



## Insurance on insurers: How state insurance guaranty funds protect policyholders

Daniel Hartley, senior economist and economic advisor

---

### Introduction and summary<sup>1</sup>

Life insurance policies are fairly common financial products in the United States. As of 2022, 46% of households held [term life insurance](#) and 17% of households held cash value policies with an average cash value of \$55,000.<sup>2</sup> Many insurance products are covered by state insurance guaranty associations. These guaranty associations provide a partial guarantee to insurance policyholders that they will continue to have their claims paid in the event that their insurer is declared insolvent. While this may bring to mind guarantees for bank deposits, the life insurance guaranty system differs in a number of important ways from deposit insurance provided by the Federal Deposit Insurance Corporation (FDIC). If you open a bank account in the United States, you probably know that were the bank to run into trouble, your deposits would be [guaranteed by the FDIC](#) up to a prespecified limit (currently, \$250,000). But what would happen if your life insurer were to run into trouble? The rules—as well as the process—for getting insurance policies honored (up to state limits) are different than those for getting back your bank deposits. This article discusses how the insurance guaranty process works in the context of considering the ways in which state insurance guaranty associations and insurance commissioners might respond to an insolvency of a large life insurer.<sup>3</sup>

Large life insurers are complicated organizations. Many of the largest U.S. life insurance companies are part of corporate groups that may be based domestically or abroad. In the United States, insurers are regulated mainly at the company level by the insurance commissioner of the state in which the company is domiciled (which I refer to as the company's home state). However, an insurance company's policyholders may be spread across the country. What protections do policyholders have when an insurer runs into trouble?

Coverage limits depend on the type of insurance product. For example, individual [annuities](#) are typically covered up to \$250,000. If an individual had a fixed annuity life insurance policy that was paying out \$400 per month with a present value of all future payments of \$400,000, then they could expect to receive \$250 per month based on the present value of \$250,000 that was covered by the guaranty fund. Limits for most other products are similar. However, the limits vary from state to state and product to product. If the insurer runs out of money and is unable to honor a policy, then the state guaranty association of the state in which the policyholder resides provides the coverage.<sup>4</sup>

In practice, as illustrated by the two largest insurer insolvencies that I discuss as examples—namely, the Penn Treaty and Executive Life insolvencies—the resolution process can involve delays that deplete assets, introduce uncertainty regarding the degree of coverage for policyholders, and cause inequity across the coverage provided to different types of policies.

## ***What happens when an insurer runs into trouble?***

Usually, the insurance commissioner of the insurer's home state is responsible for deciding when an insurer becomes financially troubled enough to petition state courts to put the insurer into receivership. Receivership gives the state control over the insurer and generally can take one of three forms: conservation, rehabilitation, or liquidation.<sup>5</sup> These three forms are increasing in severity, with conservation the least stringent and only liquidation leading directly to a sale of assets and the cancelation of policies. If the insurer is liquidated, state insurance guaranty associations become involved and are responsible for making sure that policyholders are paid, up to stated guarantee limits.

The decision to put an insurer into any of the stages of receivership is generally made by a court after a petition by the insurance commissioner of the insurer's home state. The commissioner's petition to put an insurer in rehabilitation or liquidation often can be challenged in court by interested parties, including the insurer. These challenges can lead to delays in starting the resolution process. During a delay, claimants will continue to get paid in full on their claims (if possible) and generally there are no extraordinary restrictions on the ability of policyholders to withdraw from savings elements of their policies.

## ***The role of state guaranty associations***

When an insurer is put into liquidation, state guaranty associations become involved and are responsible for making sure that policyholders are paid, up to stated guarantee limits. The money to cover the guaranty associations' guarantees is raised ex post by levying assessments on other intact insurers in the same state and insurance line. If more funds to provide coverage for policyholders are needed than can be raised in a single year, then guaranty associations typically have several options. They can issue bonds backed by the flow of future assessments to match the timing of claims coming due with assessments, but they are not obligated to do so. State laws also typically give a guaranty association board the option of asking the state courts to impose "haircuts" on the policies, that is, to not honor the full guarantees for the policyholders of the insolvent insurer if economic conditions for the remaining member insurers are bad.

It is worth noting that the guaranty association boards are composed primarily of representatives from insurers that do business in the state. In the wake of the failure of a large life insurer there are a number of ways that the guaranty associations could respond. The failure of a very large life insurer could leave intact insurers in some states facing large assessments that could stretch over many years.

## ***How do policyholder protections compare with bank deposit protections?***

Policyholders may not know ex ante whether—or the degree to which—they will be covered. Ex-post funding, long-lived liabilities, possible delays in providing guarantees, guaranty association board makeup, and discretion in whether to honor the guarantees mean that policyholders face uncertainty about when and to what extent their contracts will be honored—in sharp contrast to bank deposit insurance provided by the FDIC. While life insurer failures are rarer and less frequent than bank failures, the two insurer failures that I discuss in this article show that delays are possible (as in the case of Penn Treaty) and that it is unclear, ex ante, which policyholders will be made whole and which will suffer losses (as in the case of Executive Life).

In contrast to FDIC deposit insurance, which must be advertised by FDIC-insured banks, the [Life and Health Insurance Guaranty Association Model Act](#) (as of the latest version, dated the first quarter of 2018) includes a ban on using the existence of guaranty association coverage in inducing the sale of insurance.<sup>6</sup>

In the next section, I discuss the rules governing state guaranty associations. Following that, I draw some lessons from the largest two insurance company insolvencies in recent history. Finally, I close with

some possible implications of a large insurer failure, given the current resolution process and state insurance guaranty system.

## **Overview of insurance receivership and state guaranty rules**

In this section, I provide an overview of the rules governing receivership of insurance companies and state guaranty associations. I focus on the regulatory criteria for identifying insolvent insurers and the regulatory structures for handling them. I then shift my focus to how the guaranty associations are involved in the liquidation process, how they are organized, and how they raise funds.

### ***What is the legal framework for insurance receivership?***

One of the ways the state insurance commissioner or regulatory agency monitors the health of insurers is by imposing risk-based capital (RBC) requirements. RBC requirements are statutory minimum levels of capital that an insurer must hold based on an insurer's size and the riskiness of its assets and operations. The [Risk-Based Capital for Insurers Model Act](#) (as of the latest version, dated January 2012) gives guidelines for calculating risk-adjusted capital and specifies RBC thresholds that trigger company action (below which the insurer must submit a plan to the regulator), regulatory action (below which the regulator may take control of the insurer), and mandatory control (below which the regulator is compelled to take control of the insurer).<sup>7</sup> This act requires insurers to submit a report of RBC levels annually.

When problems arise, the procedure for dealing with the failure of an insurer is covered by state laws, which are typically based on one of three model acts that have been adopted by the National Association of Insurance Commissioners (NAIC) over the years: the Uniform Insurers Liquidation Act, the Insurers Rehabilitation and Liquidation Model Act, or the Insurer Receivership Model Act.<sup>8</sup> These laws typically specify that the state insurance commissioner of an insurer's home state or a designee of the commissioner makes the decision of when to file to put the insurer into receivership and usually acts as the "receiver," meaning that they will handle the task of winding down the assets and policies of an insolvent insurer.<sup>9</sup> A filing for receivership must be approved by a state court to take effect. Receivership typically has three possible forms: conservation, rehabilitation, or liquidation (see figure 1 in the next subsection).

Orders of rehabilitation and liquidation can be appealed. The NAIC's 2024 *Receiver's Handbook for Insurance Company Insolvencies* indicates that the insurer has the right to appeal orders of rehabilitation and that "orders of liquidation may be appealed by management and/or shareholders of the insurer" (National Association of Insurance Commissioners, 2024, pp. 12, 17). Also, since these actions are public, other interested parties, such as insurance brokers that are receiving ongoing commissions on policies that they have previously sold, may also become legally involved.

### ***Forms of receivership***

Each form of receivership has its own purpose. The goal of conservation is to provide time for the receiver to determine if the insurer is healthy enough to continue meeting its contractual obligations or whether rehabilitation or liquidation is appropriate. Conservation is typically limited to 180 or 360 days and is usually not publicly disclosed (National Association of Insurance Commissioners, 2024, p. 12). This allows a troubled insurer to continue operating for a time without the stigma associated with regulatory actions. Rehabilitation can be used to restore the financial health of the insurer, to run off its liabilities in a way that avoids liquidation, or to prepare the insurer for liquidation. Liquidation is used if the insurer has been found to be "insolvent" (typically, a formal ruling by a state court). In contrast, insurers in conservation or rehabilitation are referred to as being "impaired." Further details about the three forms of receivership are in figure 1.

## 1. Insurance receivership actions

	Conservation	Rehabilitation	Liquidation
Confidential (ex parte)	Usually	No	No
Limited time period	Yes	No	No
Finding of insolvency	No	No	Yes
Bankruptcy analogy	Not applicable	Chapter 11	Chapter 7
Sequence	These actions are not necessarily sequential. The regulator petitions the state court for the one most appropriate for the situation.		

Source: Chicago Fed staff analysis of National Association of Insurance Commissioners (2024).

### ***Activating the state guaranty association***

State guaranty associations typically step in when an insurer has been put into liquidation. However, they may be notified of problems earlier. To aid in detecting and preventing impairments and insolvencies, state insurance commissioners are typically required to notify the commissioners of all other states within 30 days if the commissioner revokes or suspends a license or makes a formal order that an insurer take an action “for the security of policy owners, contract owners, certificate holders, or creditors.”<sup>10</sup> The commissioner must also report to their state’s guaranty association any of these items, along with any notifications the commissioner has received from other state commissioners; in addition, the commissioner must report to the guaranty association if they have “reasonable cause” from an examination to believe that an insurer may be impaired or insolvent.<sup>11</sup> Many states require that insurers are examined at least [once every five years](#).

State guaranty associations are tasked with providing insurance up to prespecified limits for residents of their state who are policyholders.<sup>12</sup> This purpose and the organization of the guaranty associations are established in state laws that implement a model act created by the NAIC. The Life and Health Insurance Guaranty Association Model Act provides the template for state laws enabling the guaranty associations for life and health insurance. The model act specifies the purpose, composition, powers, and duties of the guaranty associations. All 50 states plus the District of Columbia have adopted legislation related to this model act.

### ***Life and health insurance guaranty associations***

The guaranty associations for life and health insurers are separate from those for property and casualty insurers. The model act for life and health insurers separates life insurance from health insurance and further splits life insurance (what it refers to as the “life insurance and annuity account”) into three subaccounts: a life insurance subaccount, an annuity subaccount, and an unallocated annuity subaccount.<sup>13</sup> The typical guaranty association’s life and health coverage limits are shown in figure 2, by type of policy.<sup>14</sup> The act allows states to determine individually whether the guaranty association covers unallocated annuities. Currently, most states, but not all, [cover unallocated annuities](#). In addition to the coverage limits shown in figure 2, there is a [\\$300,000 overall cap](#) for any particular individual with multiple policies with the insolvent insurer.

## 2. Guaranty association coverage limits, by type of policy

Type of policy	Maximum exposure of guaranty fund to an individual policy (U.S. dollars)
Life insurance death benefits	300,000
Life insurance net cash surrender or withdrawal	100,000
Present value of annuity benefits, including cash surrender and withdrawal	250,000
Group annuities	250,000
Health: Long-term care insurance benefits	300,000
Health: Disability income insurance benefits	300,000
Health: Benefit plans	500,000

Notes: The amounts for the maximum exposure of the guaranty fund to an individual policy are all according to the National Association of Insurance Commissioners' Life and Health Insurance Guaranty Association Model Act, [available online](#). Typically, group annuities are unallocated and thus are only covered by guaranty funds in states that cover unallocated annuities.

Source: National Organization of Life & Health Insurance Guaranty Associations, Policyholder Information microsite, "The safety net at work" [webpage](#) and "Frequently asked questions" [webpage](#).

### ***Guaranty association boards and membership***

The Life and Health Insurance Guaranty Association Model Act establishes a guaranty association whose board is made up of seven to 11 people from member insurers and two people not affiliated with the insurance industry. Insurer members are selected by member companies subject to the approval of the commissioner. The unaffiliated members are typically appointed by the commissioner.<sup>15</sup>

According to the model act, any insurer licensed to sell the type of insurance to which the model act pertains in the state is a member of the state's guaranty association. For example, an insurer that is licensed to sell life insurance in Illinois is a member of the Illinois Life and Health Insurance Guaranty Association.

The rules set out in the model act specify how the costs of providing policyholder coverage are split across states. Each state's guaranty association provides coverage for policyholders who live in their state if the insurer is licensed to sell insurance in the state.<sup>16</sup>

### ***How do the guaranty associations raise funds to provide coverage?***

Typically, life insurance products have two phases: Initially, policyholders pay premiums; in the later phase, the insurer pays out benefits.<sup>17</sup> Each year, the state guaranty associations must cover the difference between the payments due to be paid out to policyholders of an insolvent insurer and the premiums flowing in from policyholders of that insurer during the course of the year. To do this, the state guaranty associations use proceeds from the sales of—or earnings from—any assets of the insolvent insurer that were transferred to them by the receiver and additional funds raised by a levy on other insurers in the state where the policyholders reside.<sup>18</sup>

The additional funds provided by the state guaranty associations are raised ex post by levying assessments on insurers in proportion to the premiums that they wrote in a specific state and insurance line in the three years prior to the event that triggered the payments (impairment or insolvency), according to the Life and Health Insurance Guaranty Association Model Act (section 9). The guaranty associations are

typically activated only after an insurer has been found to be insolvent and has been placed under an order of liquidation by a court.

There is an order as to how the guaranty associations raise any necessary funds. First, the guaranty association assesses the remaining life insurance firms that share the subaccount (life insurance, annuity, or unallocated annuity) of the failed firm.<sup>19</sup> The assessments are capped at 2% of direct premiums written in most states. If the maximum assessment in a life insurance subaccount does not provide sufficient funds to make the necessary claim payments in one year, then the guaranty association will assess the other life insurance subaccounts (for example, if there isn't enough from the assessments from the life insurance subaccount, then assessments on the annuity and unallocated annuity subaccounts will be levied).<sup>20</sup>

If, after levying the assessments on the other life insurance subaccounts, a guaranty association still cannot raise the funds needed in a single year, then two questions arise. First, how many years are needed to raise the money through assessments? Second, does the timing of the need for the money line up with its availability?

If funds are needed more quickly than they can be raised through assessments, the guaranty association may issue bonds to raise funds to fulfill its duties but is not obligated to do so. When guaranty associations opt to issue bonds, they are typically state revenue bonds, which are secured by the stream of future insurer premium assessments.

The guaranty association may also, subject to approval by a court, impose permanent policy or contract liens (that is, impose haircuts on the coverage, reducing it below the payout cap) if the amount that can be assessed (in one year) is less than the amount needed to fulfill its duties or if the economic and financial conditions are bad enough that permanent policy or contract liens are in "the public interest."<sup>21</sup> It is unclear what weight the guaranty association would assign to policyholders of the insolvent insurer versus profitability of the remaining intact insurers (whose representatives would make up most of the guaranty association's board members) when assessing what action would be in "the public interest." However, it is important to note that because of reputational and regulatory concerns, there are strong incentives not to impose haircuts on coverage from the guaranty associations.

Finally, note that a majority of states allow insurers to either partially or fully recover their assessment payments through state premium tax reductions.<sup>22</sup> State tax reductions mean that there is less of an incentive for a guaranty association, which is primarily run and funded by surviving insurers, to impose haircuts on coverage for policies of an insolvent insurer because they are compensated for the cost through tax breaks; however, tax reductions also mean that state taxpayers may, indirectly, be left with the bill.

## **How insurance insolvency resolution has worked in practice**

With the exception of AIG, which did not go into receivership because it was [rescued](#) by the Federal Reserve, the Federal Reserve Bank of New York, and the U.S. Department of the Treasury, most life and health insurance company failures since the early 1990s have involved small insurers.<sup>23</sup> The two largest failures (presented in order of size from the second-largest to the largest) illustrate some of the potential risks of the system and how varied the resolution process experience may be across policyholders.

## ***Example 1: Penn Treaty***

Penn Treaty Network America Insurance Company was a medium-sized insurer that predominately issued long-term care insurance.<sup>24</sup>

### ***Why did Penn Treaty run into trouble?***

Penn Treaty sold long-term care insurance at a price that turned out to be too low. Long-term care insurance was a relatively new product and a number of actuarial assumptions that went into pricing policies turned out to be overly optimistic from the insurer's point of view. Policyholders wound up keeping policies until the payout stage at higher rates than expected, mortality rates were lower than expected, and claim costs were significantly higher than expected. The company became impaired and entered rehabilitation in early 2009 after the loss of a **reinsurance** contract caused them to have to restate liabilities so that in total the liabilities exceeded the firm's assets.<sup>25</sup> However, Penn Treaty was not liquidated until 2017, at which point it had essentially run out of assets. The Penn Treaty insolvency turned out to be the second-largest one in guaranty association history, after the Executive Life insolvency, which I discuss next. As of September 2017, it was estimated that guaranty funds would need to assess insurance companies \$2.7 billion to cover the guaranteed portion of Penn Treaty obligations.<sup>26</sup>

### ***Why did the resolution process take so long?***

It took eight years from the time Penn Treaty was put into rehabilitation until liquidation began partly because of lawsuits.<sup>27</sup> Insurance brokers whose contracts were structured such that they received commissions during the premium payment period sued to delay the liquidation, allowing them to continue to receive commissions. Managed care companies also filed lawsuits, arguing that because long-term care and managed care insurance are both in the accident and health guaranty fund account, the guaranty fund assessments would fall on managed care carriers who may have issued very little long-term care insurance. The resolution of Penn Treaty was delayed while these lawsuits were being litigated.

### ***What were the implications for policyholders?***

During the delays, Penn Treaty's financial condition deteriorated further. This left policyholders in the position of having to continue to pay premiums (in order to keep their policies) without knowing the degree to which they would be insured in the long run. Otherwise, policies would have lapsed. This level of uncertainty could be draining, both financially and psychologically.

In addition to delays, there were fairness concerns. During the delays due to litigation, policyholders were paid in full on any claims, which drew down reserves and left fewer assets to pay claims for policyholders who hadn't yet made claims. However, policyholders who happened to have claims after liquidation began faced benefit reductions. In 2017, it was estimated that "about 50 percent of the remaining policyholders are expected to have claims in excess of what will be paid by the guaranty association covering their policies."<sup>28</sup> This raised the question of how equitable the receivership and guaranty fund processes are to policyholders who may be in different parts of the life cycle of the policy—for example, those still paying premiums versus those receiving benefits.

## **Example 2: Executive Life**

Another case where delays potentially caused inequitable treatment of policyholders is the failure of Executive Life Insurance Company (ELIC), based in California. Executive Life issued a large amount of annuities guaranteeing high rates of interest, which it funded in large part with junk bonds.<sup>29</sup> It became impaired in 1991 as policyholders, concerned about Executive Life's junk bond exposure, withdrew money, forcing a liquidation of the junk bonds at fire-sale prices (Lieber, 2008; and Coffin et al., 2012). The impact of the failure on policyholders depended on whether they had purchased their policy from ELIC or its subsidiary, Executive Life of New York (ELNY), and which type of policy they had. Some policyholders were transferred to solvent insurers relatively quickly and faced no loss of policy value or liquidity while others faced years of uncertainty—and, in some cases, they received only a fraction of the payments promised from their policies.

Executive Life is the largest failure involving guaranty funds to date. The guaranty associations' assessments totaled \$3.7 billion.<sup>30</sup>

### ***How was the subsidiary handled differently?***

In December 1991, ELIC was **ordered to liquidate**; over the next three years, ELIC experienced a “fairly orderly” liquidation, but its subsidiary ELNY did not.<sup>31</sup> ELNY was put into rehabilitation in 1991. In 1992, most policies were transferred to MetLife and were made whole. Only policyholders with structured settlement annuities<sup>32</sup> remained behind. There were about 10,000 policyholders in this group who continued to receive payments until ELNY nearly ran out of assets in 2012. At this time ELNY was put into liquidation, and about 1,500 policyholders faced benefit reductions. A consortium of life insurance firms voluntarily contributed funds to help cover some of the losses of policyholders residing in states where ELNY was not licensed to do business.<sup>33</sup> Structured settlement policyholders with benefits in excess of guaranty fund limits incurred losses on their policies.

### ***What are the lessons from these examples?***

The first example—namely, the Penn Treaty insolvency—illustrates that the length of time between when a state insurance commissioner wants to declare an insurer insolvent and the commencement of action being taken by the state guaranty associations can have an impact on the extent to which policyholders receive full coverage. This is because policyholders are entitled to a share of the firm's assets. If the assets are depleted during the intervening period through payments to other policyholders, the payments of legal fees and consultant fees, or expenses such as commissions, then policyholders, particularly those with policies that exceed the guaranty fund coverage limits, may be left worse off than they would have been if much swifter action had been taken.

One thing to note about the Penn Treaty insolvency is that long-term care insurance does not typically have a cash value or savings-like feature, meaning that there was no potential for a run on the company. If similar problems become evident at a life insurer with a large amount of cash value policies or other liquid liabilities, a run may develop, potentially magnifying the asset shortfall. This can be seen in the second example.

The example of Executive Life shows that the delay in the resolution process is also not always equitable for different types of policyholders. If solvent companies take over parts of an insolvent insurer they may cherry-pick liabilities and assets, leaving the remaining policyholders with claims on riskier or less valuable assets.



The examples of the Penn Treaty and Executive Life failures illustrate that the resolution process can be subject to numerous delays due to a number of factors and that the degree to which the different types of policyholders will eventually be paid out may not be obvious at the onset of the failure (in fact, some may never be made whole after waiting a long time for the process to be completed).

## Conclusion

Although history provides examples of insurance company failures, these failures have occurred at relatively small companies—most much smaller than even Penn Treaty and Executive Life. The protections provided by the state insurance guaranty system contrasts with FDIC bank deposit insurance, which is designed to be equitable, fast, transparent, prefunded, and administered at the national level. Some of these differences stem from the fact that the state insurance guaranty system is solving a different problem than deposit insurance for banks: A run on an insurer is typically less likely to happen than a run on a bank. However, the few examples of insurer failures raise important questions regarding the combination of legal uncertainty and timing, as well as the equitable treatment of similarly situated policyholders.

It is unclear how the insolvency of a relatively large U.S. insurer would impact the state guaranty fund system. In 2008, AIG, a large complex insurer, was rescued because of concerns about the systemic consequences of a disorderly failure. This rescue allowed AIG’s life insurance subsidiaries to avoid the receivership process and the involvement of the state guaranty system (McDonald and Paulson, 2015).

The guaranty system is funded ex post, with the funding subject to a per-year cap. The failure of a large life insurer could leave some states in the position of having to levy assessments on the remaining insurers for many years. There is some chance that the flows of money out of the guaranty funds may exceed the flows coming in from the assessments. If this is the case, the guaranty association may issue bonds to attempt to match the timing of the need to pay claims with the timing of the assessments. However, life insurance policies typically have long horizons, so the money to pay claims may not be needed immediately, which may make it easier for the timing of assessments to match the timing of claims.

With that said, insurance regulation in the United States has evolved since the Global Financial Crisis. The changes include a number of efforts by the NAIC—for example, [insurance group supervision](#), [enterprise risk management](#), and the [Own Risk and Solvency Assessment \(ORSA\)](#) programs—related to the supervision, assessment, and management of risk.

---

## Notes

- <sup>1</sup> I am grateful for help on an earlier version of this article from Zain Mohey-Deen, for excellent research assistance from Thanases Plestis, and for comments and editing from Nate Anderson, Han Choi, Alejandro Drexler, Anna Paulson, Andy Polacek, and Richard J. Rosen.
- <sup>2</sup> Author’s calculations based on data from the Board of Governors of the Federal Reserve System, 2022 *Survey of Consumer Finances*.
- <sup>3</sup> I focus on life insurers rather than property and casualty (P&C) insurers because life insurers typically face more risk of runs, owing to the potential differences in liquidity between life insurers’ liabilities (for example, savings-like policies) and their assets (for example, corporate bonds). I also consider the case of a long-term care insurer insolvency as it illustrates complexities of the insurance receivership process in the presence of long-term policies.
- <sup>4</sup> For an excellent overview of policyholder protection, see Gallanis (2014).
- <sup>5</sup> I use “generally” when describing the process because receivership rules are set by state laws that can differ from state to state.
- <sup>6</sup> Model acts are examples of legislation that states can pass as is or modify before enacting.

- 
- <sup>7</sup> For more on the RBC requirement for insurance companies, see this National Association of Insurance Commissioners [webpage](#).
- <sup>8</sup> National Association of Insurance Commissioners (2024, p. 8). In contrast to insurer insolvencies, many other types of insolvencies are handled at the federal level. For insolvencies of banks insured by the FDIC, the agency provides insurance for depositors up to a prespecified limit (currently \$250,000 per customer) and may act as “receiver” of the bank, handling the task of selling assets and settling debts. Insolvencies of nonfinancial firms are typically handled through the bankruptcy process, which is laid out in federal law.
- <sup>9</sup> In contrast, as I discuss later on, guarantees for policyholders, up to prespecified limits, are typically provided by the state guaranty association of the state where the policyholder resides rather than the insurer’s home state.
- <sup>10</sup> Life and Health Insurance Guaranty Association Model Act, section 12(A)(1)(a)–(c), [available online](#).
- <sup>11</sup> Life and Health Insurance Guaranty Association Model Act, section 12(A)(2)–(3), [available online](#).
- <sup>12</sup> Rather than being covered by the guaranty association of the insurer’s home state, policyholders are covered by the guaranty association of the state in which they reside.
- <sup>13</sup> Life and Health Insurance Guaranty Association Model Act, section 6(A), [available online](#). Unallocated annuities are group annuity contracts where the insurer has no record of individual participant accounts (National Association of Insurance Commissioners, 2024, pp. 213–214). An example of an unallocated annuity is a group life insurance policy provided by an employer.
- <sup>14</sup> A handful of states provide additional coverage. See National Organization of Life & Health Insurance Guaranty Associations (2016, 2023).
- <sup>15</sup> Life and Health Insurance Guaranty Association Model Act, section 7(A), [available online](#).
- <sup>16</sup> Typically, the insurer’s home state guaranty association also covers residents of states in which the insurer is not licensed to sell insurance. Because each state has its own licensing requirements for the sale of insurance, an insurer may not necessarily be licensed to sell insurance in all 50 states. Sometimes policyholders purchase insurance from a licensed insurer in their state, but then move to a state in which the insurer does not have a license.
- <sup>17</sup> A large share of the information presented in this subsection comes from the Life and Health Insurance Guaranty Association Model Act, [available online](#).
- <sup>18</sup> One concern is that assets could be moved out of a subsidiary prior to failure, leaving the guaranty association with a larger shortfall to cover. States typically specify rules to deter a parent company from raiding the assets of a subsidiary prior to its failure. Specifically, a receiver can recover capital transfers to affiliates that were made in the five years prior to receivership unless the insurer can show that when paid, the distribution was lawful and reasonable and that the insurer did not know at that time that the distribution might adversely affect the ability of the insurer to fulfill its contractual obligations; see the Life and Health Insurance Guaranty Association Model Act, section 14(F)(1)–(5), [available online](#).
- <sup>19</sup> As explained earlier, the model act splits the life insurance account into three subaccounts: life insurance, annuity, and unallocated annuity (see note 13).
- <sup>20</sup> Life and Health Insurance Guaranty Association Model Act, section 9(E), [available online](#).
- <sup>21</sup> Life and Health Insurance Guaranty Association Model Act, section 8(F)(1), [available online](#).
- <sup>22</sup> The National Organization of Life & Health Insurance Guaranty Associations compiled a [list](#) of these tax reductions (or offsets) for the 50 states (and the District of Columbia).
- <sup>23</sup> McDonald and Paulson (2015); and the National Organization of Life & Health Insurance Guaranty Associations, [2017 insolvency cost workbook](#).
- <sup>24</sup> Long-term care insurance covers the cost of assistance people need when they are unable to care for themselves—for example, assistance with activities such as bathing, dressing, and preparing and eating meals.
- <sup>25</sup> See Mohey-Deen and Rosen (2018).

- 
- <sup>26</sup> Author's calculation based on data from the National Organization of Life & Health Insurance Guaranty Associations, [2017 insolvency cost workbook](#).
- <sup>27</sup> This paragraph about Penn Treaty is largely based on AM Best (2016) and Walsh (2017).
- <sup>28</sup> Pennsylvania Insurance Department (2017).
- <sup>29</sup> About two-thirds of Executive Life's assets were junk bonds (Fogel, 1992, table 2, p. 5).
- <sup>30</sup> Author's calculation based on data from the National Organization of Life & Health Insurance Guaranty Associations, [2017 insolvency cost workbook](#). For a comparison of ELIC to the largest life insurers of the time, see DeAngelo, DeAngelo, and Gilson (1994, table 5, p. 306).
- <sup>31</sup> This paragraph about ELNY is largely based on Coffin et al. (2012). Notably, although ELIC's liquidation was described by Coffin et al. (2012) as "fairly orderly," some ELIC policyholders faced significant difficulties. For instance, some of them were subject to a 30% drop in their annuity payments for two and a half years while legal disputes, some involving different groups of policyholders set against each other, were going on (Lieber, 2008).
- <sup>32</sup> Structured settlement annuities are annuities that are purchased for claimants under lawsuits as directed by courts. The sums involved can be substantial. The claimants are often disabled or impaired and may have a reduced life expectancy.
- <sup>33</sup> As discussed earlier, this situation can occur if a policyholder takes out a policy while living in a state where the insurer is licensed and subsequently moves to a state where the insurer is not licensed.

---

## References

- AM Best, 2016, “Penn Treaty liquidation presents potential shock to the health marketplace,” special report, Oldwick, NJ, December 1, [available online by subscription](#).
- Coffin, Bill, Elizabeth Festa, Warren S. Hersch, Michael K. Stanley, and Shawn Moynihan, 2012, “The complete ELNY saga,” *National Underwriter Life & Health*, Vol. 116, No. 11, November, pp. 26–58.
- DeAngelo, Harry, Linda DeAngelo, and Stuart C. Gilson, 1994, “The collapse of First Executive Corporation junk bonds, adverse publicity, and the ‘run on the bank’ phenomenon,” *Journal of Financial Economics*, Vol. 36, No. 3, December, pp. 287–336. [Crossref](#)
- Fogel, Richard L., 1992, “Insurance regulation: The failure of four large life insurers,” statement of the assistant comptroller general, General Government Programs, before the U.S. Senate, Committee on Banking, Housing, and Urban Affairs, Washington, DC, February 18, [available online](#).
- Gallanis, Peter G., 2014, “Policyholder protection in the wake of the financial crisis,” in *Modernizing Insurance Regulation*, John H. Biggs and Matthew P. Richardson (eds.), pp. 207–240. [Crossref](#)
- Lieber, Ron, 2008, “What happens when your insurer goes under?,” *New York Times*, November 14, [available online by subscription](#).
- McDonald, Robert, and Anna Paulson, 2015, “AIG in hindsight,” *Journal of Economic Perspectives*, Vol. 29, No. 2, Spring, pp. 81–106. [Crossref](#)
- Mohey-Deen, Zain, and Richard J. Rosen, 2018, “The risks of pricing new insurance products: The case of long-term care,” *Chicago Fed Letter*, Federal Reserve Bank of Chicago, No. 397. [Crossref](#)
- National Association of Insurance Commissioners, 2024, *Receivers’ Handbook for Insurance Company Insolvencies*, 2024 ed., Kansas City, MO, [available online](#).
- National Organization of Life & Health Insurance Guaranty Associations, 2023, “The Life & Health Insurance Guaranty Association System: The nation’s safety net, 2023–2024 edition,” report, Herndon, VA, [available online](#).
- National Organization of Life & Health Insurance Guaranty Associations, 2016, “The Life & Health Insurance Guaranty Association System: The nation’s safety net, 2016 edition,” report, Herndon, VA.
- Pennsylvania Insurance Department, 2017, “PA insurance commissioner announces court approval of liquidation of Penn Treaty and American Network Insurance Companies; assures policyholders claims will be paid by state guaranty funds pursuant to state law,” PR Newswire, March 1, [available online](#).
- Walsh, Mary Williams, 2017, “Policyholders in limbo after rare failure of insurer,” *New York Times*, April 1, [available online by subscription](#).

*Economic Perspectives* is published by the Economic Research Department of the Federal Reserve Bank of Chicago. The views expressed are the authors' and do not necessarily reflect the views of the Federal Reserve Bank of Chicago or the Federal Reserve System.

Marcelo Veracierto, Economics Editor; Helen Koshy and Han Y. Choi, Editors; Julia Baker, Senior Production Editor; Sheila A. Mangler, Editorial Assistant.

© 2024 Federal Reserve Bank of Chicago

*Economic Perspectives* articles may be reproduced in whole or in part, provided the articles are not reproduced or distributed for commercial gain and provided the source is appropriately credited. Prior written permission must be obtained for any other reproduction, distribution, republication, or creation of derivative works of *Economic Perspectives* articles. To request permission, please contact Helen Koshy, managing editor, at 312-505-6723 or email [Helen.Koshy@chi.frb.org](mailto:Helen.Koshy@chi.frb.org). *Economic Perspectives* and other Bank publications are available at <https://www.chicagofed.org>.

**ISSN 0895-0164**