House Legislative Analysis Section

Manufacturer's Bank Building, 12th Floor
Lansing, Michigan 48909
Phone: 517/373-6466

RISK RETENTION GROUPS/PURCHASING GROUPS

House Bill 4157 as enrolled
Second Analysis (1-8-90)

Sponsor: Rep. Mary C. Brown
House Committee: Insurance
Senate Committee: Commerce & Technology

THE APPARENT PROBLEM:

The federal Liability Risk Retention Act of 1986 was enacted in response to the problems businesses and other entities had finding liability insurance. It permits groups of organizations engaged in similar or related activities that give rise to similar risks to form their own insurance company, to be called a "risk retention group" Such a group is essentially an insurance company chartered in one state and then granted special federal permission to write insurance in other states. It is a company, however, that is limited to selling coverage to its own membership. The 1986 act also authorized the creation of groups of related entities for the purposes of purchasing liability insurance coverages, either from existing insurance companies or from risk retention groups. (A 1981 federal law had allowed special risk retention groups, but only for product liability and completed operations coverages.) While the federal law pre-empts state regulation of these new groups for the most part, particularly when they are domiciled in another state, states are permitted to impose some consumer protection regulations and to impose taxes. Some people believe Michigan should adopt regulations based on the model developed by the National Association of Insurance Commissioners (NAIC).

THE CONTENT OF THE BILL:

The bill would amend the Insurance Code to create a new Chapter 18, which would regulate risk retention groups and purchasing groups formed under the federal Liability Risk Retention Act of 1986. (That act, in short, permits groups of entities engaged in similar or related activities giving rise to similar risks to form their own insurance companies, which are limited to selling liability coverages to group members.) Generally speaking, the bill applies to three kinds of groups: (1) risk retention groups chartered in the state; (2) risk retention groups chartered in other states but operating in Michigan; and (3) purchasing groups. The bill would take effect January 1, 1990.

Risk Retention Groups To be chartered in Michigan, a risk retention group would have to obtain a certificate of authority from the insurance commissioner and be licensed as a domestic stock or mutual casualty insurance company. It would have to comply with statutes, rules, regulations, and requirements applicable to those kinds of companies (including tax requirements). In applying for the certificate, the group would have to identify the initial group members and the group's organizers or administrators and describe the amount and nature of its initial capitalization. The group's certificate would be limited to the business of liability insurance. Before it could offer insurance, a group chartered in the state would have to submit for approval by the insurance commissioner a plan of operation or a feasibility study. The submission would have to include, among other things, verification that group members were properly related; a description of coverages, deductibles, coverage limits, rates, and rating classifications; historical or expected loss exposures; financial statements for the past three years or projections for the next three years; opinions by an independent actuary; and identification of management, underwriting and claims procedures; marketing methods, managerial oversight methods, investment policies, and reinsurance agreements. The name under which a group would be chartered would include a brief description of the group's membership followed by the phrase "risk retention group" Before a risk retention group chartered elsewhere could begin operations in Michigan, the group would have to submit to the insurance commissioner the name of the state in which it was chartered and its place of business, a copy of the plan of operation or feasibility study submitted in the home state, a copy of the financial statement submitted to the home state, and a registration form designating the insurance commissioner as the group's agent for the purpose of receiving service of legal documents or process, accompanied by a $25 registration fee. The group would also have to submit a copy of the most recent examination (or any other examination requested) of the group, and at the request of the insurance commissioner, a copy of any audit or other information needed to determine the group's financial condition. Each year by March 1, a group would have to submit an updated financial statement certified by an independent public accountant and containing a statement of opinion on loss and loss adjustment expense reserves made by a qualified actuary or loss reserve specialist. (A group operating in the state prior to the effective date of this bill would have until February 1, 1990, to comply with these requirements.)

Further, the out-of-state group would be liable for a tax of two percent on direct business for a risk residing or located in the state. The group and its agents or representatives would have to comply with Chapter 20 of the Insurance Code, which deals with unfair and prohibited trade practices. A group would have to submit to an examination by the insurance commissioner to determine its financial condition if its home state does not conduct an examination within 60 days of a request for one by Michigan's commissioner. Further, an out-of-state group would have to comply with a lawful order issued in a voluntary dissolution proceeding or a delinquency proceeding begun by the insurance commissioner if there had been a finding of financial impairment.

A risk retention group, no matter where chartered, could not join or contribute financially to the property and casualty guaranty association or any similar mechanism in the state, and a group, its insureds, or claimants against its insureds could not receive any benefit from such guaranty associations. (Guaranty associations are supported by the insurance industry to help pay claims in the case of an insolvency by an insurance company.) A risk retention group, however, that provides no-fault liability insurance for cars or trucks would be a participating member in the Michigan Automobile Placement Facility

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(which is a pool for high-risk drivers supported by auto insurers). Applications and policies issued by a group would have to carry a notice in ten-point type that pointed out that the group might not be subject to all insurance laws and regulations of the state and that insolvency guaranty funds would not be available to the group.

Risk retention groups would be prohibited from: soliciting or selling insurance to a person not eligible for membership in the group; soliciting or selling while in a hazardous financial condition or while financially impaired; having as a member or owner an insurance company, unless the group was entirely made up of insurance companies; and issuing a policy containing coverage of a kind generally prohibited by law or declared unlawful by a final and binding decision of an appellate court. Any group that violated a provision of the new chapter would be subject to fines and penalties applicable to licensed insurers, including revocation of the right to do business.

Purchasing Groups Before doing business in the state, a purchasing group would have to inform the insurance commissioner of its name and state of domicile, the other states in which it was doing business, the types and classifications of liability insurance it intends to purchase, the companies from which it intends to purchase coverages and the home states of the companies, the method by which and the person through whom insurance will be offered to group members, and the officer responsible for the group. The commissioner could require other information to verify the purchasing group was qualified. (Groups already doing business before the effective date of the bill would have to submit this information by February 1, 1990.) The group would have to submit a statement of registration designating the commissioner as its agent for the purpose of receiving service of legal documents or process, accompanied by a $25 fee. A purchasing group could only purchase insurance for risks in the state from a chartered risk retention group, from an insurance company authorized in the state, or from a surplus lines insurer if the transaction is conducted under surplus lines regulations. (Surplus lines coverages are those not readily available from carriers in the state and are purchased by means of special surplus lines agents.) When a group purchased coverage from a risk retention group or from a unauthorized insurance company, it would have to notify its members in writing that the risk was not protected by an insolvency guaranty fund and that the carrier might not be subject to all of the state's insurance laws and regulations. A group could not purchase insurance providing for a deductible or self-insured retention unless the deductible or self-insured retention was the sole responsibility of each individual member of the purchasing group. Purchasing groups would be subject to premium taxes in the same way other insurance customers are.

In order to be involved in soliciting, negotiating, or procuring liability insurance for a purchasing group or on behalf of a purchasing group, a person or entity would have to meet the licensing requirements in Chapter 12 of the Insurance Code, which deals with agents, solicitors, and counselors, and, for purchases from unauthorized insurers, Chapter 19 of the code, which regulates surplus lines agents and brokers.

MCL 500.456 and 500.1801

FISCAL IMPLICATIONS:

The Senate Fiscal Agency estimates that the bill would produce $50,000 in annual revenue to the state from the two percent tax on direct business to be paid by risk retention groups operating in the state but chartered elsewhere. There would also be $9,625 in one-time revenue from registration fees paid by risk retention groups and purchasing groups, according to the SFA. This is based on Insurance Bureau estimates that there are 50 risk retention groups and 335 purchasing groups currently that would have to pay a $25 registration fee. The cost of additional examinations by the bureau would be offset by examination fees. (10-23-89)

ARGUMENTS:

For:

The bill provides state insurance regulators with the authority allowed them under the federal Liability Risk Retention Act of 1986 over risk retention groups and purchasing groups. The federal law was passed to respond to complaints in the mid-1980's that liability insurance was not available. State regulators say the federal law severely limits the state's ability to regulate the new entities, but does allow states to make the groups observe unfair trade practices laws and to pay premium taxes. The bill would also allow the state to guard against financial crises that could leave the state's consumers without the coverage they had paid for. This is particularly important because risk retention groups do not participate in the guaranty funds sponsored by the insurance industry to protect customers in the event of an insolvency. The Insurance Bureau reports that underfinanced insurers have engaged in selling high-risk liability insurance through purchasing groups they have created outside of their own states of domicile. State regulators elsewhere, notably in Iowa, have successfully challenged these practices in court, and the content of the court decisions needs to be incorporated into state law. The bill is said to be based on a model act developed by the National Association of Insurance Commissioners (NAIC).

Against:

Some people might argue that many of the bill's provisions are unnecessary because they are already part of the federal law.