Robert E. Underdown, AIC, ARM

The Insurance Archaeologist™
Insurance & Risk Management Consultant

Insurance Company Solvency and Policyholder Protection

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With the near collapse of AIG, the world's largest insurance company many people are asking questions about the financial soundness of a variety of insurance companies. Here is a potential backstop based on the Guarantee funds that operate in each state in the US.

WHAT TO LOOK FOR

All insurance companies' public comments indicate they are well capitalized and have plenty of funds in reserve. Such statements, as we have seen, can be self-serving if not downright false.

The purpose of this article is to clarify an important fact for insurance policyholders. It is the exposure presented by the use of Non-Admitted (also known as unauthorized insurers) insurance versus Admitted carriers for your insurance company.

The information that follows deals with the protection provided by the state guarantee funds for property and casualty insurance companies who write policies in a given state. The issue of Non-Admitted insurance companies can apply to all lines of coverage from auto and homeowners for personal or commercial policies.

ADMITTED

The distinction here is between the two different categories of insurance companies typically doing business in each state. First are the "Admitted" insurance companies. They are the more closely regulated by the state insurance departments. Most insurance companies are Admitted carriers. For an admitted carrier to do business in a state they are required to file their rates and forms with the state insurance department and many states have the right of prior approval of the rates and forms filled by an insurance company.

The benefit of purchasing your policy from an Admitted insurance company is that the state guarantee fund will step in if there is insolvency and pay claims to policyholders and claimants. Generally, the funds pay up to the policy limits subject to certain caps which are set by state law. The limit varies from $300,000 to $1 million.

NON-ADMITTED

Alternatively, some insurance company groups like AIG and other large insurance groups have a combination of Admitted and Non-Admitted insurance companies in their group. For example, AIG has several (sixteen at last count) different insurance companies in their group and some of the companies may not be licensed as Admitted in every state in the US and so they operate as a Non-Admitted company. Thus, the parent group has an alternative company that can quote rates and terms different from their Admitted companies. This is a proven way to provide marketing flexibility for the Insurance Group and to give the policyholder more choice.

In some states, there may not be an alternative to select an Admitted company for certain lines of coverage such as specialty risks like earthquake, flood and some types of professional liability among others. However, with the buyers’ market we are presently experiencing, this is the optimum time for finding Admitted companies for a broader range of lines of coverage.

Here is a standard disclaimer from a state insurance department regarding oversight of Non-Admitted insurance companies. "The Director of the Department of Insurance is not required to determine the actual financial condition or claims practices of any unauthorized insurer." This is a very clear indication of the lack of any oversight on the part of the state insurance department.

PROTECTION FOR POLICYHOLDER AND THE PUBLIC

For the Admitted insurance companies, each state operates a guarantee fund that provides a level of protection for policyholders (first party claims, fire etc.) and the public (third party claimants, vehicle liability claimants against policyholders).

As an insurance expert having some experience handling claims against a guarantee fund, I can attest that it is a time consuming and arduous task to secure your payment either as an insured or first party or as a liability claimant or third party.

In addition, I have testified as an expert witness in cases when an insurance broker recommended a non-admitted company to their client without clearly explaining the potential consequences of the lack of a state's guarantee fund protection.

SUMMARY

In the past, a general recommendation was that the best method to know the financial health of an insurance company is to consult the independent rating agencies such as A.M. Best, Fitch and Moodys. With the volatility in today's financial markets, an insurance companies rating can change very quickly so I propose the idea of the state insurance guarantee funds as a backup position.

For the insurance purchaser, it is important to know if your policy is written with a Non-Admitted company and thus you are not covered by the state guarantee fund. The Admitted status should be a question during the purchase phase of your insurance policy.

You can tell if your insurance policy is written with a company that is Non-Admitted by looking at the first page of the policy where the insurance company name appears. If your policy was written with a Non-Admitted insurance company, there will be a stamped notice that indicates an Excess and Surplus Lines tax and fee charge for the policy.

Therefore, if you are renewing an insurance policy and have the option to choose between an Admitted company versus a Non-Admitted company, you can make an informed decision based on any difference in premium and the solvency risk you may be assuming.

Robert E. "Bob" Underdown, AIC, ARM, The "Insurance Archaeologist"™, is a nationwide insurance consultant based in Scottsdale, Arizona. He serves corporations in the area of risk management and the legal community as an expert witness in insurance litigation. Mr. Underdown is an expert in agent/broker; insurance company and TPA standards of care and bad faith claims. In addition, he is an expert in life insurance suitability. Find out more at www.Insurance-Expert.com or call (480) 216-1364.