

***New Jersey Assembly Bill 5051—A Bill to Establish New Jersey Life and Health Insurance Guaranty Association—Fund; a Fund to Protect Policyholders in the Event that the Insurance Company Becomes Impaired or Insolvent; and to Provide for Related Matters—N.J. Stat. Ann. §§ 17B:32A-1 to -19 (West 1991)***

New Jersey Assembly Bill 5051 (hereinafter A. 5051) established a nonprofit legal entity, the New Jersey Life and Health Insurance Guaranty Association (Association).<sup>1</sup> The Association is empowered to create and manage a fund designed to protect policyholders from possible hardships due to insolvency<sup>2</sup> or impairment<sup>3</sup> of a member insurer<sup>4</sup> that issues life and health insurance policies and certain annuities.<sup>5</sup> The bill provides coverage of \$500,000 for a life insurance policy and an unlimited health insurance benefits coverage.<sup>6</sup> The bill is retroactive to encompass losses due to the failure of Executive Life and GHI, a medical service corporation that became insolvent in 1987.<sup>7</sup>

***I. Legislative History***

A. 5051 was introduced in the New Jersey Assembly on June 24, 1991.<sup>8</sup> The bill passed the Assembly by a vote of seventy-

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<sup>1</sup> N.J. STAT. ANN. § 17B:32A-5 (West 1991).

<sup>2</sup> “‘Insolvent’ means a member insurer which after the effective date of this act, is placed under an order of liquidation by a court of competent jurisdiction with a finding of insolvency.” *Id.* § 17B:32A-4.

<sup>3</sup> “‘Impaired’ means a member insurer which, after the effective date of this act: (1) is determined by the commissioner to be potentially unable to fulfill its contractual obligation; or (2) is placed under an order of receivership, rehabilitation or conservation by a court of competent jurisdiction.” *Id.*

<sup>4</sup> “‘Member insurer’ means any insurer licensed in this [s]tate or which holds a certificate of authority to transact any kind of insurance in this [s]tate . . . , and includes any insurer whose license or certificate may have been suspended, revoked, not renewed or voluntarily withdrawn.” *Id.*

<sup>5</sup> *Id.* For specific structure, contributions and management of the fund *see infra* text accompanying notes 36-41.

<sup>6</sup> *Id.* § 17B:32A-3.

<sup>7</sup> Briefing Paper from Assembly Republican Office to its members [hereinafter Briefing Paper] (July 15, 1991) (discussing the pros and cons of the proposed legislation).

<sup>8</sup> NEW JERSEY STATE LEGISLATURE BILL GUIDE, A CUMULATIVE GUIDE TO THE 204TH LEGISLATURE, SECOND ANNUAL SESSION, JANUARY 8, 1991 TO AUGUST 5, 1991, at 102 (June 24, 1991) [hereinafter CUMULATIVE GUIDE TO THE 204TH LEGISLATURE].

four to zero.<sup>9</sup> At that time, A. 5051 established a guaranty fund only for Blue Cross and Blue Shield of New Jersey.<sup>10</sup> On June 27, 1991 the Senate, by a vote of twenty-seven to zero with seventeen no votes, passed A. 5051 with floor amendments.<sup>11</sup> The Senate amendments drastically expanded the scope of the bill to include all health and life insurance carriers.<sup>12</sup> On June 30, 1991 the Senate passed the amended version of the bill by a vote of forty to zero, and the Assembly concurred with the Senate by a vote of seventy-eight to zero.<sup>13</sup>

On July 15, 1991 Governor James J. Florio conditionally vetoed A. 5051.<sup>14</sup> Although he commended the legislature for the timely passage of A. 5051, the Governor urged revisions in two key areas.<sup>15</sup> First, he recommended that the coverage should be increased from \$100,000 to an unlimited amount for health insurance, and that the life insurance coverage as provided by the Assembly be increased from \$300,000 to \$500,000.<sup>16</sup> Second, the Governor proposed that the tax deduction for contributing insurance companies should be decreased.<sup>17</sup>

Later that day, the Assembly approved the recommendations made by the Governor by a vote of sixty-two to zero, while the Senate approved the modifications by a vote of thirty-seven to

<sup>9</sup> *Id.*

<sup>10</sup> Briefing Paper, *supra* note 7.

<sup>11</sup> CUMULATIVE GUIDE TO THE 204TH LEGISLATURE, *supra* note 8, at 102.

<sup>12</sup> Briefing Paper, *supra* note 7 (citing Senate Amendments proposed by Sen. Lesniak to A. 5051).

<sup>13</sup> CUMULATIVE GUIDE TO THE 204TH LEGISLATURE, *supra* note 8, at 102.

<sup>14</sup> Conditional Veto Message of A. 5051, by James J. Florio, Governor, New Jersey, to the New Jersey Legislature. (July 15, 1991).

<sup>15</sup> *Id.* The Governor declared that the bill "will vastly improve the climate for life and health insurance in the state." *Id.*

<sup>16</sup> *Id.* The Governor stated, "I believe that health insurance is such a critical necessity in today's society [and] that there should be no artificial limit on what is covered by the guarantee fund." *Id.*

<sup>17</sup> *Id.* The Governor stated,

[I] believe that creation of a guarantee fund should have minimal impact on taxpayers. The bill currently allows contributing companies to deduct from their premium taxes fifty percent of any assessment over five years. I recommend that contributing insurance companies be allowed to deduct no more than twenty percent of their tax liability in any year, and that no deductions will be allowed until an additional year after the assessment is made.

*Id.*

zero.<sup>18</sup> The Governor then signed A. 5051 into law.<sup>19</sup>

## II. Legislative Intent

A. 5051 was originally designed as a guarantee fund exclusively for Blue Cross and Blue Shield of New Jersey.<sup>20</sup> The legislation was proposed in response to the National Blue Cross and Blue Shield Association's request for such a fund if its New Jersey chapter was to continue the use of its trade name.<sup>21</sup> Additionally, the lawmakers were responding to the fact that New Jersey was only one of three remaining states in the nation without such a fund.<sup>22</sup> With the state takeover of Mutual Benefit Life, industry insiders feared that some of New Jersey's health insurance companies might also be facing financial difficulties; therefore, the legislation took on additional urgency and importance.<sup>23</sup>

The fund was designed to protect policyholders in the event that an insurance company declares bankruptcy.<sup>24</sup> Furthermore, the legislature believed that such legislation would prevent a run on insurance companies when their financial situation deteriorates.<sup>25</sup>

## III. Extent of the Coverage

The statute extends protection to both residents and nonresidents of the state.<sup>26</sup> A. 5051 covers direct, non-group, health, annuity and supplemental policies.<sup>27</sup> Additionally, A. 5051 covers policies and contracts that were issued by medical service corporations that were declared insolvent or impaired by the court on or after September 1, 1987.<sup>28</sup> However, the bill does not

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<sup>18</sup> CUMULATIVE GUIDE TO THE 204TH LEGISLATURE, *supra* note 8, at 102.

<sup>19</sup> *Id.*

<sup>20</sup> Florio Approves Insurance Bailout Fund, TRENTON TIMES, July 16, 1991, at 50.

<sup>21</sup> Briefing Paper, *supra* note 7.

<sup>22</sup> *Id.*

<sup>23</sup> Coleen Dee Berry, *Guarantee Fund OK'd to Protect Policyholders*, ASBURY PARK PRESS, July 16, 1991, at 5.

<sup>24</sup> Briefing Paper, *supra* note 7.

<sup>25</sup> Donna Leusnen, *Insurance Safe Guards Enacted*, STAR LEDGER (Newark), July 16, 1991, at 43. Assemblyman Michael Adubato commented on the passed legislation and its effects, stating if it were passed sooner "maybe, maybe, just maybe Mutual Benefit Life would not have had the run on its assets." *Id.*

<sup>26</sup> N.J. STAT. ANN. § 17B:32A-3(a)(1) (West 1991).

<sup>27</sup> *Id.* § 17B:32A-3(b)(1).

<sup>28</sup> *Id.* § 17B:32A-3(b)(2). See *supra* text accompanying note 7.

cover policies not guaranteed by the insurer, risk-investment type policies or policies already covered by Pension Guaranty Corporation.<sup>29</sup>

The Association's liability to an individual, regardless of the number of policies held by the individual, shall not exceed \$500,000 for life insurance death benefits with no more than \$100,000 in cash surrender value.<sup>30</sup> A. 5051 also covers annuity benefits up to \$500,000 per individual with a \$100,000 maximum cash surrender value.<sup>31</sup> A \$2,000,000 coverage is also provided for any one unallocated annuity contract.<sup>32</sup> With respect to accident or health insurance policy the benefits are unlimited.<sup>33</sup>

The unlimited health insurance coverage does have a caveat.<sup>34</sup> In order for the health provider to receive payment from the Association, the provider must forgo twenty-percent of the fee charged to the policyholder.<sup>35</sup>

#### *IV. Structure of the Association*

Membership in the Association is mandatory for all insurance companies conducting business in the state.<sup>36</sup> Those companies that cease to conduct business in the state shall remain a member of the Association for the next four years.<sup>37</sup> The Association shall have a board of directors composed of no less than five but no more than nine members.<sup>38</sup> The board members will be elected by members of the Association.<sup>39</sup> The Commissioner<sup>40</sup> will be the direct supervisor of the Association, and approve the nominations for membership on the board of directors.<sup>41</sup>

<sup>29</sup> *Id.* § 17B:32A-3(c)(7).

<sup>30</sup> *Id.* § 17B:32A-3(d)(2)(a).

<sup>31</sup> *Id.* § 17B:32A-3(d)(2)(b).

<sup>32</sup> *Id.* § 17B:32A-3(d)(2)(b)(3).

<sup>33</sup> *Id.* § 17B:32A-3(d)(2)(b)(4); *see supra* note 16.

<sup>34</sup> Briefing Paper, *supra* note 7.

<sup>35</sup> N.J. STAT. ANN. § 17B:32A-3(e).

<sup>36</sup> *Id.* § 17B:32A-5(a).

<sup>37</sup> *Id.*

<sup>38</sup> *Id.* § 17B:32A-6(a).

<sup>39</sup> *Id.*

<sup>40</sup> "'Commissioner' means the Commissioner of Insurance." *Id.* § 17B:32A-4.

<sup>41</sup> *Id.* § 17B:32A-6(a).

### V. Association's Power and Duty

The Association, with the approval of the Commissioner, may "guarantee, assume, or reinsure, or cause to be guaranteed, assumed, or reinsured" policies of an impaired insurer.<sup>42</sup> Thus, the Association may elect to provide substitute benefits in lieu of obligations by the impaired insurer.<sup>43</sup> Similarly, the Association may choose to extend substitute coverage provided that the coverage meets three criteria.<sup>44</sup> First, the issue of alternative policies can not be conditioned on proof of insurability.<sup>45</sup> Second, the alternative policy shall meet at least minimum statutory requirements of the state.<sup>46</sup> Third, premiums of the alternative policy shall be based on a rate schedule adopted by the Association and shall not be set arbitrarily.<sup>47</sup> If a policyholder fails to pay the premium within thirty-one days of notice by the Association, the substitute coverage shall terminate together with Association's obligation under the alternative policy.<sup>48</sup>

To assist and strengthen the position of the Association as a business and legal entity, A. 5051 provides that the Association has standing in a court of law.<sup>49</sup> Moreover, the Association has the power to sue or be sued, borrow money, and employ a staff to facilitate financial transactions of the Association.<sup>50</sup>

### VI. Funding the Association

The Association will draw its funds from mandatory contributions levied upon member insurers.<sup>51</sup> The assessment shall be divided into two categories.<sup>52</sup> First, Class A assessments will rep-

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<sup>42</sup> *Id.* § 17B:32A-7(a)(1).

<sup>43</sup> *Id.* § 17B:32A-7(b).

<sup>44</sup> *Id.* § 17B:32A-7(c)(4)(a). All alternative policies offered by the association are subject to the Commissioner's approval. *Id.*

<sup>45</sup> *Id.* § 17B:32A-7(c)(4)(b).

<sup>46</sup> *Id.* § 17B:32A-7(c)(5)(b).

<sup>47</sup> *Id.* § 17B:32A-7(d)(6). If the Association wishes to use different rates than those used in the calculated policy, the rates must be set based on actuarial tables approved by the Commissioner. *Id.*

<sup>48</sup> *Id.* § 17B:32A-7(f).

<sup>49</sup> *Id.* § 17B:32A-7(l). As part of the standing to sue, the Association may require assignment of any cause of action from any person receiving benefits that fall within this act. *Id.* § 17B:32A-7(m).

<sup>50</sup> *Id.* § 17B:32A-7(n).

<sup>51</sup> *Id.* § 17B:32A-8. The board of directors shall assess contributions. *Id.*

<sup>52</sup> *Id.* § 17B:32A-8(b).

resent the cost of administrative functions of the Association.<sup>53</sup> Second, Class B assessments will be made when one of the members of the Association becomes insolvent or impaired.<sup>54</sup>

Class B assessments, made by the board, shall be determined on a basis that takes into account the premiums that an assessed member received in the state.<sup>55</sup> Those assessments can be appealed to the Commissioner with the understanding that while the appeal is pending the obligation to the Association still has to be paid.<sup>56</sup> If a member insurer fails to contribute the assessed amount, the Commissioner may suspend or revoke the certificate of that member to transact business in the state.<sup>57</sup> However, if payment of the assessment by the member insurer would endanger the financial stability of the member, the assessment is deferred.<sup>58</sup> Furthermore, the total of all assessments (Classes A and B) on a member insurer shall not exceed two-percent of that insurer's average premiums for a calendar year.<sup>59</sup> If the maximum assessment fails to meet the financial needs of the Association to carry out its functions, then the additional funds needed shall be assessed in the next calendar year.<sup>60</sup>

## VII. Conclusion

The New Jersey Legislature's goal to protect policyholders from possible hardships due to failure of an insurance carrier is a commendable one. The positive impact of the legislation on the public is manifested by the fact that most individuals have some form of investment associated with the industry. That investment may be in the form of a retirement plan or health insurance. In fact, some individuals might have their entire life savings in-

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<sup>53</sup> *Id.* § 17B:32A-8(b)1. These assessments are not related to a particular insurer becoming insolvent or impaired. *Id.*

<sup>54</sup> *Id.* § 17B:32-8(b)(2). See *supra* notes 2-3.

<sup>55</sup> *Id.* § 17B:32A-8(c). The formula will take into account the most recent years prior to the insurer becoming insolvent. *Id.*

<sup>56</sup> *Id.* § 17B:32A-10(c). Any final decision in this matter is subject to review of a court with proper jurisdiction. *Id.*

<sup>57</sup> *Id.* § 17B:32A-10(b). As an alternative, a penalty may be levied against the non-complying member; the penalty should not be greater than five-percent of the unpaid assessment per month. *Id.*

<sup>58</sup> *Id.* § 17B:32A-8(d). The deferred amount is assessed against the other member insurers. *Id.*

<sup>59</sup> *Id.* § 17B:32A-8(e).

<sup>60</sup> *Id.*

vested with insurance companies. Providing a safety net to protect those individuals was long overdue in light of the fact forty-seven states already provided their citizens with adequate protection.

Moreover, the demand by Blue Cross and Blue Shield for such legislation underscores the importance of A. 5051. Failure to pass such legislation would have had a direct impact on 500,000 individual subscribers of New Jersey Blue Cross and Blue Shield.

Additionally, the financial difficulties of Mutual Benefit Life accentuates the reality of the current state of economy. If a giant such as Mutual Benefit Life can become financially strapped, it is not hard to imagine that the same fate can befall other companies.

The legislature wisely adopted Governor Florio's proposal of unlimited health insurance coverage.<sup>61</sup> Limiting the coverage would have exposed individuals who are confronted with staggering medical bills with the frightening possibility that their coverage will run out due to the failure of their insurance carrier. Such a predicament is the last thing that an ill person or his family needs.

The annuity benefit coverage of \$500,000, however, is too excessive. The legislature should have left the Assembly's proposal of \$100,000 in tact. Such a large coverage could increase the cost to the fund once a company becomes insolvent. This means that the large cost of bailing out a failed company eventually will be passed to the consumers in the form of higher premiums.

A smaller coverage would not only keep the cost of bailouts down but also promote diversification of investment portfolios on the part of the policyholder. Knowing that the annuity is only covered up to \$100,000, a wise investor would diversify into other investments or could purchase annuities from a number of other companies. Therefore, failure of one insurance company would have a reduced effect on an investor who invested in more than one company. The same principal applies to the large coverage provided by the legislation for life insurance policies. A

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<sup>61</sup> See *supra* text accompanying notes 16, 33.

smaller coverage would promote diversification and smaller costs once a company fails financially.

The provision that allows insurance companies to write-off 20% of their assessment, three years after the assessment has been paid, is a much sounder provision than the original 50% write-off.<sup>62</sup> To allow for more than a 20% write-off would result in a great loss of tax revenues for the state. This concept is well illustrated by the fact that the failure of Executive Life is estimated to cost the Association \$600,000,000. Thus, to allow more than a 20% write-off would be fiscally unsound for the state. Since the state is already in financial difficulties, the loss of any revenue is undesirable.

Only the failure of a member insurance company will trigger the Class B assessment and the outlay of substantial amounts of capital. This is a practical structure since otherwise member companies would have to keep reserve capital in a united fund. Such an arrangement would take away a substantial amount of working capital from the companies. The current structure allows the member companies to outlay only minimal capital for administrative functions of the fund.

The provision that precludes any assessment that would endanger the financial stability of a carrier is a sound and practical one.<sup>63</sup> It would be unfortunate that in the process of bailing out one company another carrier would meet the same fate because of the financial strain due to the assessment.

Overall, A. 5051 is a suitable answer to the demands of the market place and the financial environment. If the fund is run as a nonprofit organization with minimum administrative costs it has great potential for improving the stability of the insurance industry.

A monitoring system should be implemented so the fund does not become a costly bureaucracy. The operation costs of the fund should be kept to a minimum and only in the instance when a member carrier needs assistance should there be any real outlay of capital.

The legislation has great potential to become a positive component of the insurance industry. The correct management of

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<sup>62</sup> See *supra* text accompanying note 17.

<sup>63</sup> See *supra* text accompanying note 58.



the fund will insure that policyholders of the state have the safety net that they deserve.

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