Admitted v. Non-admitted- What is the Difference? And What Happens When a Carrier is Declared Insolvent

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When receiving a carrier's quote, inevitably the question is asked "is it admitted or non-admitted?" We always ask it, but do we really understand what the differences are between admitted and non-admitted carriers? And do we know what happens when admitted v. non-admitted carriers go into liquidation? And most importantly, what should the client know? The designation of an insurance company by a state's Insurance Commissioner as "admit-ted" may seem to give the company a stamp of authority, however, this designation is primarily an administrative one rather than a mark of quality or stability. As you may be aware, many large insurers have admitted and non-ad-mitted companies, as well as subsidiaries. So let's take a close look at what admitted v. non-admitted really means.

What is an 'Admitted' Insurance Company?

An admitted carrier is often referred to as a "standard market carri-er." In order to qualify as an admitted carrier, an insurance company must file an application with each state's insurance commissioner and be approved. Approval as an admitted carrier requires compliance with a state's insurance requirements, including the filing and approval of that company's forms and rates. This process often takes a long time as the state insurance commissioner has to review the company's financials, rating model and policy form(s) before the commissioner would be in a position to provide their approval.

Once a carrier is licensed to transact insurance business in a certain state, the carrier is required to pay a portion of their income into the insurance guaranty association of that state. One of the main selling points of being an admitted is that the carrier's liabilities are backed by that state's "guaranty fund." This means that in the event that an admitted company becomes insolvent, the state will use money from that state's guaranty fund to help pay off policyholders' claims.

What is a 'Non-Admitted' Insurance Company?

A non-admitted carrier is often referred to as an "excess and surplus line carrier" and operates in a state without going through the submission and approval process required for admitted companies. Non-admitted carriers are not bound by filed forms or rates, and therefore have much greater flexibility to write and design policies to cover unique and specific risks, and to adjust their premiums accordingly. When standard markets can't or won't write a risk, or if an admitted carrier cannot offer the appropriate terms, the non-admitted market is available to fill this gap. Non-admitted insurance carriers are regulated by the state Surplus Lines Offices, however, regulation is far less invasive than for the admitted markets. The most obvious difference between admitted and non-admitted is that purchasers of non-admitted policies do NOT have the protection afforded by the state's guaranty fund. In addition, each state charges taxes for non-admitted insurance. Further, agents must be licensed in surplus lines to sell non-admitted insurance. It is important to note that the designation as "non-admitted" does not mean and should not be taken as an indication that these insurance carriers aren't legitimate or financially stable. In fact, in order to sell surplus lines insurance, non-admitted insurance companies have to set aside a large monetary reserve or secure adequate re-insurance to make up for the fact that they are not protected by the state's guaranty fund. We note that most states have rules that are set up to protect the admitted markets and make it more difficult to write on surplus lines paper. These rules require, 1) three declinations from an admitted market before one can go to a surplus lines market, 2) mandate that the surplus lines broker provide written notice that the proposed coverage is with an unauthorized insurer, and 3) that any loss suffered in the event of insolvency of the non-admitted insurer will not be covered by state's guaranty fund.

Insolvency

When it has been determined by the insurance commissioner that an insurance company is having significant financial difficulties, the insurance company will go through a process called "rehabilitation." During rehabilitation, the state's insurance commissioner will make every attempt to help the struggling company regain its financial footing. If it is determined that the company cannot be rehabilitated, the company is declared insolvent and the court will order the liquidation of the company.

Liquidation of an Admitted Carrier

If the carrier to be liquidated is an admitted company, the processing/payment of existing and future claims is taken over by that state's guaranty fund. However, the guaranty fund's obliga-tions are limited by their regulations and will only pay claim amounts up to that state's cap. In some cases, if the Insured exceeds a certain revenue threshold (considered as having a "high net worth") they may not qualify for any guaranty fund coverage. Depending on the state, guaranty funds usually provide only $100,000 to $500,000 (with most state's at $300,000) of protection per policy even if the policy purchased had a much higher limit. In addition, in the event that several liquidations take place in one state, the state's guaranty fund may be depleted (if not fully exhausted) of funds when a subsequent liquidation is initiated. Based upon what are often underfunded guaranty funds as well as each state's monetary cap, policyholders often only receive pennies on the dollar of their true loss amount. Finally, while state guaranty funds try to pay claims as quickly and efficiently as possible, payments are often slow as their human resources are very limited and the claim processing procedures are usually overly cumbersome. In sum, although the guaranty funds provide some level of comfort in the event a carrier becomes insolvent, in reality, when an admitted carrier becomes insolvent, policyholders can be left with little or no assistance with their claims, and often are left to pay much of what should have been a covered loss.

Liquidation of a Non-admitted Carrier

If a non-admitted insurance company goes “belly up” their policyholders do not have access to the state guaranty funds. When a non-admitted company is liquidated, the liquidator/receiver collects the assets of the company, determines all the liabilities/creditors outstanding, develops a plan to distribute the company’s assets and submits the plan to the Court for approval (much like a typical bankruptcy pro-ceeding). In most cases, the insurance company’s estate will not yield sufficient money to pay the company’s cred-itors (including their policyholder’s claims) in full. During the liquidation process, policyholders often have to fund defense and settlement payments themselves before they can request reimbursement from the estate. In order to recover covered loss amounts that they have funded, policyholders are required to submit a “Proof of Claim” to the liquidator which describes and provides documentation of their covered loss. Usually, the policyholder will have to wait patiently while the liquidator reviews and considers their submission, and then as the estate is liquidated, the liquidator will distribute the funds in the order set forth by the court, and distribute the amount of funds, pro rata, to each group. Usually, long after the policyholder has filed their Proof of Claim, the liquidator will send some amount of “reimbursement,” which will again, often be pennies on the dollar of the real amount of loss that the policyholder had actually incurred. It is worth noting that the largest surplus lines writer in the United States is Underwriters at Lloyd’s, London (“Lloyd’s”). In 1925, Lloyd’s, in an effort to create stability and certainty with respect to the solvency of its members, created the “Lloyd’s Central Fund.” This fund was created to pay claims in case any underwriting member should be unable to meet his or her liabilities. Each year, every Lloyd’s Syndicate pays a percentage of their annual premium income into the Central Fund (much like the admitted market does with the guaranty funds). However, unlike the guaranty funds, the Central Fund does not have a cap, rather, the only cap for the Central Fund is the policy limit. (We note that Lloyd’s is admitted in IL, KY and the Virgin Islands and that when Lloyd’s writes on admitted paper, those policies are subject to the state’s guaranty funds, and do not have the protection of the Lloyd’s Central Fund). Accordingly, if a policy is written through Lloyd’s, the Lloyd’s Central Fund will cover that loss up to the full limit of that policy.

Bottom Line

The choice between admitted and non-admitted insurance companies is something that needs to be considered. However, examining the financial strength of the individual providers, the breadth of coverage and competitiveness of terms, rather than their status as admitted or non-admitted, are the most important factors for comparison. While your ultimate choice of an insurance company may be restricted based on the type of insurance you need, the priority should always be to seek a high-quality provider, regardless of whether the company is admitted or non-admitted.