Improving State Guaranty Funds Can Strengthen Consumer Protections and Market Stability

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Contents

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KEY HIGHLIGHTS

- *Recent insolvencies in the long-term care insurance industry have exposed inadequacies in the structure of state guaranty funds, which are pools of funding used to pay claims when a company is deemed insolvent by the courts.*

- *The current guaranty fund system can be improved by expanding the base of insurers who contribute to the funds and equalizing the burden shared between life and health insurance companies.*

- *Changes adopted by the National Association of Insurance Commissioners provide states with a blueprint for better addressing insolvencies and protecting policyholders.*

OVERVIEW

State guaranty associations, also commonly referred to as guaranty funds, offer critical protection to policyholders in the event of insurer insolvencies. The funds ease the burden and uncertainty for policyholders by intervening quickly after an insolvency occurs. The funds can protect policyholders against substantial financial loss—such as preserving the value of life insurance policies, ensuring claims are paid, and protecting individuals' assets. For instance, the funds may pay claims for needed health care services, limiting disruptions in care for consumers and ensuring that providers are paid. Overall, when designed correctly, responsibility for payments into guaranty funds are borne equitably by insurers who offer policies in the particular line of business.

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Recent insolvencies in the long-term care (LTC) insurance industry are straining life and health insurance guaranty funds. However, key changes to the guaranty fund structure adopted by the National Association of Insurance Commissioners (NAIC) provide states with a framework to better protect consumers and the marketplace.

GUARANTY FUNDS PROTECT CONSUMERS FROM INSURER INSOLVENCY

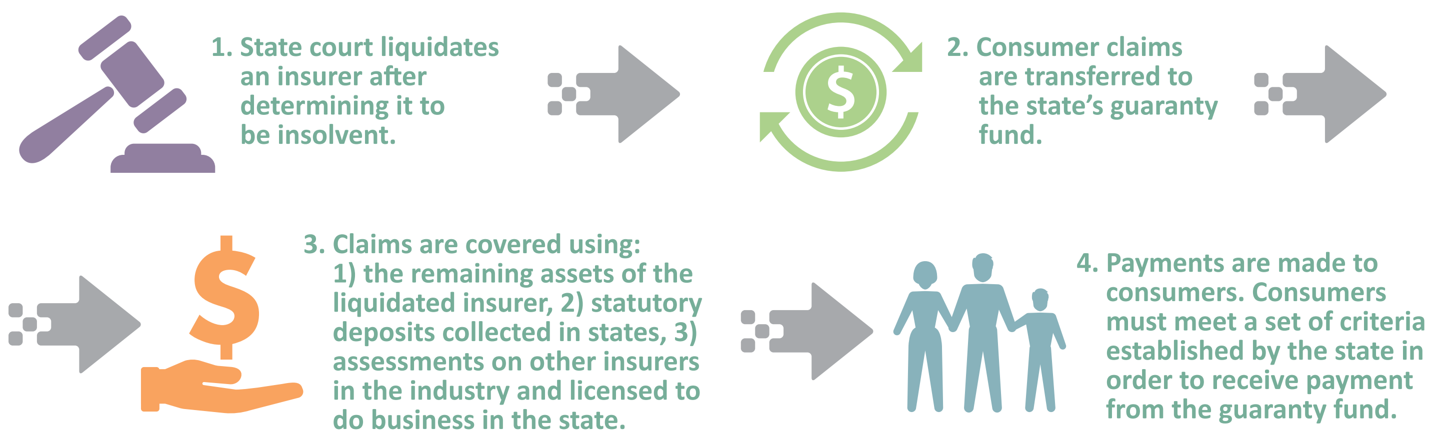
State guaranty funds are funding pools created at the state level and funded via payments from insurers doing business in that state. The guaranty fund covers consumers' insurance claims if and when an insurer becomes insolvent. These funding pools are not financed in advance. Instead, insurers are assessed a share of the total dollar amount required to cover all outstanding claims when a company becomes insolvent. This amount is equal to the claims that are owed minus the company's remaining assets. (See Figure 1)

Each state has at least one guaranty fund. Property and casualty guaranty funds cover most insurance policy types, with the exception of life and health insurance. Life and health insurance policies (including LTC insurance) are covered by a separate guaranty fund.[1]

The maximum amount of LTC claims that will be paid by a life and health insurance guaranty fund varies by state. Guaranty funds typically cover up to $300,000 in benefits per policyholder for each of the following policy types: life insurance, long-term care, and disability insurance.[2] Though seven states set LTC caps as high as $500,000 and New Jersey has no specific dollar cap in place.[3] Life and health insurance guaranty funds also typically cover up to $500,000 in major medical or basic hospital, medical and surgical, claims and up to $100,000 for other health insurance benefits.[4]

In the absence of guaranty funds, consumers could face substantial financial losses and/or not be able to afford needed health care or long-term care services in the event of an insurer insolvency.

Figure 1. What Happens When an Insurer Becomes Insolvent[5]



LONG-TERM CARE INSURANCE INSOLVENCIES HIGHLIGHT WEAKNESSES IN GUARANTY FUNDS

Recent insolvencies in the LTC insurance industry have exposed shortcomings in the health and life insurance guaranty funds, which are costly for consumers and the market as a whole. The most recent insolvency—that of Penn Treaty Network America Insurance Company (Penn Treaty)—ranks as the largest health insurance insolvency case and second largest insurer insolvency overall. Penn Treaty was initially put into "rehabilitation" in January 2009 by the Pennsylvania insurance commissioner in an attempt to save the company, but rehabilitation was unsuccessful and the company was liquidated in early 2017.[6] Penn Treaty's obligations totaled $4 billion, but assets were only $700 million. The guaranty fund covered the approximately $3.3 billion remainder.[7,8]

Because LTC insurance is classified as health insurance, major medical health insurers pay a disproportionate amount of the claims costs during an insolvency under the traditional assessment approach, compared to life insurance companies.

Penn Treaty's insolvency was costly for the health insurance industry. Health insurers were required to cover hundreds of millions of dollars in claims, which ultimately increased premiums for all members over several years.[9] This was due to several rules governing guaranty funds.

First, LTC insurance policies are classified as health insurance, even though only a small fraction of the policies are written by major medical health insurers. Most LTC insurance policies are written by life insurance companies. As a result, the financial assessments resulting from the Penn Treaty insolvency were paid by all health insurers, even if an insurer never sold LTC insurance policies.[10]

Second, because LTC insurance is classified as health insurance, major medical health insurers pay a disproportionate amount of the claims costs during an insolvency under the traditional assessment approach, compared to life insurance companies.

Finally, state laws governing guaranty funds exempt HMOs from participation meaning that assessments are spread over only a portion of the health insurance issuers in a market. This also means that the members of HMOs are not protected against insurer insolvency, which is a critical gap in consumer protections.

In order to address these issues, the NAIC worked closely with health insurers and life insurance companies to identify ways to improve the structure of life and health insurance guaranty funds.

MODEL ACT CHANGES STRENGTHEN GUARANTY FUNDS

The NAIC's Life and Health Insurance Guaranty Association Model Act provides guidance to states on how to structure their guaranty funds. In 2017, the NAIC adopted amendments to the Model Act that address key issues regarding guaranty fund coverage for LTC insurance insolvencies. The revisions represent a joint effort by NAIC, life insurance companies, including the American Council of Life Insurance, and health insurance companies.

NAIC's amendments to the Model Act made two key changes to how guaranty funds respond to insolvencies in LTC insurance.[11,12] One change added HMOs to the assessment base for guaranty funds; historically HMOs have been exempt from contribution. This ensures that all companies in the relevant insurance sector help fund an insolvency, regardless of the type of products or insurance they offer. The second change split any needed assessments equally (i.e., 50/50) between health insurers and life insurance companies. Historically, health insurance companies have paid the majority of assessments for LTC insurance insolvency even though they offered very few of the policies themselves.

Amendments to the Model Act will increase the stability of the health and life insurance marketplaces and strengthen consumer protections.

The amendments to the Model Act will increase the stability of the health and life insurance marketplaces and strengthen consumer protections in the following ways:

Including HMOs in the assessment base promotes competition in the health insurance market. Under the status quo, non-HMO health insurers bear a disproportionate share of insolvency assessments, the costs of which must be included in the premiums of non-HMOs but not HMOs. Requiring HMOs to pay a share of insolvency assessments puts HMOs and non-HMOs on more equal footing in the marketplace. Further, historical reasons for excluding HMOs are no longer as relevant, because there is increasing similarity in the products offered by HMOs and non-HMOs, particularly as the Affordable Care Act's benefit requirements have reduced, if not eliminated, differences in products.

Expanding the assessment base will help generate sufficient funding, quicken the payment process, and alleviate consumers' concerns. Sufficient funding and timely payment are key in ensuring policyholders receive services and don't experience disruptions in care. For LTC insurance policyholders, avoiding disruption in coverage is particularly important if they are currently receiving services paid for by the policy, whether those services are provided in a nursing facility or are allowing them to live independently at home.

Rebalancing guaranty fund contribution levels supports the stability of health insurance markets. Health insurers have been primarily responsible for insolvencies associated with LTC insurance policies they did not write and actuarial projections they did not make. In order to fund insolvency assessments, insurers must pass along at least a portion of the costs to their members in the form of higher premiums—regardless of whether those members have LTC insurance or even use LTC services and supports. Reducing the burden on health insurers will limit the premium impact of future insolvencies and increase insurance affordability and market stability for policyholders.

A dozen states have acted to adopt the changes in the updated NAIC Model Act.

State legislatures may now consider and enact these changes. As of the date of this paper's publication, a dozen states have acted to adopt the changes in the updated NAIC Model Act.[13] With other states expected to consider guaranty fund changes in their upcoming legislative sessions, it is important for legislators, their constituents, and other stakeholders to understand the benefits of the NAIC changes for states and consumers.

CONCLUSION

Insolvency in the LTC insurance market creates problems for consumers, states, and insurance markets. The changes adopted by the NAIC—representing the collaborative efforts of multiple stakeholders—will modify the structure of guaranty funds to better address the LTC insurance market. By adopting the amendments to the Model Act, states will enhance consumer protections and foster greater stability in their health insurance markets.

END NOTES

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