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The View from Overseas

After a year dominated by COVID-19, the international regulatory arena is heating up again—here's what that could mean for the United States

It's been a while since we spoke with our international correspondents about the regulatory scene outside the United States. Fortunately, Sara Manske and Scott Kosnoff (Partners with the Faegre Drinker Biddle & Reath law firm, where they represent the guaranty system on public policy matters in Washington and internationally) were kind enough to catch us up on what's been going on in Europe and elsewhere.

NOLHGA Journal: *Thank you for joining us again. Before we dig into the details of international resolution matters, will you give us an overview of major happenings on the international insurance standard-setting scene over the past 18 months or so?*

Sara: Of course—and thank you for having us back again! The last year and a half was important as far as international insurance standards go. In November 2019, at its Annual Meeting in Abu Dhabi, the International Association of Insurance Supervisors (IAIS) finally adopted the Insurance Core Principles (ICPs) and Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame).

Scott: For a little background, the IAIS is essentially an international version of the NAIC, with member supervisors and regulators from more than 200 jurisdictions. Its mission is to promote effective and globally consistent insurance supervision. The U.S. members are the Federal Insurance Office, the Federal Reserve Board, the NAIC, and the insurance regulators from the 56 states and territories.

The ICPs provide a global framework for insurance supervision that is accepted by all IAIS member jurisdictions. They apply to all insurance companies and groups, regardless of size, complexity, types of products, or level of international activity. The ICPs are not self-executing; they must be adopted into law by the member countries. Member countries have the flexibility to tailor their laws and regulations to achieve the outcomes stipulated in the ICPs.

ComFrame builds upon the ICPs, focusing on effective groupwide supervision of

["The View from Overseas" continues on page 12]

IN THIS ISSUE

1 The View from Overseas

2 The Challenges of Legacy LTCi Resolution

4 Ready for a New Year

8 A Whole New World

22 Calendar

President's Column by Peter G. Gallanis

The Challenges of Legacy LTCi Resolution

As I write this, various commentators are noting that the coronavirus pandemic first hit home for Americans about a year ago, when the NBA and other sporting seasons were suspended, and when most places of business essentially halted on-premises work. Shortly after that, the dreadful counts of new cases, hospitalizations, and deaths took off. The effects in the insurance world were as sudden and dramatic as they were everywhere else. Whatever one's priorities might have been until then, they changed almost overnight to pandemic response efforts.

A year ago, I had been working on a column about the challenges of resolving legacy long-term care insurance (LTCi) blocks of business. Like everyone else, I changed course and began working with friends and colleagues in the guaranty system, in industry, and in the regulatory world as we tried to assess the nature and reach of the pandemic's threat to the insurance sector and how best to move forward for the benefit of the constituencies we serve.

Now, with more than 100 million Americans vaccinated (and with millions more being added every day), and with infection numbers having fallen significantly below where they were in January (though still too high for comfort), we all hope and pray that soon we will be able to return to the lives that we set to the side a year ago. For me, that means bringing this column back to the topic of legacy LTCi resolution challenges.

(I note at the outset that the opinions and assertions in this column are my own alone; I do not now speak for the NOLHGA Board, NOLHGA's MPC or Penn Treaty Task Force, or any guaranty association or member company. Very likely, opinions to the contrary are held in good faith by others in the guaranty system.)

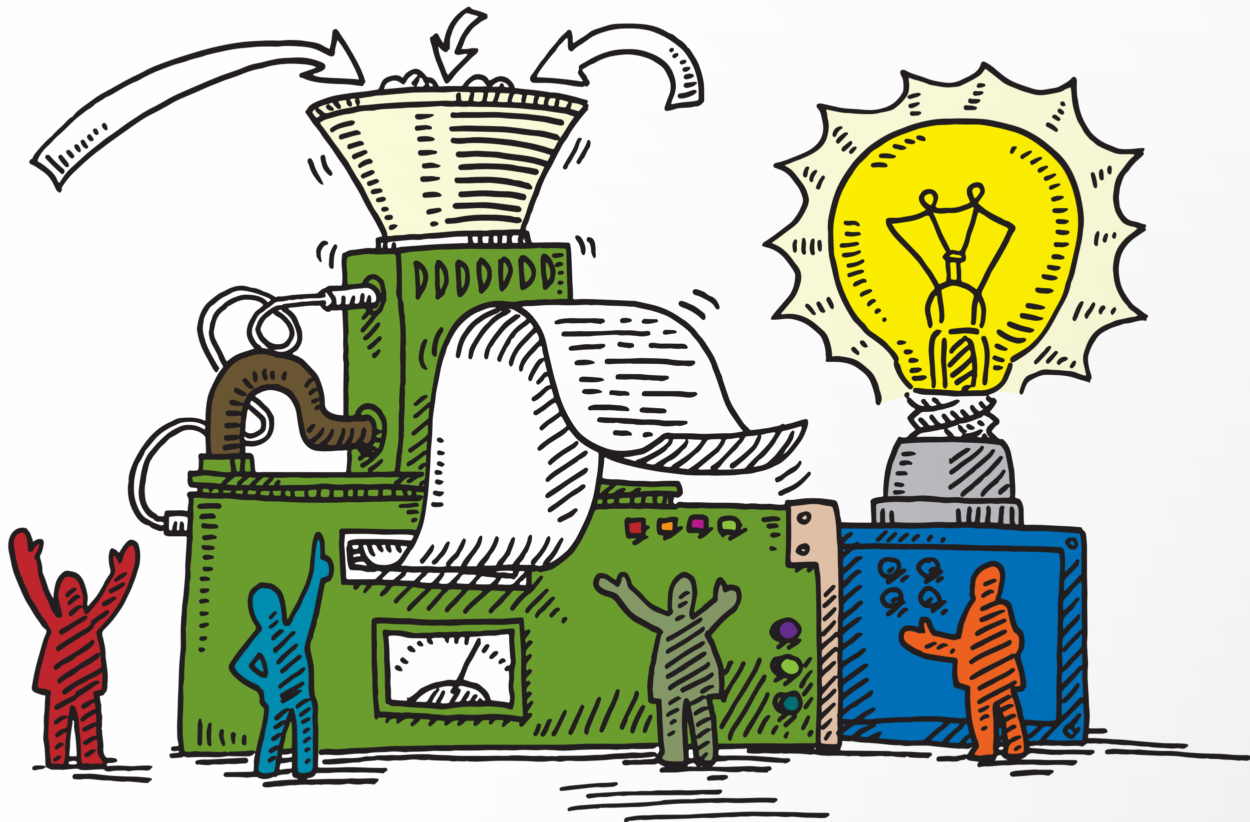
Critical Thinking about Insurance Resolution. This column was originally intended—before the pandemic—to be the third in a series of articles suggested by MPC Chairs Pamela Olsen and Tom Sullivan on how our successful Guaranty Association Task Force teams have analyzed the problems to be solved in major insolvencies, and how such analysis in turn can lead to the development of the best possible guaranty system–supported resolution plans. The first column was about the development of the ELNY plan[1], and the second was about the development of the Penn Treaty plan.[2] In this column, I'll try to address what the lessons learned in developing the ELNY and Penn Treaty resolution plans suggest about resolving legacy LTCi business, particularly for companies in financial distress.

Funding Gaps & Mousetraps

When I wrote the earlier article on the development of the Penn Treaty plan, I was guided by the observation of the brilliant American inventor and engineer Charles F. Kettering, who once said that "…[a] problem well stated is a problem half solved." What I tried to do in that article was to state as well as I could the list of significant, discrete needs that must be addressed regarding a failed or failing block of LTCi policies. The column described how those problems were addressed in the laboratory of the Penn Treaty case, and then began to consider whether—as some have suggested—other approaches to legacy LTCi in a troubled company situation might yield a better outcome.

Put another way, it has been suggested that it is possible to "build a better mousetrap" to address troubled company LTCi blocks. Is that true? If it were, I suspect that we would all cheer such an option. But let's review again what material,

> "Certain core realities about the legacy LTCi challenge are both fundamental and also largely unknown to those who haven't had the mixed pleasure of having to resolve a legacy LTCi block, as we in the guaranty system have done."



discrete needs must be met in such a situation. Then let's consider what we now know that we can do—and have done—to address those identified needs. And then let's begin to take up the challenge we've heard from outside commentators, who ask if there are things that can be done differently that might yield better results for stakeholders.

Defining LTCi Resolution Challenges. Certain core realities about the legacy LTCi challenge are both fundamental and also largely unknown to those who haven't had the mixed pleasure of having to resolve a legacy LTCi block, as we in the guaranty system have done. Here's a review of the most significant of those challenges, which were noted at greater length in the earlier Penn Treaty column.

The Funding Gap. The first and most obvious problem for any failing legacy LTCi block is the inadequacy of funding sources. That is, the reason that the block is failing is that scheduled future premiums, plus invested assets (including projected investment earnings), are inadequate to pay when due projected insurance policy benefits and the costs of administering those benefits (let alone to pay taxes and commissions and yield a profit). Quantifying this "funding gap" presents two challenges: Accurately quantifying funding needs, and analyzing and strategizing for the application of funding sources.

As the earlier article notes, there are, of course, technical challenges in quantifying both the value of funding source components and the value of funding needs—particularly reserves for benefits to be paid; but in a nutshell, that's a solvable math problem. The shortfall between funding sources and funding needs is the essential financial problem in legacy blocks. As former Texas Commissioner Sullivan noted at NOLHGA's last in-person Annual Meeting at Austin in October 2019, there is no easy and pain-free way to eliminate that shortfall.

In addressing a legacy LTCi block funding shortfall, who might suffer the pain that Commissioner Sullivan described? If the insurer has a small, unprofitable LTCi block and lots of profitable non-LTCi business, the shortfall might be defrayed by surplus from other, profitable lines written by that insurer. Healthy multi-line carriers hate that idea, but that is what is actually happening with *most* LTCi legacy business today: The majority of outstanding LTCi business resides on the books of companies that are reasonably financially strong.

["President's Column" continues on page 16]

Ready for a New Year

NOLHGA's 2020 Annual Meeting examined how the industry and guaranty system adapted to the challenges of 2020 and prepared themselves for 2021

By Sean M. McKenna

NOLHGA completed its 2020 meetings with its 37th Annual Meeting in October. Originally slated to be held in Nashville, the meeting moved online due to pandemic-related travel restrictions, meaning that it was instead viewed from attendees' homes or offices (or local Starbucks, if they could find one that was open).

The 2020 Annual Meeting featured an abbreviated agenda, with four closed-session presentations by receivership task forces; addresses from the Incoming and Outgoing Chairs (see "NOLHGA Chairs Praise System's Ability to Adapt" on p. 6); the President's Address (an edited transcript of which appeared in the November 2020 *NOLHGA Journal*); and panels on the economic impact of the COVID-19 pandemic and the outlook for the insurance industry.

The two panels—*COVID-19: Economic Impacts & the Paths to Recovery* and the *Industry Outlook Panel*—looked at the current state of the pandemic and the insurance industry before turning their attention to 2021 and beyond. Here's a summary of general observations and the panelists' thoughts about the future.

Roads to Recovery

In the *COVID-19* panel (moderated by NOLHGA President Peter Gallanis), noted economist Ed Dolan (The Niskanen Center) said that despite initial hopes for a quick recovery, the damage to the economy was so great that "it's going to look a lot more like a long-tailed Nike swoosh than a V." While he praised early stimulus efforts ("to its credit, Congress acted very quickly"), he added that most of those efforts fell short in one way or another.

The Payroll Protection Plan, he said, was underfunded and not well-targeted. The direct payments to consumers were hamstrung by the use of state unemployment agencies, which were not designed to handle that kind of effort. And, because the nation's health insurance system is largely based on employer-sponsored insurance ("some people would call employer-sponsored insurance the original sin of U.S. healthcare," Dolan said), millions lost their insurance as unemployment skyrocketed.

Dolan then focused on ideas that could help the United States better respond to the next crisis. He pointed to the German *Kurzarbeit* ("short work") system, which keeps workers on the payroll, at reduced

hours, during a crisis. "Everybody—firms, workers—is registered with it," he explained. "Normally they don't get payments, but when trouble strikes, they can activate it at the push of a button." That push button quality, he added, would be useful with both cash payments to consumers and insurance.

For cash payments, he pointed to Milton Friedman's negative income tax proposal or what he called the "modern version" of it, the universal basic income: "The idea here is that this would enroll everybody in the country in a system, which would allow them to get small payments every month." With the system already in place, payments could be tailored to meet the demands of a new crisis.

Dolan suggested that the same thing could be done with insurance. "At the Niskanen Center, we've been promoting a form of insurance called universal catastrophic policy, which enrolls everyone in a baseline plan that has an income-based high deductible," he said,. "It's not all the insurance everybody needs; it's all the insurance some people need." All these ideas, Dolan explained, are based on the same principle: "The most important thing is that this would be an always-on system, just like your television set. One that's set to standby—that you can turn back on at the touch of a button to meet the unexpected."

Sally Rosen (AM Best Rating Services) provided the outlook for the health insurance industry in 2021, noting that high unemployment meant a decrease in the commercial market, which could have far-reaching effects. "When you have a decrease in commercial enrollment, you tend to have increasing numbers of individuals eligible for Medicaid as they lose their jobs," she explained. "State budgets are already under pressure from loss of revenue. Adding individuals to the Medicaid rolls could further pressure state budgets."

A bigger concern in the health market is the prospect of increased morbidity in 2021 and beyond due to the pandemic. "You have individuals with medical conditions who did not go to the doctor, as well as conditions that were not diagnosed as part of preventative exams," she said. "Left untreated, that can result in higher morbidity." This is in addition to the possible long-term effects of COVID-19, which aren't known at this time.

Rosen added that so far, the pandemic has had a beneficial effect on the long-term care (LTC) market. "There's been an increasing number of families that removed their loved ones from nursing facilities over the concern of the spread of the virus," she explained. "From a long-term care perspective, it's actually less expensive to care for an individual at home than it is in a long-term care facility, so that can lower the claim." Overall, LTC claims have decreased during the pandemic, she said.

Turning to the life and annuity industry, Tom Rosendale (also with AM Best Rating Services) said that the future looks murky, especially on the asset side of insurers' balance sheets. "What we're concerned about is asset impairments, such as bond defaults and further rating downgrades," he said. "It's going to be sector specific, obviously." One sector he has his eye on? "Commercial mortgage loans are about 12% of invested assets for life and annuity companies in the United States, and loss recognition in that asset class takes a while to emerge."

Rosendale also predicted some trouble in the pension plan sector ("we would expect declines in the discount rate assumptions, which will affect pension

"At the Niskanen Center, we've been promoting a form of insurance called universal catastrophic policy, which enrolls everyone in a baseline plan that has an income-based high deductible."

Ed Dolan

plan liabilities") and with interest-sensitive products. "Companies will de-emphasize products like fixed deferred annuities or indexed annuities and variable annuities," he said. "Even if companies don't withdraw from a product category, if they price themselves out of the market, it's effectively a product withdrawal."

In closing, Rosendale said that AM Best has concerns about a number of sectors, including leisure/hospitality, transportation, restaurants, and retail. Looking at specific asset classes, he singled out structured securities, the sovereign debt of nations that rely on tourism, and commercial mortgages—with that last one being particularly tricky. "Companies may move toward permanent or close to permanent work-from-home scenarios for more employees," he said. "Does that reduce the demand and the valuations of

NOLHGA Chairs Praise System's

Ability to Adapt

Outgoing NOLHGA Chair Tom English and Incoming Chair Bob Corn both praised the guaranty system's ability to adapt to changing times in their addresses at the 2020 Annual Meeting. English pointed to the greatest change facing the system (and the world)—the COVID-19 pandemic. "The NOLHGA team did an excellent job managing some very trying times," he said, "and it's a tribute to our members that our system really didn't miss a beat as we all learned to work virtually."

Tom English

Bob Corn

English noted that the issues the system thought it would face in 2020—low interest rates, trouble in the long-term care (LTC) insurance market, private equity investors entering the market, and business transfer and corporate division legislation—are still waiting for us in 2021, but he added that "we're well-positioned to get back in front of policymakers as the pandemic moves into the rearview mirror."

In addition, he said that the current LTC receiverships highlight the importance of NOLHGA's GA Laws Committee, which assists states in bringing their guaranty association statutes in line with the most recent version of the NAIC GA Model Act: "If these receiverships turn into liquidations, having all the guaranty associations working from the same playbook will make all our lives—and the lives of policyholders—a lot easier."

English closed his remarks by calling for one more change—a change back to when NOLHGA held in-person meetings (once the pandemic is under control). "You just can't replicate the conversations in the hallways or the lunch lines, or the working relationships that start over a meeting or lunch," he said. "We're welcoming a lot of new people into our system, and that's always done best when it's done in person."

Corn picked up on the theme of welcoming new members to the guaranty community in his remarks. "I've heard people express concerns about the guaranty system and how we've lost a lot of talented administrators," he said. "But I'm encouraged by the new administrators who have stepped up and filled the shoes of their predecessors. The guaranty system will evolve, survive, and even thrive with new members."

Corn also noted that the insurance industry adapted to a number of challenges in 2020. "It's been particularly gratifying to see the various accommodations the insurance industry has made for people facing financial hardship as a result of the pandemic," he explained. "But it's also been heartening to see the renewed and enhanced commitment and concrete actions the insurance industry has taken to promote inclusion and diversity and to address and redress inequality and systemic racism."

In closing, Corn reminded the audience of the vital role the insurance industry plays in supporting policyholders—"we're here for people at their worst moments"—and the equally vital role the guaranty system plays in supporting the industry and state regulation. "The guaranty system is the safety net for the people who rely on insurance," he said. "You can be assured that if we ever fail in our mission to protect policyholders of insolvent insurance companies, there would be a demand for change to the state-based system of insurance regulation."

commercial real estate, particularly office space? On the other hand, they may utilize more space per person to maintain distancing. It's a concern that we have, but it's a little difficult to assess just yet."

Choose Your Disruption

The *Industry Outlook Panel* (moderated by Prudential Financial's Gerrie Marks, who's also a member of the NOLHGA Board of Directors) took up some "difficult to assess" issues facing the life, annuity, and health insurance industry—not just the pandemic, but new technologies, new markets, and legislative and political changes.

On the technology front, Wayne Chopus (President and CEO of the Insured Retirement Institute, or IRI) admitted that "the life and annuity sales process is highly antiquated—not exactly the Amazon-like experience a lot of our consumers and advisors expect." His organization is working to change that by releasing four guiding principles for annuity sales—using e-signatures on all possible transactions, moving to a risk-based supervisory model on transactions that can't employ e-signatures, suspending Medallion Signature Guarantee requirements, and adopting alternative means of delivery for all policies and supporting documents. Chopus emphasized that these changes are not simply short-term fixes for annuity sales during the pandemic—they're long-term goals for the IRI's members.

Aaron Sarfatti (Equitable) picked up on Chopus's point, noting that Equitable's annuity sales process moved online in April 2020. "You had a cohort of advisors who were slow to adopt, and this kind of forced the issue," he said. "It was either do business this way, or you struggle to do business. It happened very quickly, and I absolutely don't see it going back." He added that Equitable's life insurance business accelerated its use of "big data" in underwriting during the pandemic.

Beth Fritchen (Oliver Wyman Actuarial Consulting) noted that new technology played a large role in the way health insurers adapted to the pandemic. In addition to the rise of telehealth, "health insurance companies are using a lot of artificial intelligence and predictive modeling in their underwriting to become more efficient," she said. "They've been doing a lot with predictive analytics, trying to figure out the total cost of care, optimizing pricing, and classifying risk as best they can."

Turning to new markets, both Chopus and Sarfatti were bullish on the rise of annuity products in corporate retirement plans—part of the Secure Act of 2019 and its successor, the Securing a Strong Retirement Act of 2020 (or Secure 2.0). Sarfatti called the inclusion of annuities in corporate retirement plans a "game changer," and Chopus noted that much of the IRI's five-point plan to help people recover retirement income lost during the pandemic (see "Social Distance Learning" in the November 2020 *NOLHGA Journal*) has been incorporated into Secure 2.0.

It's more or less illegal to hold a panel one week before a presidential election and not ask for predictions, and Fritchen bravely stepped forward to offer her opinion on what a Biden win might mean for the health industry. "The Biden plan has a public option, and it's got Medicare at 60, so it could be really disruptive to the private insurance market" she said. "It's going to depend on the reimbursement rates that are assumed in that public option. If they're at Medicare payment rates, we could see a large part of the private employer insurance members moving over to that public option."

Fritchen added that, oddly enough, the public option probably won't result in a huge drop in the number of uninsured people. "You could have people who had insurance through their employers becoming uninsured, and they're healthy enough that they don't choose to buy the public option," she said. "That's what our modeling has shown with the Biden plan."

Thanks again to everyone who attended or presented at the 2020 Annual Meeting. We hope to see you all at the 2021 Annual Meeting! ✪

Sean M. McKenna is NOLHGA's Director of Communications.

"You had a cohort of advisors who were slow to adopt [to online annuity sales], and this kind of forced the issue. It happened very quickly, and I absolutely don't see it going back."
Aaron Sarfatti

UNITED STATES
PRESIDENTIAL ELECTION
VOTE
2020
DEMOCRAT
REPUBLICAN

A Whole New World

What impact will the 2020 elections—state and federal—have on the insurance industry and the guaranty system?

By Pat Hughes, Jigar Gandhi & Kacey Stotler

After a contentious election cycle, followed by even more acrimony in the months following the November 2020 elections, the Biden Administration has taken office with the express intent of applying a different approach to financial services regulation. The guaranty system, like all stakeholders, needs to assess the potential impacts of the new Administration, new leadership in Congress, newly staffed federal agencies, and changes in state government.

NOLHGA has engaged in a federal education project for several years, interacting regularly with members of Congress, the Federal Reserve, the Federal Insurance Office (FIO), the Financial Stability Oversight Council (FSOC), and the FDIC. These efforts have established the credibility of the guaranty system and helped us form relationships with policymakers on both sides of the aisle. The education project will continue in 2021 and beyond, but some of the major players have changed.

Not Much of a Wave

Despite predictions of a "blue wave" that would give Democrats control of the Senate and a larger majority in the House, Republicans ultimately out-performed expectations.

In the House, Republicans picked up 14 seats, narrowing Democrats' majority to just 11 seats. As a result of their victories, Republicans will increase their representation on important committees, such as the House Financial Services Committee.

Among the key losses for Democratic incumbents was Representative Lacy Clay (D-MO), who narrowly lost to Cory Bush in the Democratic primary (Bush went on to beat Anthony Rogers (R), Alex Furman (L), and Martin Baker (I) in the general election). Prior to his defeat, Rep. Clay chaired the Financial Services Committee's Subcommittee on Housing, Community Development, and Insurance. The subcommittee has jurisdiction over insurance generally, in addition to finance and economic stabilization issues. Clay's

replacement, Representative Emanuel Cleaver (D-MO), will have considerable influence over the direction of insurance-related policy in the House.

In the Senate, the Republicans' loss of Georgia seats held by Kelly Loeffler and David Perdue overshadows the victories by incumbents Susan Collins (Maine) and Thom Tillis (North Carolina), whose seats were at risk. Incoming Democratic freshmen Raphael Warnock and Jon Ossoff will replace Loeffler and Perdue, resulting in a 50-50 tie in the Senate. This means that Vice President Kamala Harris will break any tied votes in her capacity as President of the Senate.

As a result of the tie, Senate committees will have the same number of Democrats and Republicans on each, but Democrats will control the legislative agenda. The tie will also greatly empower moderates, who will hold crucial votes on issues on either side of the aisle, an effect that has already emerged in the early days of the administration and Congress. A tied Senate last occurred in 2000 at the outset of the George W. Bush Administration.

The work of the Senate Banking Committee will remain important, given its jurisdiction over insurance, finance, and economic stability. Senator Sherrod Brown (D-OH), the incoming Chairman of the committee, has continually pushed for stricter government oversight of the financial services industry. In recent comments, Sen. Brown stated that the Banking Committee will seek to improve housing and banking services for low-income Americans, fight global warming, and foster racial equality. He has also urged the Biden Administration to bring on more activist regulators.

Pat Toomey (R-PA) has replaced Senator Mike Crapo (R-ID) as the committee's Ranking Member since Crapo was term-limited out of the committee (he is now Ranking Member of the Senate Finance Committee). Sen. Toomey—who is viewed as a pragmatic, moderate senator—is not running for re-election in 2022 and therefore will be operating as a lame-duck member until the end of his term.

The Biden Team

President Biden has named several professionals familiar with policymaking in the Nation's Capital to his administration, including current members of Congress. With unified Democratic control of the White House and Congress, some have urged Biden to push an aggressive agenda. However, tight margins in both the House and Senate will limit the possibility of a bold, far-reaching progressive legislative agenda for at least two years. The expected lack of bipartisan consensus in Congress will likely result in greater action through executive orders and rulemaking. We have already seen that start to play out in the early stages of the Biden administration.

President Biden's choice for Treasury Secretary, Janet Yellen, previously served as Chair of the Federal Reserve under President Obama and head of the Council of Economic Advisors under President Clinton. Her appointment likely signals a return to a more activist FIO.

The Federal Reserve will continue under its current leadership, with Jerome Powell remaining as Chair until at least 2022 and Randal Quarles continuing to serve as the Vice Chair for Supervision until October 2021. Quarles also serves as Chair of the G-20's Financial Stability Board, which monitors financial stability on a global scale.

Quarles is viewed as a strong voice on insurance issues. Under his leadership, the Federal Reserve's proposed building blocks approach as a group capital requirement would aggregate state-based insurance entity capital requirements under Federal Reserve jurisdiction into a consolidated requirement. The proposal would establish minimum requirements and a buffer on top of the minimum.

Due to the de-designation of insurance SIFIs during the Trump administration, we saw less Federal Reserve engagement at the International Association of Insurance Supervisors (IAIS). If we see a rise in Federal Reserve oversight of insurance activities in the Biden Administration, the Federal Reserve's activism at the IAIS may increase.

State of (Very Little) Change

Although federal elections get much of the press attention, insurance is obviously regulated by the states, so state government has a large impact on the industry and the guaranty system. In 2020, state elections resulted in minimal change.

Gubernatorial races played out as expected. All nine incumbent governors won their races—Democrats in Delaware, North Carolina, and Washington, and Republicans in Indiana, Missouri, North Dakota, New Hampshire, West Virginia, and Vermont. Republicans also captured the two open gubernatorial seats, with Greg Gianforte winning in Montana and Spencer Cox winning in Utah.

Republicans continued their success in state legislatures. They maintained every state legislature the party controlled before the election and flipped control of both the New Hampshire House and Senate. Following the 2020 election, Minnesota remains the only state with a "split" legislature, with a Republican State Senate and a Democratic State House.

Insurance commissioner races also favored the status quo, with all four incumbent insurance commissioners retaining their seats—Trinidad Navarro (Delaware), Mike Causey (North Carolina), Jon Godfread (North Dakota), and Mike Kreidler (Washington). Republicans' ability to capture open seats extended to insurance commissioners, with Troy Downing winning the open seat in Montana. While these elected commissioners hold prominent positions on various NAIC committees, none currently lead work streams directly affecting solvency or receivership matters.

Unlike the results of the 2020 election, last year saw considerable churn for appointed positions. The vast majority of insurance commissioners (45 out of 56) are gubernatorial or mayoral appointments. Nine new commissioners were appointed (Arizona, Arkansas, the District of Columbia, Illinois, Kentucky, Ohio, New Hampshire, Tennessee, and Utah). As of March 2021, Minnesota and Texas have interim appointments.

Changes at the NAIC

Commissioner David Altmaier (Florida) assumed the NAIC presidency on January 1, 2021, continuing as a steady voice for NAIC leadership. Commissioner Altmaier has long been influential within the NAIC, successfully leading important workstreams such as the Group Capital Calculation Working Group. Director Dean Cameron (Idaho) and Director Chlora Lindley-Myers (Missouri) became the NAIC President-Elect and Vice President, respectively. NAIC members elected Commissioner Andrew Mais (Connecticut) as Secretary-Treasurer, setting him up to become NAIC President in 2024.

NOLHGA is committed to working to maintain strong relationships with NAIC leadership and insurance commissioners.

On the committee front, the NAIC's Receivership and Insolvency (E) Task Force (RITF) leads NAIC workstreams related to insurer insolvencies. This includes monitoring the effectiveness and performance of state administration of receiverships and the state guaranty system; coordinating cooperation among regulators, receivers, and guaranty associations; and adopting revisions to the *Receivers Handbook*, among other tasks.

The RITF oversees two working groups addressing issues important to the guaranty system: the Receivership Financial Analysis Working Group (RFAWG) and the Receivership Law Working Group (RLWG). RFAWG monitors receiverships involving nationally significant insurers, while RLWG reviews and provides recommendations on any identified issues that may affect states' receivership and guaranty association laws.

The 2020 election cycle did not significantly impact the work of the RITF or its working groups. Texas chaired the RITF in 2020, but it currently has an acting commissioner. Administrations overseeing the leadership of RFAWG and RLWG were not affected by the elections.

Given solvency concerns and receivership activity in the long-term care insurance (LTCI) marketplace, the work of the NAIC's Long-Term Care Insurance (EX) Task Force has been of particular interest to the guaranty system. The task force has focused on legacy LTCI blocks, in particular the rate increase approval process for such blocks, and that focus is expected to continue into 2021.

Similar to the RITF, the election did not significantly affect the 2020 leadership of the LTCI Task Force. Scott White (Virginia) and Michael Conway (Colorado) will continue to chair the task force and are viewed by industry as steady and knowledgeable regulators.

The NAIC's Restructuring Mechanisms Working Group (RMWG) is charged with drafting a white paper on the perceived need for restructuring statutes and the impact that restructuring may have on guaranty associations and policyholders. The election cycle did not affect the leadership of RMWG. Co-chairs Glen Mulready (Oklahoma) and Elizabeth Dwyer (Rhode Island) appreciate the importance of preserving guaranty association coverage in any restructuring, and NOLHGA will continue to contribute to the dialogue and development of models on the topic.

What It All Means

With 38 gubernatorial elections and midterm elections in 2022, the next two years will serve as a referendum on state governors as the country looks to move beyond the COVID-19 pandemic. The next two years will also be key for President Biden, who will seek to advance his priorities with narrow Democratic majorities in Congress.

Regardless of who is in office, guaranty associations will need to continue to engage with policymakers. By maintaining frequent communication with regulators, policymakers, and stakeholders, NOLHGA can work to ensure that those making decisions about resolution policy have a solid understanding of how well the U.S. guaranty system has protected policyholders over the years. ✯

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["The View from Overseas" continues from page 1]

internationally active insurance groups, or IAIGs. It's designed to help supervisors address groupwide risks and avoid supervisory gaps by providing a common language. Like the ICPs, ComFrame elements must be adopted by individual jurisdictions to have the force of law.

NOLHGA Journal: *Could you remind me what an IAIG is?*
Sara: An IAIG is an insurance group that (1) writes in at least three jurisdictions, with more than 10% of its gross premiums coming from outside its home jurisdiction; and (2) based on a 3-year rolling average, has total assets of at least $50 billion or total gross written premiums of at least $10 billion.

NOLHGA Journal: *Were there any elements of the ICP and ComFrame standards adopted in November 2019 that garnered more attention than others?*
Sara: Absolutely. Over the last few years, most of the industry's interest in international standard setting has centered on the insurance capital standard (ICS), which is part of ComFrame. The ICS is a consolidated groupwide capital standard that is intended to give supervisors of IAIGs a common language to discuss solvency around the globe. When it adopted ComFrame in November 2019, the IAIS also adopted ICS Version 2.0, which is to be used during a five-year monitoring period, which started on January 1, 2020. During the monitoring period, the ICS will be used for confidential reporting and discussion among supervisors in supervisory colleges to identify flaws or unintended consequences in the ICS.

NOLHGA Journal: *So the IAIS's package of international standards was adopted in November 2019. What happened next?*
Scott: Like most of the world, as the implications of the COVID-19 pandemic became more apparent, the IAIS delayed or suspended almost all activity that had been planned for 2020 and shifted to monitoring the impact of COVID-19 in the global insurance sector, particularly any build up of systemic risk.

During the monitoring period, the insurance capital standard (ICS) will be used for confidential reporting and discussion among supervisors in supervisory colleges to identify flaws or unintended consequences in the ICS.

In 2019, the IAIS adopted a framework, called the Holistic Framework, designed to move systemic regulation away from a purely entity-based approach toward a more activities-based approach. As part of this global monitoring function and in response to the COVID-19 pandemic, the IAIS issued a data call to large, internationally active insurers seeking information about the impact of the pandemic on insurers operationally and financially.

The IAIS also turned its attention to emerging issues affecting the global insurance industry, including climate risk, aging populations, InsurTech, cyber risk, financial inclusion, and sustainable development. In February 2020, the IAIS published an issues paper on the insurance industry's use of big data, algorithms, advanced analytics, and artificial intelligence. In October 2020, it issued for public consultation a draft Application Paper on the Supervision of Climate-related Risks in the Insurance Sector, with comments due in January 2021.

NOLHGA Journal: *How is the United States responding to the adoption of the ICPs and ComFrame?*

Sara: At the NAIC's 2019 Fall National Meeting, the Group Solvency Issues (E) Working Group asked NAIC staff to review ComFrame to identify any "significant elements not already incorporated into the US system of insurance regulation." In February 2020, NAIC staff reported that many of the key elements of ComFrame already are included in U.S. law and that certain other elements may not be appropriate for the United States. The NAIC staff also identified, at a high level, some potential gaps in U.S. law and recommended actions to fill those gaps. At the 2020 Virtual Summer National Meeting, the working group decided to form drafting groups to propose revisions to the NAIC handbooks and the Own Risk and Solvency Assessment (ORSA) Guidance Manual as appropriate to further ComFrame implementation. The drafting groups continue their work to identify potential areas for improvement of the handbooks. We expect to see further developments from these drafting groups this year.

The United States does not intend to implement the ICS for U.S.-based IAIGs. Rather, the NAIC is working with other authorities, both domestic and international, to develop an outcome-equivalent alternative to the ICS called the "Aggregation Method." The Aggregation Method leverages current legal entity reporting and required capital to produce a measure of group capital adequacy.

Scott: The IAIS is in the process of developing criteria to assess whether the Aggregation Method provides comparable outcomes to the ICS. The IAIS has developed (1) a draft definition of comparability, and (2) draft high-level principles to inform the criteria that will be used in the assessment; both of these are the subject of a current consultation, with comments due this past January. The IAIS comparability assessment is scheduled to be completed by the end of the five-year monitoring period so that the ICS (and potentially the Aggregation Method) can "go live" on January 1, 2025.

In Case You Need a Glossary

ComFrame	Common Framework for the Supervision of Internationally Active Insurance Groups
EIOPA	European Insurance and Occupational Pension Authority
FSB	Financial Stability Board
IAIG	Internationally Active Insurance Group
IAIS	International Association of Insurance Supervisors
ICPs	The IAIS's Insurance Core Principles
ICS	International Capital Standard
IFIGS	International Forum of Insurance Guarantee Schemes
Insurance KAAM	The FSB's Key Attributes Assessment Methodology for the Insurance Sector
PPS	Policyholder Protection Scheme
ReWG	The IAIS's Resolution Working Group

NOLHGA Journal: *Fascinating. The IAIS has clearly been quite busy. Have resolution matters dropped off the radar?*

Sara: It is true that the resolution elements of the ICPs and ComFrame have been stable since 2018. The IAIS's Resolution Working Group (ReWG) has been working to supplement those resolution elements by drafting application papers on resolution-related topics. When we spoke in 2018, we discussed a paper on recovery planning that the ReWG had in the works. That paper was adopted in November 2019.

On November 9, 2020, the ReWG published a consultation paper on resolution powers and planning, which was open for comment until February 5.

Scott: The goal of the paper is to provide guidance on supervisory practices related to resolution (which is defined by the IAIS as "actions taken by a resolution authority towards an insurer that is no longer viable, or is likely to be no longer viable, and has no reasonable prospect of returning to viability"). It focuses on (1) resolution powers—the toolkit that resolution authorities should have at their disposal when faced with an insurance company resolution; and (2)

As part of this global monitoring function and in response to the COVID-19 pandemic, the IAIS issued a data call to large, internationally active insurers seeking information about the impact of the pandemic on insurers operationally and financially.

resolution plans—methods for identifying in advance the options for resolving all or parts of an insurer or insurance group with the aim to be better prepared for resolution.

NOLHGA Journal: *Does the paper address Policyholder Protection Schemes (PPSs)—the international name for guaranty systems?*

Sara: It does, and in a way about which we are pleased. Comments from NOLHGA and the National Conference of Insurance Guaranty Funds (NCIGF) on international resolution policy over the past several years have centered on three key themes: (1) policyholder protection must be a resolution priority, as opposed to a singular focus on financial stability; (2) a PPS must be brought into a proposed resolution early so that the PPS can do its job more effectively; and (3) a PPS is not just a checkbook, but instead can be a source of information and experience in planning for a resolution. Due to consistent messaging by NOLHGA and the NCIGF over the years, all three themes were contained in the public consultation draft!

NOLHGA Journal: *That's great news. Given that, did NOLHGA comment on the resolution consultation paper?*

Scott: Oh, for sure. NOLHGA's comments emphasized the importance of involving PPSs in resolution planning and strategizing. The consultation paper also suggests that resolution planning and resolvability assessments may require specific information from PPSs, including PPS coverage and capacity, which NOLHGA intends to address.

NOLHGA Journal: *So, no further action on the resolution front?*

Sara: The ReWG will consider drafting an application paper specifically focused on the role of PPSs in resolution, with a public consultation expected in the second or third quarter of 2022. You better believe we will be keeping an eye on that.

Scott: There has been news from the Financial Stability Board (FSB). As a reminder, the FSB was formed by the G20 to bring together senior policymakers from ministries of finance, central banks, and supervisory and regulatory authorities for the G20 countries and key financial centers, as well as international and regional standard-setters like the European Central Bank and European Commission. The FSB's mission is to promote and monitor global financial stability by setting internationally agreed upon policies and minimum standards that its members commit to implement at the national level.

Sara: On August 25, 2020, the FSB published the Key Attributes Assessment Methodology for the Insurance Sector (Insurance KAAM). To put this in context, in 2011 the FSB adopted the Key Attributes of Effective Resolution Regimes (the "Key Attributes"), setting forth inter-

national standards for the resolution regimes that should be applied to any financial institution that "could be systemically significant or critical if it fails." In 2014, the FSB adopted an annex that clarified how the Key Attributes should apply in the insurance context, including Crisis Management Groups, resolvability assessments, and recovery and resolution planning.

The 2020 Insurance KAAM sets out the methodology to assess whether a jurisdiction complies with the Key Attributes in the insurance sector. The Insurance KAAM will be used in a jurisdiction's resolution regime self-assessment; peer assessments; and IMF/World Bank assessments, including the Financial Sector Assessment Program (FSAP).

NOLHGA Journal: *Are PPSs mentioned?*

Scott: They are, and in an important way. The Insurance KAAM sets out five "pre-conditions" that a jurisdiction should have in place to support an effective resolution regime. One of those preconditions focuses on the need to have a mechanism for protecting policyholders. Jurisdictions that have a PPS should (1) promote a high level of coordination and cooperation between a PPS and other agencies to support clear allocation of responsibilities, accountability, and effective crisis management; and (2) ensure the involvement of a PPS at a sufficiently early stage of a crisis if it is necessary to facilitate the resolution of an insurer.

Sara: Again, this is a big deal because those two criteria reflect the themes that NOLHGA and the NCIGF have been conveying to international standard setters for years. The FSB has aligned with our worldview.

NOLHGA Journal: *That's great—there's always plenty of room on that bandwagon. Switching gears a little, when we last spoke, you had recently represented the U.S. guaranty system at a recovery and resolution program hosted by the European Insurance and Occupational Pension Authority (EIOPA).*

Scott: That's right. As a reminder, EIOPA is an independent advisory body to the European Commission, and it helps shape policy at the EU and member-state levels. EIOPA actually directed the speaking invitation to the International Forum of Insurance Guarantee Schemes (IFIGS). Peter Gallanis and NCIGF President Roger Schmelzer thought it wise for the U.S. guaranty system to be represented at the EIOPA program, and that turned out to be a really good decision. A few months after the program, the European Commission asked EIOPA whether the national insurance guarantee schemes in the EU should be harmonized. Given the potential impact this could have on IAIS standard setting, we were eager to have some input on EIOPA's recommendations.

NOLHGA Journal: *Were we able to have any input?*

Scott: Quite a bit, thanks to our active participation in IFIGS. Here were some of the highlights:

- We participated in a workshop on Solvency II and insurance guarantee schemes at EIOPA's offices in Frankfurt.
- We commented on EIOPA's consultation paper that discussed whether and how to harmonize the EU's national insurance guarantee schemes.
- Dimitris Zafeiris, Head of EIOPA's Risks and Financial Stability Department, spoke at the IFIGS 2019 Annual Conference, which the NCIGF and NOLHGA hosted in Washington.
- We participated in a second workshop in Frankfurt that was focused exclusively on insurance guarantee schemes.
- After EIOPA delivered its formal recommendations to the European Commission calling for a European network of national insurance guarantee schemes with minimum harmonization, we participated in a third workshop that focused on how to operationalize EIOPA's recommendations.

The EIOPA representatives clearly appreciate getting input from IFIGS, even though they don't agree with us on all counts.

NOLHGA Journal: *It sounds like our participation in IFIGS is really paying off.*

Scott: We totally agree. Without our participation in IFIGS, we wouldn't have been included in any of the EIOPA conversations. It's still a young organization, but IFIGS is gaining recognition among international policymakers as a valuable resource on resolution and insurance guarantee scheme matters. NCIGF President Roger Schmelzer chaired the organization in 2019 and laid the groundwork for IFIGS's future.

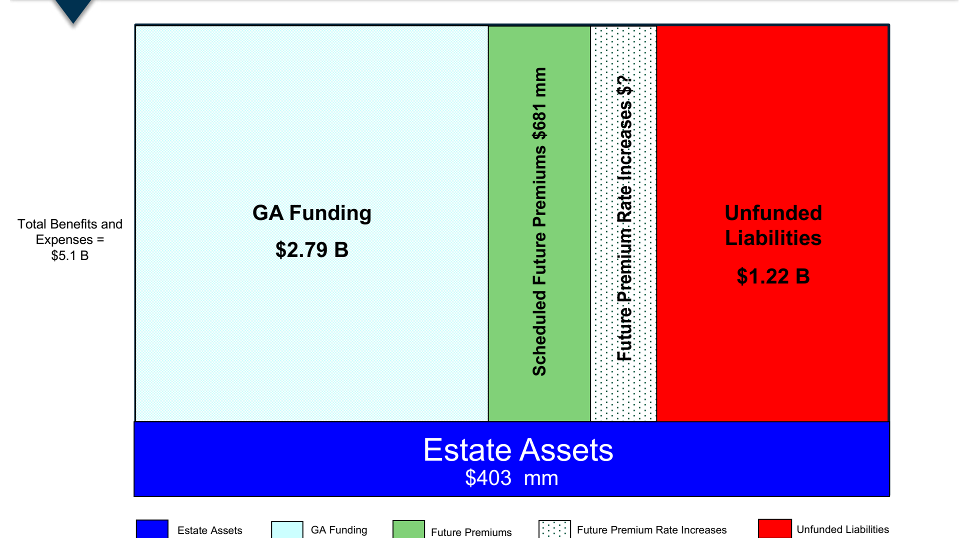
NOLHGA Journal: *As we wrap up, what impact will COVID-19 have on international insurance standards?*

Sara: Over the past decade, the international standard setters addressed supervisory weaknesses exposed by the 2008 financial crisis. With the adoption of the ICPs, ComFrame, and the Holistic Framework at the end of 2019, those standard setters were ready to shift their attention to emerging trends impacting the global insurance industry, as we discussed above. If the COVID-19 global pandemic highlights new or unaddressed weaknesses in global financial supervision, however, we may be in for another round of crisis-related international standard-setting activity. ✯

["President's Column" continues from page 3]

In a monoline carrier like Penn Treaty, where there is no surplus within the insurer from non-LTCi blocks, the funding shortfall can be addressed only by tapping a few sources: (i) a potential capital infusion from a parent or affiliated company willing to make such a contribution; (ii) external capital, assuming someone wishes to invest in such a block; (iii) premium increases (or, in the alternative, benefit reductions or policy cash-outs)—but that approach has an effective, practical upper boundary in mature blocks of business (which are the very blocks that we're discussing); (iv) guaranty association assessments; and (v) elimination of some benefits that had been promised by the insurer to policyholders having claims that exceed guaranty association limits—"haircuts," if you will.

Figure 1. Penn Treaty Liquidation (3/1/17)



Note: Atypically large shortfall of assets to covered liabilities.
Also, material liabilities identified for policies with claims projected to exceed GA benefit levels.

The Penn Treaty[3] Plan—First Steps

How was the Penn Treaty funding shortfall at liquidation—roughly $4 billion—addressed? There was no parent entity or third-party investor willing to make a capital infusion into a venture that was so deeply underwater. Instead, upon liquidation the guaranty associations assumed and are running off the guaranty association–covered liabilities of Penn Treaty (most of them through a nonprofit runoff vehicle formed by the associations known as LTC Re).

A simplified overview of the resolution plan's financial structure at liquidation can be seen in the accompanying Figure 1. To illustrate the situation at liquidation and after the resolution plan was implemented, I follow here the analytical methodology used in the earlier article on ELNY (see Endnote 1).

The overall rectangle (ignoring the subdivisions) represents the entirety of policy liabilities on Penn Treaty's books when it entered liquidation (about $5.1 billion, including the value of policies on claim at liquidation as well as the statutorily mandated reserves for, in effect, the "equity investment" in policies that had not yet gone on claim, which are known among LTCi actuaries and regulators as "active life reserves").[4] One funding source was the allocable assets of the estate at the time of liquidation, which had a value of about $403 million. Another funding source is represented by the value, at liquidation, of policy premiums then scheduled to be paid in the future—about $681 million. After accounting for those two items, liabilities still exceeded funding sources by about $4 billion. Figure 1 shows a placeholder for potential future premium increases, but since none of those had been finalized as of liquidation, that value is considered zero for present purposes.

Entry of an order of liquidation with a finding of insolvency triggered the statutory obligations of guaranty associations to provide the policy coverage called for by their state laws. Figure 1 shows that, at liquidation, the guaranty association funding obligation was expected to be about $2.79 billion in the aggregate for all affected associations. As of liquidation, those obligations were to be funded through assessments.

The good news is that, within guaranty association statutory coverage levels, policies are going to be paid in full from the substantial assessments made by the associations and the other funding sources described above. NOLHGA's actuaries calculate that more than 90% of policyholders will receive the entire amounts owed on their policies.

The bad news is that, except for any small amount of assets that may end up being allocated to them, there are no funding sources for claims not fully covered by the guaranty associations. Thus, Figure 1 reflects (as of the date of liquidation, and without giving effect to resolution plan elements subsequently pursued) a "haircut" to excess-of-covered claims in the amount of about $1.22 billion. This, I surmise, is the kind of pain to which Commissioner Sullivan referred in 2019.

The Premium Adjustment Program

So with Figure 1 summarizing the "starting point" for development of the guaranty association resolution plan, the Penn Treaty Task Force focused both on the issues that would be confronted in any runoff of a life, annuity, or long-tailed health claim block, plus some special issues arising only in LTCi cases.

Actuarially Supported Premium Adjustments. The biggest difference between the Penn Treaty block of LTCi business and the policies at issue in most other cases addressed in the guaranty

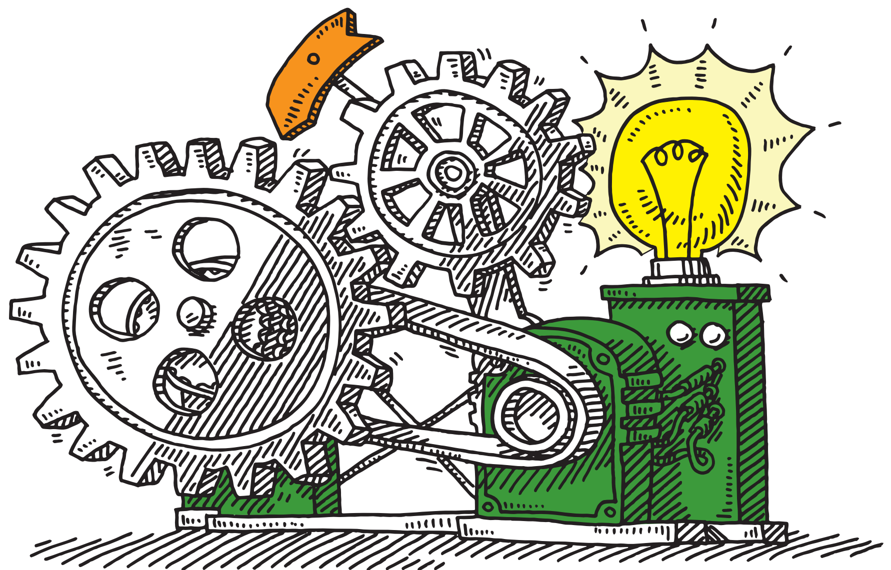
system was that LTCi policies, by their terms, may be the subject of actuarially supported premium increases, if those increases are both applied across classes of contracts (i.e., without considering changes in individual policyholder risk profiles) and approved by the regulators in the states where policies were issued. For most legacy LTCi blocks, the number of premium-paying policyholders has declined so much over time (due to deaths, claim status, and lapsation) that there is not a sufficient base of policyholders to support the premium increases necessary to eliminate significant funding gaps, especially if the assets are at a relatively low level (as was the case for Penn Treaty). The premium increases needed to close the funding gap would have to be astronomically high.

Coordinated nationwide programs to adjust underpriced LTCi premiums were still somewhat uncommon in the several years leading up to Penn Treaty's 2017 liquidations. In that period, the Penn Treaty Task Force devoted significant attention to whether and how such a plan should be pursued by the guaranty associations after liquidation. Ultimately, the Task Force determined that, upon liquidation, the associations should pursue such a coordinated, nationwide program to adjust premiums on many significantly underpriced policies. Neither the company (pre-rehabilitation) nor its Receiver had seriously pursued premium adjustments for many years. Although preparatory work was done by the guaranty associations before liquidation, the program didn't really begin to be implemented until the liquidation order was entered.[5]

The Task Force designed an effective rate adjustment program that mainly involved filing traditional rate adjustment requests, on a state-by-state basis, with the insurance departments of the states where the policies had been issued. To maximize the ability of policyholders to select the outcome that best suited policyholder needs, policyholders were afforded the opportunity to avoid paying higher premiums, either by electing a somewhat less rich benefit structure for the same (or a similar) premium, by terminating future premiums in exchange for acceptance of "reduced paid-up" (RPU) status, or (in most states) by accepting an option to terminate coverage in exchange for an actuarially determined cash payment.

The program's design was intended to achieve interstate equity by normalizing, to the extent possible, premiums on similar policies that had been issued in different states and that had different histories of premium adjustments.

By and large, regulators were very responsive to the program proposed by the Penn Treaty guaranty associations. Those regulators sought and received an appropriately high level of supporting detail for the premium adjustment requests. The program was an unprecedented success. For present purposes, the point is that the Penn Treaty resolution plan incorporated a significant, though appropriate, amount of premium adjustments. The aggregate value of those pre-



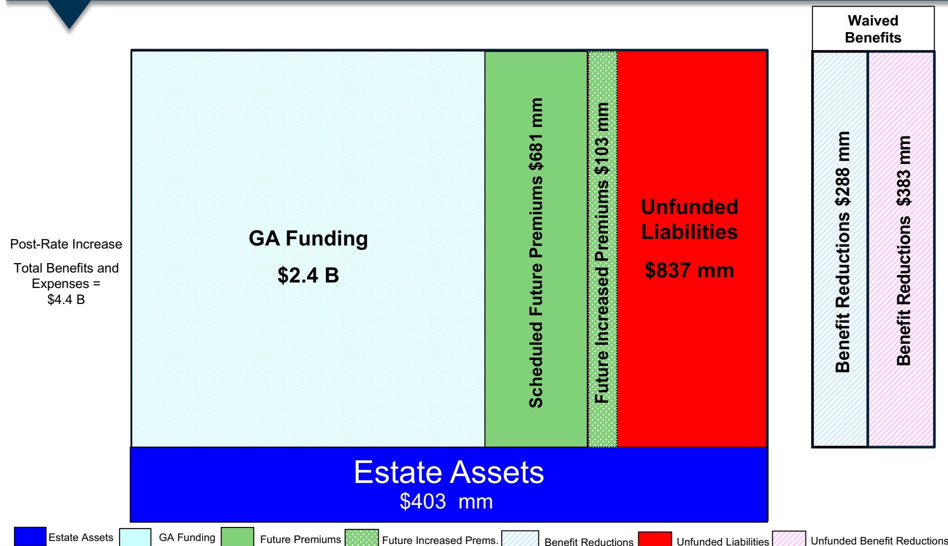
> **"Proposals for "better mousetraps" simply don't convincingly suggest any combination of new funding sources or cost reductions that would eliminate or even substantially reduce the relatively rare cases of policies that would not receive payment in full through guaranty association coverage in a traditional liquidation."**

mium adjustments provided a source to help decrease the funding gap.

Figure 2 illustrates the financial effect of the premium adjustment program (and the exercise by some policyholders of their option to accept benefit adjustments, RPU status, or policyholder "cashout" options). Essentially, the Penn Treaty premium adjustment plan affects both funding needs and funding sources so as to reduce significantly the overall funding gap, though a very substantial gap remains. The funding gap includes both the net obligations of guaranty associations and the obligations as to which policyholders as a group would suffer a "haircut" for want of a funding source ("Unfunded Liabilities" on Figures 1 and 2).

Even after the adjustments from the rate adjustment program, Figure 2 shows remaining required guaranty association net funding of about $2.4 billion (vs. $2.79 billion in Figure 1) and remaining Unfunded Liabilities of $837 million (vs. $1.22 billion in Figure 1). This total funding gap reduction of about $773 million results from the anticipated payment of about $103 million in increased premiums, but also the elimination of liabilities shown in Figure 1. Note that benefits otherwise payable by the guaranty associations in the amount of about $288 million have been eliminated through the exercise by policyholders of benefit reduction elections; and claims for benefits in the amount of about $383 million that would not have been covered by guaranty associations—and that could not have been paid from any other source—have likewise been eliminated by policyholder benefit reduction elections.

Figure 2. Penn Treaty Liquidation (3/1/17)
Impact of Rate Increase Program



More Traditional Challenges

Besides the special challenge of the Penn Treaty rate adjustment program, developing a Penn Treaty resolution plan required careful attention to a number of other challenges that are presented, one way or another, in most insurer liquidations: policy and claim administration, investment management, and stakeholder accountability. Those issues were addressed to some extent in the preceding article on Penn Treaty, but are recapped here for the sake of completeness.

Professional administration of the policies and claims presents a challenge in all liquidations, but few cases combine the complexity and duration of an LTCi administration commitment. LTCi policies will be in force for decades, and they are "high-touch" policies involving specialized issues. Experienced professionals who thoroughly understand LTCi are required for the administration of any significant block. Regulators care about LTCi administration, and they should. Additionally, administration is an expense issue, not only in the conventional income statement sense, but also in the sense that truly effective administration can have a positive impact both for the policyholders (improving their care and preserving their remaining available benefits) and for the costs of paying benefit claims under the policies.

Likewise, careful, professional management of the assets supporting the policy runoff helps to maximize available funding sources and prevent unexpected losses to guaranty associations and their stakeholders.

A final important consideration in any resolution plan is accountability to stakeholders: Especially when the result of the funding shortfall involves pain borne by policyholders and other stake-

> **"The biggest difference between the Penn Treaty block of LTCi business and the policies at issue in most other cases addressed in the guaranty system was that LTCi policies, by their terms, may be the subject of actuarially supported premium increases…"**

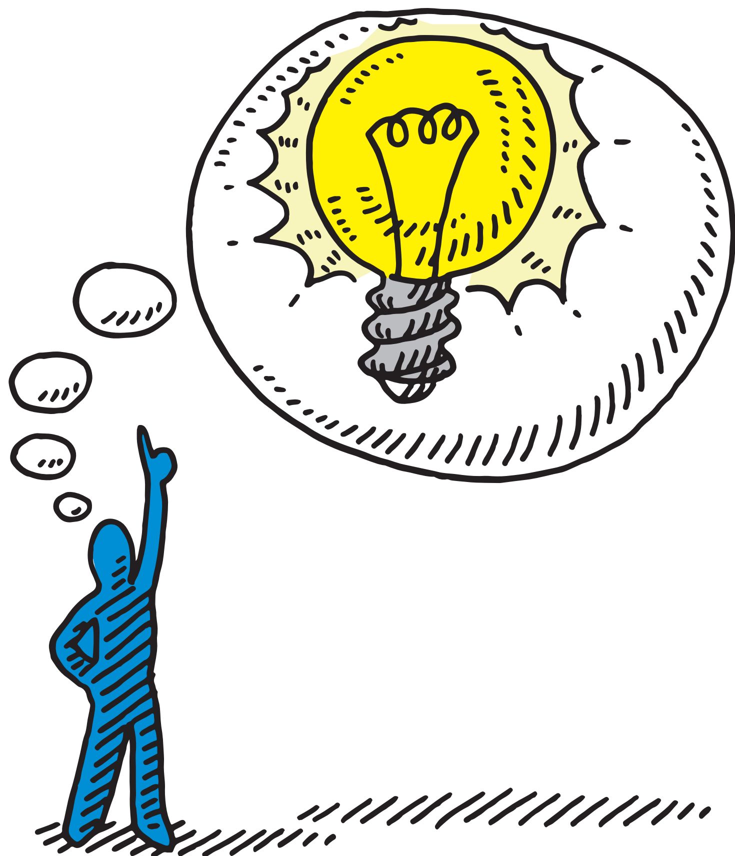
For most legacy LTCi blocks, the number of premium-paying policyholders has declined so much over time (due to deaths, claim status, and lapsation) that there is not a sufficient base of policyholders to support the premium increases necessary to eliminate significant funding gaps, especially if the assets are at a relatively low level (as was the case for Penn Treaty).

holders, there is both a political and a moral necessity to demonstrate that the job is being done right.

So, how has the guaranty system done in the Penn Treaty case?

Scoping the Liabilities. First, on the matter of understanding the scope of the funding challenge, we are confident that we have properly estimated the liabilities that need to be addressed. The work of our actuarial advisor on this case, LTCG, has proven to be very accurate: LTCG has regularly projected benefit payments since the guaranty system first got involved with Penn Treaty over 10 years ago and has subsequently checked the accuracy of those projections against subsequent actual claims development. To date, those projections have been proven out by actual experience almost to the dollar.

Reserving is never perfect, but at this point we think we know what running off this block will cost. The LTCG liability estimates involve no puffery, and there is no incentive for puffery on the part of the Task Force, which must account to affected guaranty associations, their member companies, and their regulators.



Investment Management. On the issue of investment practices, the guaranty associations did not receive significant asset distributions from the Penn Treaty Receiver, since there were few assets to distribute by the time the liquidation was ordered; the assets that were received as early access distributions were applied immediately to pay claims. The associations did contribute a much larger amount from assessments to pre-fund the Penn Treaty claims runoff. Those funds are being invested and managed through the LTC Re runoff vehicle.

The actual investment management is being handled by a premier private-sector investment management firm selected through a competitive bidding process. The investment manager's work is overseen by LTC Re's CFO, Brenda Cushing, and by an investment committee made up of senior investment professionals from guaranty association member companies and guaranty association executive directors. To date, the investment operations have yielded results superior to market averages without taking undue risk. In addition, the associations are not paying taxes on the investment earnings—a critical point.

Policy & Claims Administration. As to policy and claims administration, the guaranty associations have engaged for that purpose one of the most capable and respected LTCi specialty administration firms anywhere, selected on the basis of a competitive proposal process, and lever-

aging the talents of a skilled work force, drawn from Penn Treaty's Allentown, Pennsylvania, community, that knows these contracts and policyholders—and how to satisfy policyholder and regulatory needs and expectations in a way that will benefit both policyholders and guaranty associations.[6]

Stakeholder Accountability. Finally, on the issue of stakeholder accountability, the first proof involves policyholder reactions. Despite continuing negative publicity about the LTCi sector, Penn Treaty policyholder complaints have remained very low since liquidation, and policyholder satisfaction with service levels appears high.

Guaranty associations and knowledgeable representatives of affected member companies are supervising the administration of the entire program, and they are keeping their constituents and regulators briefed on the details. In particular, the donated expertise of guaranty association member companies has been critical in the areas of investment oversight, accounting and risk management, and policy and claims administration. The process is transparent and accountable.

A Better Mousetrap?

So that's what the guaranty system did in the Penn Treaty resolution plan. What could have been achieved that was not achieved by the guaranty associations in that case? Where, in other words, is the "better mousetrap?"

One might begin by asking, "Better than what?" What problem is the supposed better mousetrap supposed to solve? There are several concerns that one sometimes hears expressed about the ability of the current receivership/guaranty system's ability to respond effectively to an insolvency involving LTCi policies.

Making Policyholders Whole vs. the Funding Gap. First, it is observed that not all policyholders are "made whole" in an LTCi liquidation, as we've seen in Penn Treaty. In that case, although over 90% of policyholders are expected to receive payment of 100% of their policy claims, it is also true that a relatively small number of claimants with claims exceeding statutory guaranty association benefits will not be paid in full; in fact, a few having very large claims will receive significantly less than what their policies would have paid, had the carrier not failed.

> **"Professional administration of the policies and claims presents a challenge in all liquidations, but few cases combine the complexity and duration of an LTCi administration commitment."**

But that observation does not answer the question, "Who could make up the unfunded part of the shortfall?" It is the unfunded claims exceeding guaranty association statutory coverage levels that result in policyholders not receiving full payment. The associations are already paying everything that they're permitted to pay. Without a willing source of additional funding, benefit losses on very large claims (above levels for which guaranty associations are responsible) are simply inescapable consequences of any insurance company insolvency.

The Subsidization Issue. Second, as some insurance regulators understandably consider it unfair for states that do permit actuarially supported premium adjustments to "subsidize" policyholders in states that do not do so, it is asked whether a liquidation of an LTCi writer might reflect such subsidies.

On that point, the guaranty system has long shared those concerns; even before this topic ever surfaced at the NAIC, the guaranty system resolved to substantially eliminate such potential subsidies. The "re-priced premium" methodology—at the core of the Task Force's successful planning for the Penn Treaty premium adjustment program and for allocation of estate assets among associations—effectively renders this objection a non-issue in the Penn Treaty liquidation by accounting for historical differences in premium adjustments for purposes of the Penn Treaty nationwide premium adjustment strategy.

Restructuring Mechanisms vs. the Funding Gap. Third, it has been suggested in connection with discussions of "restructuring mechanisms" at the NAIC that creative use of corporate division or insurance business transfer schemes could somehow result in the runoff of legacy LTCi blocks in a fashion generally superior to what can be done through a liquidation. It is asserted that some combination of administrative cost savings, investment earnings, or premium adjustments thought to be unavailable under the current receivership/guaranty system might somehow produce, in the aggregate, funding sources that would leave policyholders in a better situation than they would face in a liquidation.

Setting aside the various legitimate substantive and procedural concerns about business restructurings that have been discussed at the NAIC's Restructuring Mechanisms Working Group, no one who has raised this contention in public has ever addressed in detail how funding sources might be augmented to a degree sufficient to produce outcomes generally superior to liquidation.

Recall (as discussed above) that the Penn Treaty plan simply does not leave unaddressed any significant funding that could be produced in any of those areas: In Penn Treaty (and in other liquidations roughly comparable), the mechanisms developed by the guaranty associations through competitive bidding and overseen by industry subject-matter experts are already maximizing the potential benefits of investment programs, claims

and policy administration, and a fair nationwide strategy of actuarially supported premium adjustments. Proposals for "better mousetraps" simply don't convincingly suggest any combination of new funding sources or cost reductions that would eliminate or even substantially reduce the relatively rare cases of policies that would not receive payment in full through guaranty association coverage in a traditional liquidation.

GAs Provide Insolvency Funding Unlikely to Come from Other Sources. Put another way, a private-sector restructuring of a deeply insolvent carrier does not appear to hold the promise of increasing funding sources above what would be available in a well-planned, well-administered plan of liquidation that triggers guaranty association coverage. In fact, the exact opposite is true: The Penn Treaty runoff is funded as well as it is only *because* more than $2 billion have been committed to the liquidation resolution plan through guaranty association assessments. A "better mousetrap" that doesn't trigger guaranty associations would not have that funding source. (It also would not benefit from tax-exempt investment earnings, as does the runoff of the Penn Treaty block by nonprofit guaranty associations through the LTC Re runoff vehicle.)

To provide funding sources greater than those available in a liquidation, an LTCi restructuring mechanism runoff vehicle not only would have to increase premiums, maximize investment earnings, and run a lean administrative program—it would also need the infusion of substantial funds from sources external to the troubled LTCi writer. Those funds, in theory, could come from an outside investor. But that investor is going to expect its risks to be limited and its investments returned (with an after-tax profit). From what sources?

GAs Are Not Obliged to Fund Non-Liquidation "Bailouts." Some have suggested privately that guaranty associations could fund some sort of rescue mechanism for legacy LTCi blocks. They argue that this would prevent liquidations that might otherwise occur, and thus—in the long run—could prove to be a sound "investment" of association resources.

Some insurance regulators understandably consider it unfair for states that do permit actuarially supported premium adjustments to "subsidize" policyholders in states that do not do so…

That might be an economically colorable contention on the surface, were one to make a number of favorable, critical assumptions. However, the idea of guaranty associations funding such a rescue of a troubled carrier is contrary to the long-established core principle, embodied in the NAIC's Model Life and Health Guaranty Association Model Act[7] and the laws of the guaranty associations of every state and the District of Columbia[8] specifying that guaranty associations are obliged to provide statutory protections only when a member company has become the subject of a final order of liquidation, accompanied by a judicial finding that that company is insolvent.

This core principle reflects the fact that the guaranty system was never designed as a "bailout" mechanism for troubled insurers or blocks of business; rather, it was designed to serve the very different purpose of providing a safety net for policyholders (but not their insurance companies), once all other attempts to rescue the company have failed.

Beyond that core principle lie a multitude of issues, including what the late Jim Mumford described as moral hazard concerns at several levels (he mentioned policyholder decision-making, pre-insolvency decisions by troubled insurers, and regulatory decision-making). Moreover, no one involved in such a process objectively could conclude that the rescue strategy necessarily would be cost-effective, compared to liquidation. And to what company blocks would the rescue process extend? Troubled companies only? Or also troubled LTCi blocks in otherwise healthy companies? In other words, could there be any meaningful limiting principle to the concept of putting at risk in such cases guaranty association assessment funds, which in turn would risk the funds of the associations' member companies, their policyholders, stockholders, and taxpayers?

In conclusion, no one has yet proposed a coherent plan for non-receivership resolution of troubled company legacy LTCi blocks that would produce results superior to what can be achieved under existing receivership and guaranty system authorities. In particular, no one has proposed a coherent approach that would use guaranty association funding to support a broad rescue strategy for legacy LTCi blocks. If there is a "better mousetrap," it has yet to be described. ✪

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Endnotes

1. "Critical Thinking in Action—Problem Insurer Resolutions," *NOLHGA Journal* October 2017 p.2: https://www.nolhga.com/resource/code/file.cfm?ID=2992.
2. "Resolving Legacy Long-Term Care Insurance Blocks: Is There a "Better Mousetrap"?," *NOLHGA Journal* October 2019 p.2: https://www.nolhga.com/resource/code/file.cfm?ID=2992.
3. References to "Penn Treaty" refer to Penn Treaty Network America Insurance Company and its wholly owned subsidiary, American Network Insurance Company, both of which were placed in liquidation on March 1, 2017. While the two are treated as separate liquidations, I refer to them here collectively as "Penn Treaty" for ease of reference.

4. Valuation of policyholder claims for such equity elements as priority, policy-level claims against estate assets—as of and precipitated by the liquidation—have been a standard feature of U.S. insolvency jurisprudence for more than a century in cases involving life, annuity, and long-tailed, non-cancellable or yearly renewable health policies, both for claims covered by guaranty associations (to which associations are subrogated) and for claims exceeding guaranty association limits or otherwise not covered by guaranty associations—on which policyholders traditionally have received partial recoveries based on the ratio of the estate's assets to its policy-level liabilities. As noted in the earlier Penn Treaty article (Endnote 2—see Endnote 7 and accompanying text in that article), several stakeholders in the Penn Treaty liquidation have offered an argument based on statutory construction to the effect that uncovered claims should not share in the distribution of Penn Treaty's assets. That contention has been taken under advisement by the Pennsylvania Commonwealth Court, and any decision from that Court is likely to be appealed to the Pennsylvania Supreme Court. This article assumes the traditional valuation of such claims, recognizing that the issue is now in dispute.
5. Premium adjustment applications may be filed by a company that has not entered receivership or by a Rehabilitator, in addition to applications that may be filed by guaranty associations after liquidation. Liquidation imposes coverage responsibility on guaranty associations and vests them with the right to receive premiums on the policies they cover. See, NAIC Life and Health Guaranty Association Model Act §§ 8D (providing that premiums due for coverage after entry of an order of liquidation of an insolvent insurer shall belong to and be payable at the direction of the association) and 8L(9)(permitting a guaranty association, in accordance with the terms and conditions of the policy or contract, to file for actuarially justified rate or premium increases for any policy or contract for which it provides coverage). Any adjustments so imposed—pre-receivership, in rehabilitation, or upon guaranty association application post-liquidation—have the result of increasing funding sources available to honor the insurer's policy obligations. In the event the company eventually enters liquidation, premium adjustments made at any stage have the necessary consequence (by virtue of closing the "funding gap") of reducing guaranty association costs of covering benefits in liquidation.
6. A few guaranty associations have opted to run off the claims they cover "in house," relying on qualified claim professionals on staff.
7. See, NAIC Life and Health Guaranty Association Model Act §§ 5L (defining "Insolvent Insurer" as a member insurer which is placed under an order of liquidation by a court of competent jurisdiction with a finding of insolvency) and 8B (requiring that a guaranty association take certain action, in its discretion, when a member insurer is an insolvent insurer).
8. See, e.g., 215 Ill. Comp. Stat. Ann. 5/531.08(a)(2); 40 Pa. Stat. Ann. § 991.1706(b).

2021

July 21–23	**NOLHGA's 29th Legal Seminar** **Online**
August 3–4	**MPC Meeting** **Online**
August 14–17	NAIC Summer National Meeting Columbus, Ohio
October 25	**MPC Meeting** **Nashville, Tenesee**
October 26–27	**NOLHGA's 38th Annual Meeting** **Nashville, Tennesee**
December 13–16	NAIC Fall National Meeting San Diego, California

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