[INSIGHT] By Peter H. Bickford

Rethinking Insurance Guaranty Funds

It's probably a good thing that the NY Insurance Law prohibits advertising the existence or terms of a life guaranty fund in the sale or solicitation of life insurance products. The statutory caps for the NY life funds are fully committed to the $1.6 billion deficit of Executive Life Insurance Company of New York (ELNY), and without new legislation there is simply nothing available for the payment of claims in future insolvencies of life insurance companies. However, the current state of the funds might be a blessing in disguise – an opportunity for the NY Legislature, regulators and the industry to address the mishmash of confusing, inconsistent, inadequate and often misleading coverage by the State's insurance guaranty/security funds.

Peter H. Bickford

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New York has a plethora of insurance guaranty/security funds. There are three New York property/casualty funds – one for workers' compensation, one for public auto and a larger catchall property/casualty fund. And there are two life funds: the "old" and the "new," both of which technically continue to provide coverage. Although the p/c funds provide their own issues, this column is focusing on the life funds because of the crisis caused by the ELNY debacle.

Basically, the "old" life guaranty fund provides "unlimited" coverage for any claimant, wherever located, under a policy issued by a NY licensed company before August 1985. This fund, which had only a $50 million aggregate capacity, has been totally used up by ELNY claims. The "new" fund covers policies issued after August 1985 up to $500,000 with a $500 million aggregate cap (recently increased to $558 million – more on that later), but which only covers NY residents of NY licensed companies. Like most insurance guaranty funds nationwide, the NY life funds are not pre-funded and are managed by separate entities with boards comprised of industry representatives (a glaring exception are the pre-assessment NY p/c funds that are financial accounts controlled by the receiver and not separate entities with industry representation – but that's a topic for another day).

In addition to shining a bright light on the causes of the insolvency under the Liquidation Bureau's management, the ELNY failure has exposed the shortcomings of the life guaranty fund system, particularly as applied to the ELNY annuity book of business. While roughly 84% of ELNY annuitants are purportedly being fully covered, the class of annuitants most in need of coverage – seriously injured or ill structured settlement annuitants – are having their benefits cut by 50% or more. Of the almost 10,000 annuitants, about 1500 of them, almost all of them seriously ill or injured structured settlement payees, are absorbing the entire $900 million shortfall – even after the guaranty fund contributions – an average of $600,000 loss per annuitant.

Last summer, in anticipation of court approval of the ELNY restructuring plan, the NY Legislature increased the $500 million cap of the post-1985 life guaranty fund to $558 million, the amount needed to meet its commitment under the plan. As mentioned, the cap on the "old" fund was also fully used up in the ELNY plan. This means, of course, that the cupboard is currently bare for any other life insolvency without further legislation. The sticking point for increasing the cap further is the current statutory tax credit for life company assessments: the industry wants to keep or expand the credit; the regulators want it eliminated or further limited. This dispute must be resolved between the industry and the regulators if there is going to be any meaningful improvement in the life guaranty fund system. But, as ELNY demonstrates, simply addressing "who pays?" will do little to make the system responsive to lifetime annuity claims.

It is impossible in this short space to outline all the issues presented by the life guaranty funds as currently constituted, or to discuss all the possible solutions – not just in NY but nationwide. However, here are a few of the items that the State Legislature, regulators and the industry might want to consider:

- Eliminate the ridiculous restriction on the advertising of the terms and limitations of the guaranty funds. In fact, consideration should be given to *requiring* life and annuity contracts to state that guaranty fund coverage is limited and may vary depending on where you live now or may chose to live in the future.
- Coordinate with the regulators and guaranty funds nationally to provide unity of coverage in all states and to eliminate loss of coverage resulting from a claimant's change in residence.
- If meaningful coverage cannot be assured for classes of claimants such as seriously injured or ill structures settlement recipients, then consider eliminating such classes of annuities from guaranty fund coverage altogether. Traditional guaranty funds, with per claim and aggregate caps, simply do not work for structured settlement annuities, particularly those intended to provide lifetime support for seriously injured or ill recipients. It may be more honest to acknowl-

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edge this inadequacy rather than face future outrage like that caused by the ELNY plan.

- Eliminate the preferred creditor status of guaranty funds. Existing statutes grant guaranty funds subrogation and early access rights that provide them with the same or greater creditor status as the claimants they are intended to protect. This makes no sense other than as a back-door limitation of guaranty fund coverage. Certainly guaranty funds should be entitled to subrogation rights, but those rights should not be allowed to dilute claimant coverage, nor make the caps mathematically meaningless, which is currently the case. Nowhere does this preferential treatment of the guaranty funds exhibit more glaring conflict with the interest of claimants than in the ELNY fiasco.
- Finally, require the funds to be more open and communicative about their coverage limitations, current activity and financial status, including regular reports to the regulators that are made publically available.

Given the state of the life guaranty funds today, the NY Legislature, regulators and the industry have an excellent opportunity to take action to provide definition to the funds and their purpose, and to provide a leadership role in ensuring that the guaranty fund system nationwide provides real protection for those most in need of such protection.

Without meaningful changes, the adequacy, continuity and transparency of guaranty fund coverage nationwide may also become a critical element in the continuing debate on State v. Federal oversight of the insurance industry, particularly in monitoring insurance company solvency. [IA]

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[FROM COUNSEL] By Sari Gabay-Rafiy, Esq.

New York's Highest Court Strengthens Policyholder's Rights and May Place Insurance Brokers at Risk

On November 19, 2012, the New York Court of Appeals – the highest court of the State of New York, apparently strengthened the rights of policyholders as against their insurance brokers.

In *American Building Supply Corp. v. Petrocelli Group*, the plaintiff-insured was required by its lease to obtain general liability insurance in the minimum amount of $5,000,000 for bodily injury and property damage. The policy procured, however, contained the following exclusion: "This insurance does not apply to any actual or alleged 'bodily injury' property damage, 'personal injury' or 'advertising injury' to … A present, former, future or prospective partner, officer, director, stockholder or employee of any insured."

Neither the insured nor the insurance broker read the policy upon its delivery. When an employee was injured, the insurance company disclaimed coverage based on the above quoted exclusion. As a result, the insured sued its insurance broker for negligence and breach of contract in connection with the broker's procurement of insufficient coverage.

The Court of Appeals recognized that "insurance agents have a common law duty to obtain requested coverage for their clients within a reasonable time or inform the client of the inability to do so; however, they have no continuing duty to advise, guide or direct a client to obtain additional coverage."

The Court also recognized the longstanding principle that an insured is presumed to have read its policy, a presumption that has historically precluded certain actions against brokers for failure to procure requested coverage. In *Petrocelli*, however, the Court went a step further and held that **"[w]hile it is certainly a better practice for an insured to read its policy, an insured should have a right to 'look to the expertise of its broker with respect to insurance matters.'"** (Emphasis added)

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Sari Gabay-Rafiy, Esq.

In finding there were issues of fact precluding dismissal, the court noted that the insured testified he specifically requested the coverage for employees, the broker visited the premises and was aware that the only people on the premises would be the insured's employees, and "[s]ince no one but employees ever entered the premises, the coverage defendant obtained, which excluded coverage for injuries to employees, hardly made sense."

In disagreeing with the majority's ruling the dissent pointed out that the decision is likely to result in "he said-she said battles of what occurred during coverage discussions between the insured and broker."

In light of this decision, brokers should be careful to obtain the type of coverage specifically requested by a client, or advise of the inability to do so because the onus is not simply on the insured to read the policy at the time of delivery. [IA]

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