INSURED FINANCING PUTS CALIFORNIA INSURANCE GUARANTEE ASSOCIATION BACK ON SOLID GROUND

Deregulation is usually considered a positive development for business interests. There are times, however, when the intricacies of a particular industry belie common wisdom. Such was the case for the California workers' compensation insurance sector. In the 1990s, the California legislature undertook a broad deregulation plan that had the unintended effect of over-extending the State fund that guarantees coverage in the event of insurance company insolvencies. That fund, the California Insurance Guarantee Association (CIGA), was formed in 1969 to pay claims, including workers' compensation claims, when original insurers are unable to pay. As the insurer of last resort, CIGA collects fees from companies licensed to sell workers' comp coverage, which is mandatory for all employers in the state.

Following deregulation of the sector, insurers began to compete aggressively, primarily on price. While customers initially benefited from cheaper coverage, the economics were unsustainable and insurers began to declare insolvency or exit the California market. As a result, claims which would have to be paid by CIGA began to skyrocket. To fund the looming shortfall and avoid an unrealistic escalation of fees for insurers, in the Spring of 2004 CIGA officials decided to pursue a financing plan that would enable a more gradual increase in fees, while bringing the fund back to equilibrium.

Time was of the essence, so CIGA coordinated with the California Infrastructure and Economic Development Bank to arrange for a bond issue. This was one of the first bond issues of its kind to be secured by mandatory fees assessed to insurance companies providing workers' compensation insurance. A major twist was that over 53% of such fees are paid by the State workers' compensation insurer of last resort, known as the "State Fund." Touching upon the credit qualities of the State of California, the State Fund and the private sector insurance industry, the credit analysis of this transaction was complex. CIGA sought a financial guarantee to strengthen the ratings of the bonds and enable the transaction to come to market promptly. Ambac acted quickly to provide CIGA with a thorough analysis and recommendation for the transaction. In a matter of days, Ambac officials were able to contact CIGA's financing team with a financial guarantee recommendation for the deal.

As a result, $750 million of bonds came to market in August 2004 with a triple-A rating. The successful financing enabled CIGA to solidify its finances at the lowest possible cost and pursue a fee structure with insurance companies throughout the State that will serve the needs of the State, the insurers and, most importantly, the people of California.

For additional information please contact:

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