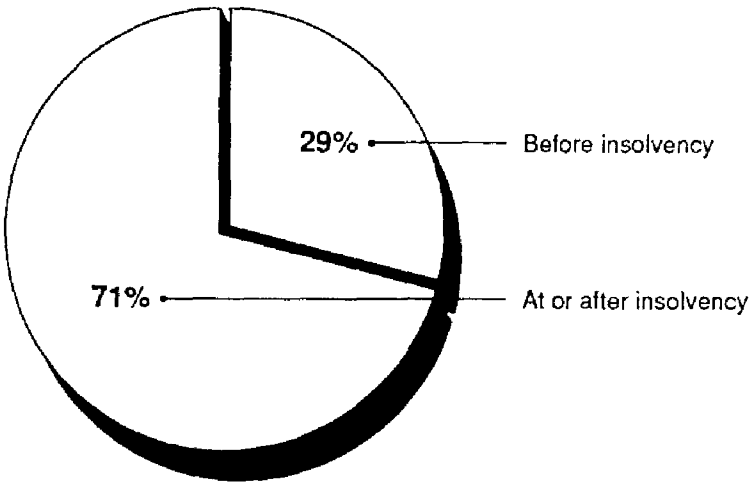
States Delayed Taking Corrective Action

According to the criteria discussed above, formal regulatory action should take place well before the point at which an insurer becomes insolvent. We reviewed data from questionnaire results for companies that had failed during the 1980s and found this did not happen in a large number of cases.

As previously noted in chapter 1, state regulators reported to us the actual insolvency date for 140 of 215 companies they took over in the

1980s.[2] The regulators gave us the date when formal action was first used for 122 of these 140 companies. In 87 of these 122 cases, or 71 percent, states took their first formal action (either regulatory action or rehabilitation) at the time of insolvency or later, as shown in figure 3.1.

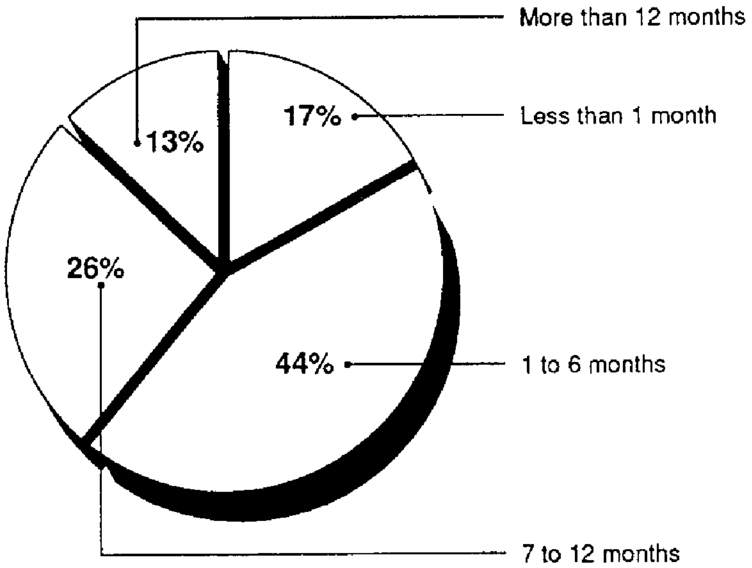
Figure 3.1: Timing of Initial Formal Actions, 1980-1989



As shown in figure 3.2, in 83 percent of the 87 cases for which formal action was taken at the time of or after insolvency, states did not take formal action until 1 month or more after the date of actual insolvency; in 39 percent of these cases, action did not occur for more than 6 months after insolvency. In one case we reviewed, the state regulator did not take action for more than 2 years after insolvency.

[2]Four states did not return our questionnaire. Therefore, more than 215 companies may have been taken over in the 1980s.

Figure 3.2: Time Between Actual Insolvency and Initial Formal Actions, 1980-1989



As discussed in chapter 1, the actual insolvency dates on which we based figures 3.1 and 3.2 were those provided by state regulators. These dates usually corresponded to the end of a period covered by an examination report or financial statement or when a company reported itself insolvent. We had actual insolvency dates for 140 cases. State regulators determined the actual date after the fact for 104 of these cases.

Our data show that when regulators were fully aware of the nature and extent of insolvency at the time it occurred, they took action quickly in most cases but delayed in others. We compared the date that regulators first took corrective action to the verified insolvency date, which may have been months or, in some cases, years after the date of actual insolvency. Regulators substantiate insolvency for a variety of reasons, one being the need to obtain an order of liquidation from the courts. Insolvency substantiation is usually done through an examination and consists of developing evidence to prove legally that the company is no longer able to meet its current and future obligations.

The states responding to our questionnaire reported verified insolvency dates for 177 failed companies.[3] In 150 of the 177 cases, regulators also gave us the date of the first formal action taken; in 57 of these cases, the

[3]As noted in chapter 1, the state regulators supplied verified insolvency dates for 177 insurers. For 140 of these, the regulators also supplied the actual date.

states did not take formal action before the date of verified insolvency. Regulators took formal actions against most of these 57 companies within the same month that they substantiated the insolvency. For 16 companies, however, they did not issue an action until 1 to 6 months after insolvencies were verified; for one insolvency, action was not issued until more than a year after the failure was substantiated.

Effect of Delayed Corrective Action

As noted previously, the longer a state waits to take formal action concerning a financially troubled company, the more business such a company will do. An increase in business for an insurer means more policies written and more claims that will eventually have to be paid. If the insurer is financially troubled, it may be writing coverages it will not be able to pay. In fact, it may write more coverage in order to generate more revenue and reverse its problem situation. If such a company is eventually liquidated, the business written while it was troubled or insolvent will increase the policyholder claims on the state guaranty funds.

One indicator of growth in an insurer's business is net written premiums.[4] Although an increase in net written premiums reflects either growth in the amount of business written or an increase in policy prices, a significant expansion generally indicates that growth contributed to the increase. In any case, premium income is a good indicator of future claims liability. For example, substantially greater increases in net written premiums for a particular company than occurred for the industry as a whole suggests real growth in the company's business and in its expected future claims.

We analyzed net written premiums for 65 of the troubled companies in our review to determine whether these companies grew during periods of financial stress.[5] Of the 65 companies we reviewed, 47 increased their net written premiums between 1984 and 1988.[6] Of these 47 companies, at least 36 underwent increases during the year that regulators identified them as troubled or in succeeding years.

[4]Written premiums are the amounts charged policyholders for insurance coverage. Direct written premiums are premiums paid for direct coverage to policyholders, thus excluding premiums to other insurers that assume part of an insurer's risk in a process known as reinsurance. Net written premiums are direct premiums plus premiums from reinsurance business accepted from another insurer, minus premiums from business transferred through reinsurance to another insurer.

[5]Our analysis was limited to 65 companies because data from financial statements were not available to us for the remainder of the companies in our review.

[6]Financial data for 1989 were not made available to us in time for our analysis.

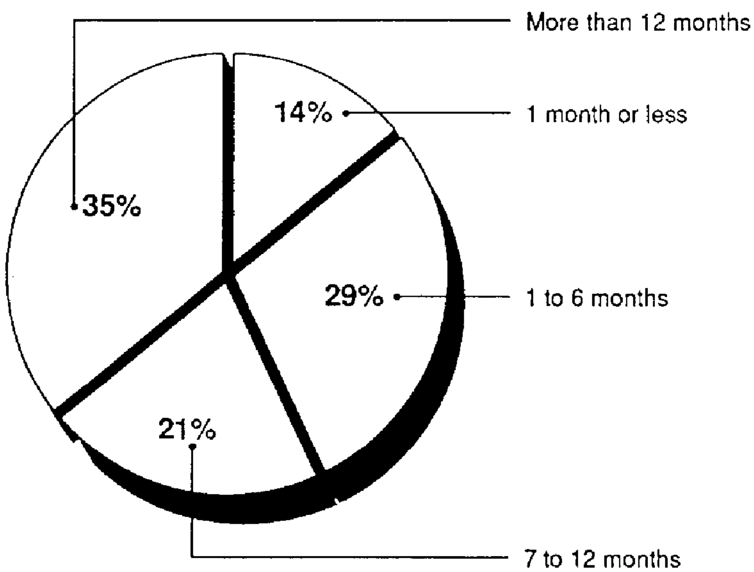
Information from our insurance failure case studies illustrates this pattern. According to the head of the California guaranty fund, Transit Casualty Company could have been taken over a year earlier than it was. Another expert estimated that as much as $1 billion in post-liquidation policyholder claims would have been prevented if corrective action to restrict business was taken a year earlier. In two other cases, states suspected that companies were at or near insolvency in 1984, but did not attempt to restrict the amount of business written until the insolvencies were substantiated approximately 4 years later.

Claim Payments Delayed for Extended Periods

As discussed in chapter 2, state regulators have the option of placing an insolvent company in rehabilitation or liquidation (or of keeping a company in rehabilitation if it is already there when insolvency is established).

Figure 3.3 shows 127 liquidations for which actual insolvency dates were reported to us. Of these, 56 percent were insolvent for 7 months or more before liquidation began. Either regulators were not aware that the insurer was insolvent, as they should have been by the criteria set forth above, or a decision was made to delay liquidation, which can have adverse consequences for individual policyholders.

Figure 3.3: Time Between Actual Insolvency and Liquidation, 1980-1990



Note: Does not add to 100 percent due to rounding.

Adverse consequences would occur if the state insurance regulator suspended claim payments while an insurer was in rehabilitation in order to preserve company assets in the near term. In such a situation, claimants would not receive payments until (1) the regulator decided that the company should resume payments or (2) the state guaranty funds were activated (generally by an order of liquidation).

Delays in liquidating a company have resulted in delayed claim payments to policyholders. Claim payments were delayed in a number of cases because companies were kept under rehabilitation.[7] For example, 47 of the troubled companies under rehabilitation that we reviewed had their claim payments suspended for a period of time. Ten had claim payments suspended for more than one year, one for nearly 5-1/2 years. For two other companies, claim payments were still suspended at the time our questionnaire was returned in 1990. Claim payments were suspended for one of these companies in November 1988 and for the other in March 1984.

NAIC has expressed concern regarding the inequities caused by rehabilitation delays. Its task force on rehabilitation and liquidation concluded that it is unfair to permit the suspension of claims for an extended period of time, since guaranty funds cannot make payments while an insurer is in rehabilitation. To remedy this situation, NAIC recently passed a model law recommending that companies in rehabilitation proceed to liquidation within 6 months after a suspension of a substantial portion of policyholder claims has occurred if a rehabilitation plan has not been filed with the courts.

Conclusions

State regulators did not use formal actions against financially troubled insurers in many cases until months or years after companies were already insolvent. Delays in taking formal action led to continued writing of business by insolvent insurers, resulting, if liquidation occurred, in higher costs to policyholders of other insurers or reduced state premium tax revenue. Regulators also kept some insurers in rehabilitation for months after they were insolvent without placing them in liquidation. During this period, some policyholders did not receive payment for claims.

[7] Of the liquidated companies for which we received information, we were told of only 15 cases in which a company was liquidated without first being subject to a formal action or rehabilitation.

Possible Reasons for Regulatory Delay

Regulatory delays such as those described in chapter 3 may be caused by many factors involving state laws, the interpretation of these laws by state courts, and the policies and operations of state insurance regulators. Many of these factors vary from state to state while some factors may apply generally across all states. Among the possible reasons for regulatory delay are reliance on delayed or unverified data in identifying troubled insurers, lack of regulatory or statutory standards for identifying troubled insurers, vague statutory definitions of insolvency, and regulatory reluctance to take quick action. NAIC has introduced some measures to assist state insurance departments in identifying and dealing with troubled insurers. However, those measures have, for the most part, been developed too recently to be able to determine what effect they have had in ameliorating regulatory delay. Further, NAIC cannot require states to use available NAIC services or to respond to NAIC initiatives.

States Have Relied on Delayed and Unverified Financial Data

In chapter 3, we stated that in an optimal regulatory system, states would receive accurate information about a problem situation soon after it occurred. In reality, such information on troubled insurance companies may be delayed for months and may not be verified when received. State insurance department officials in the five states we visited told us that the department in each state relies primarily on information supplied by insurers or gathered from field examinations to detect financially troubled companies and establish the magnitude of financial problems. Both of these sources have shortcomings in terms of timeliness and reliability.

Regulators said that the initial source of information indicating financial difficulty is likely to be the annual financial statements submitted by insurers (one of the five states we visited requires quarterly statements from all home-based insurers). In a 1989 report, we noted that insurer financial statements are not subject to independent verification in many states and that statements that reflect financial condition as of the end of a calendar year are not submitted until 2 or 3 months after the end of that year and can take 6 weeks to 3 months to review.[1]

In several insurer failures we reviewed in detail, the company reported inaccurate, incomplete, or misleading information on its annual statement. In the case of one Oklahoma insurer, a new company management admitted that the company had actually been insolvent in several prior

[1]GAO/GGD-89-129.

years and had filed false data with the insurance department in its annual statements. NAIC is now requiring annual independent audits of financial data and actuarial certification of loss reserves as part of the NAIC annual financial statement used by all states. NAIC also plans to incorporate quarterly filings in its database for those companies that are required to submit these filings. (Not all states require all licensed property/casualty insurers to file quarterly statements.)

Another major source of information about financially troubled insurers is the field examination. According to regulators in the states we visited, field examinations are used to determine the nature and extent of an insurer's financial problems once they are initially detected from financial statements. We reported in 1989 that field examinations are required only once every 3 to 5 years, unless a special examination is ordered, and can take months and sometimes years to complete.[2] For example, in the failure of Transit Casualty Company of Missouri, state regulators, concerned with the insurer's financial condition, began an examination in September of 1984 and took no further action until it was completed in June 1985. Transit continued to write business until it stopped voluntarily in April 1985, incurring more claims to be eventually paid by state guaranty funds, if at all.

Some insurance insolvency experts have also expressed concern that the examination process, by focusing solely or primarily on financial data, may be presenting an incomplete picture of a company's status. At hearings held by NAIC during the spring and summer of 1990 concerning the financial examination process, the National Association of Professional Insurance Agents suggested that the results of market conduct examinations[3] be considered along with financial data analysis in the examination process; an Oregon insurance department official stated that the scope of examinations should be expanded to include a review of the management and operations of a company as well as verification of financial data.

[2]GAO/GGD-89-129.

[3]Market conduct examinations focus on areas such as sales, advertising, rate-setting, and the treatment of claims.

Lack of State Statutory or Regulatory Standards for Identifying Financially Troubled Insurers

In four of the five states we visited, we found that no written criteria exist for the designation of financially troubled insurance companies. (Illinois does have such criteria.) In four of the five states, there was a formal "watch list" of troubled companies; in the other state, there was no such formal list, but the chief examiner kept closer track of certain companies that he believed were in difficulty. However, only one of the five departments had written guidelines for determining when an insurer should be considered financially troubled. Officials in one state told us they had considered adopting guidelines but had decided not to do so. In four of the five states we visited, determination of troubled company status was left up to the judgment of department examiners and senior officials on a case-by-case basis.

While the lack of guidelines and a case-by-case approach to determination of troubled company status allows for maximum flexibility, it also has drawbacks. Lack of specific criteria increases the chance that a state regulator may experience uncertainty or internal disagreement as to whether a company is financially troubled. Also, states may differ on whether a company is financially troubled or on how troubled it actually is. Disagreement within an insurance department or between departments can lead to delays in taking action, thereby allowing a problem or insolvent company to continue doing business unimpeded.

Both of these situations actually occurred in recent property/casualty insurer insolvencies. In the insolvency of National County Mutual Fire Insurance Company, Inc., of Texas, parts of the state insurance department had information indicating probable insolvency in August 1987, but the department did not put the insurer under supervision until October 1988, in large part because top officials disagreed as to what the company's condition actually was and what action was warranted. As a result, the company continued to do business, increasing the eventual costs to the state guaranty funds.

Interstate disagreements occurred in the case of American Mutual Insurance of Massachusetts. In the American Mutual case, a Midwestern state regulator and the operating head of several guaranty funds both told us that the home state regulators should have taken over the company a year or more before they actually did.

We do not know how states other than the five we visited decide whether or not an insurer is financially troubled. According to NAIC's Model Law Service, as of January 1991 only five states had a statute or regulation relating to troubled company status. These states—Illinois, Kansas, Texas, Virginia, and Nebraska—recently adopted provisions that set forth conditions under which an insurer may be considered financially troubled. In 1985, NAIC recommended for state adoption a Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition.

The standards adopted by the states, as well as those in the NAIC model, are generally qualitative even where they relate to quantifiable conditions. For example, the NAIC model specifies as one condition "adverse findings" from financial statements and examinations without defining what would constitute such findings. The model also refers to the age and collectibility of accounts receivable without quantifying either age or collectibility. The Texas standards, while somewhat more specific, refer to an insurer's inability to settle claims "within a reasonable time" without setting forth what such time should be. The lack of quantitative standards may allow regulators in different states to apply the same standards in different ways.

Even with these problems, the adoption of laws or regulations by five states represents a step forward. Other states may have written policies concerning what is and is not a troubled insurer (as stated above, four of the five states we visited did not). If they exist, such policies should be in the form of laws or regulations, since, as stated in chapter 3, this would make it easier for insurers and others to know what would happen as a consequence of certain conditions or actions.

As an example of the type of policy that could be established, states could define as financially troubled those companies in which reinsurance proceeds receivable more than 90 days overdue are above a specified percentage of surplus, or reserves are found to be more than a certain percentage short of what would be needed to cover future losses. Such laws or regulations could also be the basis for "tripwire" provisions such as we have recommended for banks and thrifts in our recent report on deposit insurance. Such tripwires could be put in place by specifying that under certain conditions, such as those described above, the state regulator must take certain actions, such as ordering a special field examination, ordering an insurer not to write or renew policies, or, in extreme circumstances, taking a company into rehabilitation.

State Definitions of Insolvency May Not Be Specific Enough

NAIC's Model Law on Rehabilitation and Liquidation contains a definition of insolvency that has been adopted, in exact or similar form, by many states. The model law states that insolvency takes place when an insurer's assets are less than liabilities plus the greater of capital and surplus or the total value of the stock. Since liabilities, capital, and surplus are left undefined, this definition lacks specificity, as does NAIC's model regulation on troubled company status, described above.

The statutory definition of insolvency also deals only tangentially with a central issue in determining the solvency of a property/casualty insurer—the adequacy of loss reserves. Because the insurance business centers around the payment, well into the future, of claims based on current policies, insurers need to maintain a much higher level of reserves than other businesses. In 1989 property/casualty insurer reserves were equal to 67 percent of liabilities. Future property/casualty claim payments are more difficult to predict than future life claim payments. As a result, the regulator and the company may differ on the proper level of property/casualty reserves. If an insurer sets reserve levels too low, either unintentionally or deliberately, it may appear to have positive net worth. At the same time, its capital may not be sufficient to increase the level of reserves needed to meet future claims on current policies. From a regulatory standpoint, this company would be insolvent.

While the Model Law's definition of liabilities does include reserves, it does not specify what an adequate level of reserves is or should be in relation to an insurer's actual or possible future claim payments. Instead, the Model Law states that liabilities shall include but not be limited to reserves required by state statute or regulation, or imposed by state regulators on a specific company. As well as lacking specificity, this definition creates the possibility that a certain level of reserves might be considered inadequate by one state regulator but adequate by another.

Concerns of State Regulators

State regulators we talked to provided several reasons besides those discussed above as to why they may delay taking formal actions. These reasons include concerns that formal actions may accelerate rather than reverse the financial decline of companies. They also include fear that formal actions may not be granted or upheld by the courts.

Some regulators and industry experts believe that formal actions, particularly rehabilitation, are ineffective because they accelerate the financial deterioration of troubled companies. According to these individuals, a company's business starts to dwindle once these actions are known. Policyholders that are good risks, the argument runs, are able to obtain coverage elsewhere and those that are bad risks remain with the company. The company is therefore left with increasingly smaller and more poorly written policies, which in turn, accelerate its decline. Attempts to avoid this "run on the bank syndrome" may account for some regulators' preference for informal tools to persuade companies to correct problems rather than resorting to formal actions.

Some regulators also expressed concern to us that a court would not uphold or grant a formal action if there was any question as to whether a company was solvent. Regulators in three of the five states we visited said that they did not believe the courts would grant or uphold regulatory actions or rehabilitation orders against home-based companies unless insolvency could be proven to the court's satisfaction; consequently, these regulators made no effort to issue such actions. Regulators in the fourth state said that they could issue regulatory actions against companies that were solvent but could not issue rehabilitation orders unless the company was demonstrably insolvent or consented to the order, since the court might not readily agree to rehabilitation. Regulators in the fifth state told us that the courts must uphold or grant corrective actions on any ground that the regulator adequately proves. They added that liquidation is the only formal action for which the court can insist on a finding of insolvency.

In taking an insurer from formal actions to liquidation, some regulators may have self-imposed constraints about moving quickly. Some regulators have been reluctant to liquidate because they perceive their role as saving troubled companies and view liquidation as an undesirable option or personal failure. Regulators may also be hesitant to liquidate troubled companies because it is difficult to know the point beyond which problems can no longer be solved and companies should be liquidated.

The Role of NAIC

Besides the auditing requirements for annual statement submission, NAIC has introduced other means of providing state regulators with assistance in identifying and dealing with potentially troubled insurers. Since 1972, NAIC has used IRIS to alert states to insurers that may be financially troubled and may become insolvent. IRIS begins with calculation of 11 statistical ratios from insurer financial statements filed with NAIC. Statements of companies that are outside acceptable ranges on at least four of these ratios, or are selected for other reasons, are reviewed by a team of examiners from several state insurance departments. Companies that are, in the judgment of these examiners, liable to develop more serious problems are designated as first, second, or third priority, depending on the severity of the problems. Reports on these companies are then sent to the states in which the companies are licensed. (These reports, and the lists of designated companies, are kept confidential by NAIC, and we were not permitted access to them.)

In 1990, we reported that IRIS has deficiencies that raise questions about its effectiveness and usefulness as a regulatory tool.[4] These include reliance on insurer-reported data, uneven accuracy for different sizes and types of insurers, and a tendency to identify some companies that may not warrant immediate regulatory attention. In 1990, NAIC developed a new computer-based financial analysis system to identify potentially troubled companies that require state action. While this new system is only in its second year of operation and it is thus too early to assess its effectiveness, the system does appear to address a number of the weaknesses we identified with IRIS, such as failure to use information outside of annual statement data.

Since 1989, NAIC has increased both staff and computer facilities to improve collection and analysis of financial and other data on insurance companies. Through NAIC's telecommunications network, states have online access to NAIC's database of annual financial statements for over 5,500 insurance companies (as well as quarterly data for those insurers filing such data). NAIC's databases also contain legal and regulatory information to assist state regulators in identifying persons and companies involved in problem situations in other states. NAIC has also developed automated tools to assist state regulators in analyzing financial statements and examining insurance companies by automating routine tasks such as verifying the value of securities held by an insurer and calculating insurer loss reserving patterns. NAIC is offering this audit software to states free of charge, and 35 states have thus far obtained it.

In addition, NAIC has recently established a mechanism for monitoring states' progress in handling troubled insurers. In 1989, NAIC created a new multistate peer review committee—the Potentially Troubled Companies Working Group—to track how states are handling problem companies. From those companies identified as potentially troubled by

[4]GAO/GGD-91-20.

NAIC's financial analysis staff, the Working Group identifies those companies for which states are asked to respond in writing. According to NAIC, state regulators are requested, at a minimum, to

- demonstrate an understanding of both the nature and extent of the company's problem;
- establish that the state has a sufficient plan of action to assist in correcting or stabilizing the company or the state has an orderly process to withdraw the company from the marketplace;
- establish that the state has the laws, regulations, and personnel to effectively carry out the necessary regulatory actions; and
- establish that the state has effectively communicated its concerns to other regulators with policyholders who are at risk.

States also are asked to appear before the NAIC commissioner committee that oversees the Working Group to discuss how they are handling potentially troubled insurers. According to NAIC, peer review helps to ensure that individual states are promptly addressing problems.

The peer review process is only in its second year, so it is too soon to evaluate how this process will enhance coordination of supervision of troubled multistate insurers. We have no basis on which to assess whether peer review will prompt individual states to take more timely action to deal with troubled insurers. However, the supervisory actions necessary to address problems of a troubled insurer remain primarily the responsibility of the home state regulator. Coordination on multistate insurers remains primarily a matter of negotiations between all of the states involved.

Conclusions

There are many reasons for regulatory delay in taking formal action against a troubled insurer. State insurance departments, in making a determination as to whether a property/casualty insurer is financially troubled or insolvent, use information that is supplied in part by the insurer and may not be independently verified, and that may be months or years old. Regulators evaluate this information with only a vague statutory standard for insolvency, and, in most states, no regulatory or statutory standard for defining financially troubled company status.

These problems are not the only causes of regulatory delay, and steps taken to remedy them may not totally eliminate delays in dealing with troubled or insolvent insurers. We believe, however, that the following measures would represent a step forward in protecting policyholders of financially troubled insurers and minimizing the burdens on state guaranty funds:

- more frequent submission of financial information from insurers to regulators, with independent certification of the information submitted;
- a uniform standard for determining whether an insurer is financially troubled, including requirements that certain actions be taken when specific conditions are present; and
- a uniform legal definition of insolvency based on the adequacy of loss reserves to meet future claims and the sufficiency of capital to replenish inadequate loss reserves.

Survey of Domiciliary Property/Casualty Companies Placed Into Receivership in the 1980s

U.S. GENERAL ACCOUNTING OFFICE
Washington, D.C.

____
STATE

PART I

SURVEY OF DOMICILIARY PROPERTY-CASUALTY COMPANIES PLACED INTO RECEIVERSHIP IN THE 1980s

INTRODUCTION

The U.S. General Accounting Office (GAO) is conducting a congressionally requested survey of the regulatory, supervisory and receivership actions insurance departments took against property-casualty companies they identified as financially troubled. The survey contains two separate questionnaires. Part I gathers information on the regulatory history of companies that departments have placed into conservation, rehabilitation or liquidation during the 1980s. Part II, also included in this mailing, gathers aggregate data on the supervisory and regulatory actions departments used during this same time period.

Please complete a copy of the Part I questionniare for each domiciliary property-casualty company your Department placed under receivership during the 1980s for purposes of conservation, rehabilitation or liquidation. Include actions taken prior to 1980 only if a later action occurred during the 1980s. For example, if a company was placed under rehabilitation in 1979 and liquidation in 1980, include both actions in your responses to the questions.

All survey responses will be treated as confidential. Information on individual companies will not be disclosed to anyone outside of GAO. The name of your state is on this questionnaire only to permit us to follow-up on nonrespondents.

We have included a number of copies of the Part I questionnaire. **If additional copies are needed, please photocopy the blank form. If your Department has never placed a company into conservation, rehabilitation or liquidation during the 1980s, please indicate this in question 1 and return the questionnaire.** Please return your completed questionnaires within three weeks of receipt. Space has been provided for any comments at the end of the questionnaire. If you have any questions, please call Ms. Nancy Cosentino at (415) 556-6200. In case the return envelope is misplaced, the return address is:

U.S. General Accounting Office
San Francisco Regional Office
Ms. Nancy Cosentino
1275 Market Street, Suite 900
San Francisco, CA 94103

Thank you for your cooperation.

BACKGROUND INFORMATION

1. Has your Department placed any companies under conservation, rehabilitation, liquidation or receivership during the 1980s? (CHECK ONE.)

   1. [__] Yes ⟶ **(COMPLETE ONE COPY OF THE PART I QUESTIONNAIRE FOR EACH COMPANY.)**

   2. [__] No ⟶ **(SKIP TO THE PART II QUESTIONNAIRE.)**

2. Who should we contact if any of the answers on this questionnaire need clarification?

   Name: ______________________

   Telephone number: (____) __________

-1-

COMPANY HISTORY

3. What is the company name? (If for confidentiality reasons, the company name cannot be divulged, please enter "Not Available."

____

4. Do Department records on this company date back to January 1, 1980 or, if licensed after January 1, 1980, do the records date back to the time of the license? (CHECK ONE.)

   1. [__] Yes

   2. [__] No → Records beginning with what date will be used when answering questions?

      ____/19____
      (MO) (YR)

5. Prior to placing the company into conservation, rehabilitation or liquidation, was the company licensed in more than one state? (CHECK ONE.)

   1. [__] Yes

   2. [__] No → Please answer the following:

      Did the company write business in more than one state?

      1. [__] Yes
      2. [__] No

      Did the company write reinsurance?

      1. [__] Yes
      2. [__] No

6. What was the asset size recorded on the company's annual financial statement filled prior to the first receivership action? (i.e., conservation, rehabilitation or liquidation) (ENTER DOLLAR AMOUNT.)

   $ ____________________.00

7. How did your Department begin to identify or suspect the condition(s) which led to placing the company into conservation, rehabilitation or liquidation? (CHECK ALL THAT APPLY.)

   1. [__] Examination
   2. [__] Department financial statement analysis
   3. [__] NAIC
   4. [__] Company turned itself in
   5. [__] Outside sources (e.g. newspapers, rumors, phone calls)
   6. [__] Other (Specify) ______________

   ____

8. Approximately when did your Department begin to suspect the condition(s) which led to placing the company into conservation, rehabilitation or liquidation?

   ____/19____
   (MO) (YR)

9. How did your Department determine that these condition(s) warranted placing the company into conservation, rehabilitation or liquidation? (CHECK ALL THAT APPLY.)

   1. [__] Examination
   2. [__] Department financial statement analysis
   3. [__] NAIC
   4. [__] Company turned itself in
   5. [__] Outside sources (e.g. newspapers, rumors, phone calls)
   6. [__] Other (Specify) ______________

   ____

10. Approximately when did your Department determine that these condition(s) warranted placing the company into conservation, rehabilitation or liquidation?

   ____/19____
   (MO) (YR)

-2-

11. Did the company become financially impaired? (CHECK ONE.)

    NOTE: Please use your Department's own definition of impairment or statutory insolvency when answering this question.

    1. [__] Not applicable because our Department does not distinguish between impairment and insolvency.

    2. [__] No

    3. [__] Yes ⟶ Please provide:

       Date your Department was able to prove that the company was impaired.

       ____/19____
       (MO) (YR)

       The "as of date" in your Department records indicating when the impairment began.

       ____/19____
       (MO) (YR)

12. Did the company become insolvent? (CHECK ONE.)

    NOTE: Please use your Department's own definition or criteria of insolvency when answering this question.

    1. [__] No

    2. [__] Yes ⟶ Please provide:

       Date your Department was able to prove the company was insolvent.

       ____/19____
       (MO) (YR)

       The "as of date" in your Department records indicating when the insolvency began.

       ____/19____
       (MO) (YR)

13. Was the company placed under conservation or seizure? (CHECK ONE.)

    NOTE: For purposes of this question, conservation or seizure refers to your Department taking a company over in order to conserve assets.

    1. [__] Yes (CONTINUE WITH QUESTION 14.)

    2. [__] No (SKIP TO QUESTION 15.)

14. What was the date of the conservation or seizure order?

    ____/19____
    (MO) (YR)

15. Was the company placed into rehabilitation? (CHECK ONE.)

    NOTE: For purposes of this question, rehabilitation refers to.the Department taking the company over in order to: (1) return it to financial health; (2) run its operations; or (3) run off its business without placing the company in liquidation.

    1. [__] Yes (CONTINUE WITH QUESTION 16.)

    2. [__] No (SKIP TO QUESTION 18.)

16. What was the date of the rehabilitation order?

    ____/19____
    (MO) (YR)

-3-

17. While under rehabilitation, did the company stop paying claims? (CHECK ONE.)

    1. [__] No

    2. [__] Yes → Please provide:

        Date the claims payments stopped.

        ____/19____
        (MO) (YR)

        If applicable, date the claim payments resumed.

        ____/19____
        (MO) (YR)

        If applicable, date the claim payments stopped for a second time.

        ____/19____
        (MO) (YR)

18. Was the company placed into liquidation? (CHECK ONE.)

    1. [__] No

    2. [__] Yes → Please provide:

        Date of the liquidation order.

        ____/19____

19. Did your Department take any supervisory or regulatory action(s) prior to placing the company into conservation, rehabilitation or liquidation? (CHECK ONE.)

    NOTE: Answer "Yes" if your Department took any <u>statutorily based</u> actions between the date entered in question 8 "Date Condition Suspected" - and the first receivership date indicated in questions 14, 16 or 18.

    Examples of <u>statutorily based</u> supervisory and regulatory actions are summary or corrective orders, consent agreements, impairment notices, administrative supervision, fines and cease and desist orders.

    1. [__] No

    2. [__] Yes → Please list the actions and dates taken.

ACTION	DATE
a. ____________________	
____________________	____/19____ (MO) (YR)
b. ____________________	
____________________	____/19____ (MO) (YR)
c. ____________________	
____________________	____/19____ (MO) (YR)

-4-

20. What is the current status of the company? (CHECK ONE.)

1. [__] Currently under conservation
2. [__] Released from conservation and returned to the market
3. [__] Released from rehabilitation and returned to the market
4. [__] Currently under liquidation
5. [__] Liquidation completed →

   On what date was the liquidation completed?

   ____/19____
   (MO) (YR)

6. [__] Other (Please specify) ________

   ____

   ____

21. If you have any additional comments concerning the responses to any questions in this questionnaire or have any other comments concerning the activities of this company, please use the space below.

THANK YOU FOR YOUR COOPERATION.
PLEASE RETURN BOTH QUESTIONNAIRES
IN THE ENCLOSED ENVELOPE.

-5-

U.S. GENERAL ACCOUNTING OFFICE
Washington, D.C.

STATE ______________

PART II

SURVEY OF DOMICILIARY PROPERTY-CASUALTY COMPANIES PLACED INTO RECEIVERSHIP IN THE 1980s

INTRODUCTION

This is the second part of the U.S. General Accounting Office survey on the regulation of financially troubled property-casualty insurance companies. This specific questionnaire (Part II) gathers aggregate data on the statutorily based regulatory and supervisory actions your Department used in solvency regulation when placing companies into rehabilitation, conservation or liquidation is not warranted. Examples of these actions include cease and desist orders, stipulation or consent agreements, notices of impairment, fines, and suspension or revocation of licenses.

The questions below only apply to actions taken against domiciliary property-casualty companies **between January 1, 1980 and December 31, 1989**. Unlike the Part I Questionnaire, you need complete one copy of the Part II Questionnaire.

As was the case in Part I, all survey responses will be treated as confidential. The name of your state is on this questionnaire only to permit us to follow-up on nonrespondents.

Please return this questionnaire at the same time and in the same envelope as the Part I questionnaires. If you have any questions, please call Ms. Nancy Cosentino at (415) 556-6200.

Thank you for your cooperation.

BACKGROUND INFORMATION

1. Can this questionnaire be answered based upon Department records dating back to January 1, 1980 or, for those companies licensed after January 1, 1980, to the date of the licenses?

   1. [__] Yes

   2. [__] No ----> Please enter:

Date of Records	Number of Companies Date Applies To
____/19____ (MO) (YR)	______________
____/19____ (MO) (YR)	______________
____/19____ (MO) (YR)	______________

2. What is the total number of domiciled property-casualty companies in your state?

   __________ NUMBER

3. Who should we contact if any of the answers on this questionnaire need clarification?

   Name: ______________________________ Telephone Number: (______) ______________

CONTINUED ON PAGE 2

4. When did the provision(s) described in your state's insurance code under sections <u>58-30-60</u> first become effective?

   NOTE: This question refers to all provisions listed in the above section(s). For example, any order or written list that is covered; the appointment of a supervisor to oversee the company; and <u>only if covered by those section(s)</u>, the suspension or revocation of licenses.

   ______/19______
   (MO) (YR)

5. Does the Department notify other departments in states where the company is operating when it implements the supervisory actions described in question 4? (CHECK ONE.)

   1. [__] No

   2. [__] Yes ----> Which actions are departments notified of? (CHECK ALL THAT APPLY.)

      1. [__] Orders or written lists
      2. [__] Appointment of a supervisor
      3. [__] Suspension of a license
      3. [__] Other (Please specify) ______________________

6. Please list all of other actions contained in your state's insurance statutes which your Department uses in solvency regulation aside from those referred to in question 4. (Examples are cease and desist orders, consent or stipulation agreements, impairment notices, and fines. Also include suspension or revocation of licenses if these actions are not covered under question 4. Please include the citation for each.

ACTIONS USED	CITATIONS

-2-

NOTE: IN THE SUCCEEDING QUESTIONS, THE ACTIONS REFERRED TO IN QUESTION 4 ARE CALLED **SUPERVISORY ACTIONS** AND THE ACTIONS UNDER QUESTION 6 ARE CALLED **OTHER REGULATORY ACTIONS.**

7. Please indicate the total number of **domiciliary property-casualty companies** which were the subject of supervisory **and/or** other regulatory actions between January 1, 1980 and December 31, 1989. **EXCLUDE THOSE COMPANIES IN WHICH THE ONLY ACTION WAS SEIZURE.**

   Total number of companies: ______________

8. Of the total number of companies in question 7, how many were the subject of **both supervisory and other regulatory actions** in the 1980s? (IF NONE, ENTER ZERO.)

   ____________ (NUMBER)

   Of these companies, how many:

   -- Have been placed into liquidation? .... ________

   -- Have been placed under receivership, but not into liquidation? .... ________

   -- Are still the subject of supervisory or other regulatory actions? .... ________

   -- Are no longer the subject of any receivership, supervisory, or other regulatory action? .... ________

   -- Other? (Specify: ______________________________) ... ________

9. Of the total number of companies in question 7, how many were the subject of **only supervisory actions** in the 1980s? (IF NONE, ENTER ZERO.)

   ____________ (NUMBER)

   Of these companies, how many:

   -- Have been placed into liquidation? .... ________

   -- Have been placed under receivership, but not into liquidation? .... ________

   -- Are still the subject of supervisory or other regulatory actions? .... ________

   -- Are no longer the subject of any receivership, supervisory, or other regulatory action? .... ________

   -- Other? (Specify: ______________________________) ... ________

10. Of the total number of companies in question 7, how many were the subject of **only other regulatory actions** in the 1980s? (IF NONE, ENTER ZERO.)

   ____________ (NUMBER)

   Of these companies, how many:

   -- Have been placed into liquidation? .... ________

   -- Have been placed under receivership, but not into liquidation? .... ________

   -- Are still the subject of supervisory or other regulatory actions? .... ________

   -- Are no longer the subject of any receivership, supervisory, or other regulatory action? .... ________

   -- Other? (Specify: ______________________________) ... ________

THANK YOU FOR YOUR COOPERATION.
PLEASE RETURN THE QUESTIONNAIRES IN THE ENCLOSED ENVELOPE.

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U.S. GENERAL ACCOUNTING OFFICE
Washington, D.C.

_______ STATE

PART II

SURVEY OF DOMICILIARY PROPERTY-CASUALTY COMPANIES PLACED INTO RECEIVERSHIP IN THE 1980s

INTRODUCTION

This is the second part of the U.S. General Accounting Office survey on the regulation of financially troubled property-casualty insurance companies. This specific questionnaire (Part II) gathers aggregate data on the statutorily based actions your Department used in solvency regulation when placing companies into rehabilitation, conservation or liquidation is not warranted. Examples of these actions include cease and desist orders, stipulation or consent agreements, notices of impairment, fines, and suspension or revocation of licenses.

The questions below only apply to actions taken against domiciliary property-casualty companies between January 1, 1980 and December 31, 1989. Unlike the Part I Questionnaire, you need complete one copy of the Part II Questionnaire.

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Thank you for your cooperation.

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   1. [__] Yes

   2. [__] No ——→ Please enter:

Date of Records	Number of Companies Date Applies To
____/19____ (MO) (YR)	__________
____/19____ (MO) (YR)	__________
____/19____ (MO) (YR)	__________

2. What is the total number of domiciled property-casualty companies in your state?

   __________ NUMBER

3. Does your Department have a law similar to the NAIC Administrative Supervision Model Act? (These actions are commonly referred to as summary orders or procedures, corrective orders or administrative supervision.) (CHECK ONE.)

   1. [__] No

   2. [__] Yes ----> When was this law passed? ____/19____ (MO) (YR)

4. Who should we contact if any of the answers on this questionnaire need clarification?

   Name: ______________________ Telephone Number: (_____) __________

CONTINUED ON OTHER SIDE

5. Please list all of the actions contained in your state's insurance statutes which your Department uses in solvency regulation. (Examples are cease and desist orders, consent or stipulation agreements, impairment notices, fines, etc.) Also include the citation for each.

ACTIONS USED	CITATIONS

The actions referred to in question 5 are regulatory actions.

6. Please provide the following information on domiciliary property-casualty companies which were the subject of regulatory actions referred to in question 5 between January 1, 1980 and December 31, 1989.

Total number of companies subject to regulatory actions referred to in question 5 .... ____________

Of the companies indicated above, how many:

a. Have been placed into liquidation? .... ____________

b. Have been placed under receivership, but not into liquidation? .... ____________

c. Are still the subject of any regulatory actions listed in question 5? .... ____________

d. Are no longer the subject of any regulatory actions listed in question 5 or any receivership actions? ..... ____________

THANK YOU FOR YOUR COOPERATION.
PLEASE RETURN THE QUESTIONNAIRES IN THE ENCLOSED ENVELOPE.

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Glossary

Annual Statement	A statement of the year-end financial condition submitted in the following year by an insurer to the insurance regulator in each state in which the insurer is licensed.
Casualty Insurance	Insurance concerned primarily with the insured's legal liability for injuries to others or for damages to other people's property; casualty insurance also encompasses such forms of insurance as plate glass, burglary, robbery, and workers' compensation.
Claim	A request to recover for a loss covered by an insurance policy.
Field Examination	An on-site examination of an insurance company conducted by one or more state regulators.
Financially Troubled Insurer	An insurer that is in position, or moving toward a position, that would subject its policyholders, creditors, and other claimanats to greater than normal financial risk.
Guaranty Fund	An association established by state law to pay certain claims made against an insolvent insurance company.
Insolvency	A state or financial condition in which an insurer's liabilities exceed its assets plus its capital and surplus.
Insurance	A system under which individuals, businesses, and other organizations or entities, in exchange for payment of a sum of money (a premium), are guaranteed compensation for losses resulting from certain perils under specified conditions.
Insurance Company	An organization chartered to operate as an insurer.

Insured	A person or organization covered by an insurance policy, including the "named insured" and any other parties for whom protection is provided under the policy terms.
Liquidation	A formal, court-ordered process in which an insolvent company's assets are converted to cash and applied toward its outstanding debts.
Policy	A contract of insurance.
Policyholder	A person who pays a premium to an insurance company in exchange for protection provided by an insurance policy.
Premium	The sum paid for an insurance policy. Net premiums written represent premium income retained by insurance companies, directly or through reinsurance, minus payments for business reinsured. Direct written premiums are the amounts actually paid by policyholders.
Property Insurance	Insurance providing financial protection against loss of, or damage to, real and personal property caused by such perils as fire, theft, windstorm, hail, explosion, riot, aircraft, motor vehicles, vandalism, malicious mischief, riot and civil commotion, and smoke.
Rehabilitation	A process involving the transfer of control over an insurer from insurance company management to a rehabilitator.
Reinsurance	Assumption by one insurance company of all or part of a risk undertaken by another insurance company.
Reserves	Funds set aside by insurers for future claim payments.

Related GAO Products

Insurance Industry: Questions and Concerns About Solvency Regulation (GAO/T-GGD-91-10, Feb. 27, 1991).

Insurance Regulation: The Insurance Regulatory Information System Needs Improvement (GAO/GGD-91-20, Nov. 21, 1990).

Insurance Regulation: State Reinsurance Oversight Increased, but Problems Remain (GAO/GGD-90-82, May 4, 1990).

Insurance Regulation: Problems in the State Monitoring of Property/Casualty Insurer Solvency (GAO/GGD-89-129, Sept. 29, 1989).

Property and Casualty Insurance: Thrift Failures Provide Valuable Lessons (GAO/T-AFMD-89-7, Apr. 19, 1989).

Insurer Failures: Property/Casualty Insurer Insolvencies and State Guaranty Funds (GAO/GGD-87-100, July 28, 1987).

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