[INSIGHT] By Peter H. Bickford

Safe Again!

New York life insurance and annuity beneficiaries can breath easier! They are safe again! Two years after the statutory life guaranty fund was exhausted by the Executive Life Insurance Company of New York failure, the State's legislature has passed and the Governor has signed into law legislation restoring the viability of the fund.

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The new law makes three significant changes to the guaranty fund statute. Most importantly, it removes the $500 million aggregate limit on assessments on licensed life insurers to cover future insolvencies. In early 2012, the law's aggregate limit was exhausted by the fund's commitment to the court approved plan for Executive Life to help fill a $2 billion hole. Stopgap legislation had to be adopted to increase the cap to $558 million to cover the plan, but nothing further for future insolvencies. Removing the cap altogether provides the fund with flexibility in addressing future instances of financially stressed life insurers.

The law was also amended to cover all eligible policyholders of a NY licensed company and not just resident policyholders. This change was enacted to address the "orphan" policyholder issue exposed by Executive Life when at the time of the liquidation a number of annuitants lived in a state where Executive Life had not been licensed and therefore were not eligible for guaranty fund coverage.

The third major change was to permit creation of "resolution facilities" in the State. Under the Executive Life plan, the "restructured" liabilities were transferred to a new special purpose entity owned by the participating state life guaranty associations. Rather than being a New York entity, however, it was organized as a District of Columbia captive insurer because a similar facility could not be created under existing New York law. The new law removes these impediments to using a New York entity to administer and dispose of the business of troubled New York life insurers.

With these three major fixes the life guaranty fund deficiencies glaringly exposed by Executive Life are now resolved, right? While the changes are on the whole an improvement, the major defect in the Executive Life "estate resolution" remains unaddressed. What, then, are the effects of these revisions? Not as much as advertised!

Take the removal of the fund cap, for instance. The cap was never really an issue in Executive Life. Yes, the restructuring plan approved by the court committed the fund for an amount in excess of the cap, but that excess was already covered by the stopgap legislation increasing the cap to the committed amount. The removal of the cap in the new law is more about addressing future financially strained life companies. Practically and politically the administration, legislators and industry could ill afford to ignore the depleted fund for very long.

Addressing the orphan policyholder issue was definitely an important fix. Ironically, the change was a reversion to the old law before it was changed in 1985 to impose the residency limitation and set the aggregate capacity to $500 million. As we now know, these changes ultimately proved to be problematic under the Executive Life plan.

The most curious change, however, is the provision allowing for the establishment of "resolution facilities." It is curious for a number of reasons. Why, for instance, is such a special purpose vehicle necessary under the existing elaborate statutory receivership process? It has never been clearly explained why it was important to create this vehicle in the first place, other than to further remove the New York receiver from his own mess. The existing statutory authority seemed quite adequate – if properly used – to accomplish an estate "resolution."

And if "resolution facilities" are necessary, why is the authority to form them given to the guaranty association and not to the receiver? The new law states that their purpose is for "administering and disposing of the business of the insolvent domestic life insurance company." Isn't that the superintendent's job as receiver? Is this just another way for the receiver to shirk his or her responsibility?

But, hey, why quibble over such mundane details as who runs the rehabilitation or liquidation of a life insurer. Who cares so long as policyholders and beneficiaries of New York domiciled life insurance companies are secure knowing that past defects have now been addressed and cannot recur. Perhaps you may want to pause a moment before concluding that your life insurance products are protected, particularly annuities.

The main purpose of the revisions was to remove the aggregate cap so that there would be assessment authority available for future insolvencies. However, the $500,000 per claim limitation remains untouched. On its face this does not appear to be unreasonable, particularly because New York has among the highest per claim limits in the US. The problem is that half of the $2 billion Executive Life

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shortfall was foisted on a small minority of claimants, almost all of whom were structured settlement annuitants who could least afford to have their benefits slashed. The reason they took the brunt of the shortfall was because the per claim limitations in the state life guaranty fund laws are not designed for or adequate to cover contractual obligations that could go on for decades.

Compare this treatment to the treatment of workers compensation claims in the event of a carrier's insolvency. Unlike life guaranty funds, workers compensation security funds almost universally do not have per claim limitations or caps in recognition of the nature of WC claims. Unfortunately, the life guaranty fund system does not distinguish between lump sum payouts under standard life policies and periodic payment contracts such as structured settlement annuities. The result is an inherent discrimination in the law against the latter. Thus, structured settlement annuitants needing lifetime support from disabling injuries or conditions bore the brunt of the restructured (i.e., drastically reduced) benefits under the Executive Life plan.

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This was the single most devastating effect of the Executive Life insolvency, but has been totally disregarded by the administration and the legislature in their life guaranty fund fix. Not only is this issue ignored, the statute emphatically states that not a dime more can ever be used for Executive Life. Talk about pouring salt on a wound!

There remain other shortcomings in the life guaranty fund system, but one is particularly galling. The revised law leaves untouched the archaic and arcane Section 7718 strictly prohibiting advertising of life guaranty fund coverage. Not only should this section be removed, it should be replaced with a required notice – like a surgeon general's warning – that your policy may not be fully protected in the event of your life company's insolvency, and if you are the beneficiary of a periodic paying annuity . . . forgetaboutit![IA]

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