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BILL ANALYSIS

Senate Fiscal Agency

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House Bill 4157 (Substitute H-2 as reported with amendments)

Sponsor: Representative Mary C. Brown

House Committee: Insurance

Senate Committee: Commerce and Technology

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RATIONALE

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, but 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).

CONTENT

The bill would amend the Insurance Code to create a new chapter that would regulate "risk retention groups" and "purchasing groups" formed under the Federal Liability Risk Retention Act. In addition to specifying certain filing,

examination, and fee and tax requirements relative to risk retention groups and purchasing groups, the bill would make other provisions pertaining to the Property and Casualty Guaranty Association; motor vehicle coverage; insurance agents and brokers; demonstration of financial responsibility requirements; and the powers of the Insurance Commissioner. The bill would take effect January 1, 1990.

A risk retention group would be a corporation or other limited liability association that met all of the following criteria:

- It was either chartered in a U.S. state or Washington, D.C., or chartered or licensed before January 1, 1985, and was authorized to do insurance business under the laws of Bermuda or the Cayman Islands. (A corporation with the latter type of authorization would have to have certified to the insurance commissioner of at least one U.S. state, before January 1, 1985, that it satisfied that state's capitalization requirements and would have to have been in business continuously since that date.)
- It did not exclude a person from membership solely to provide group members with a competitive advantage.
- It either had as its owners only persons who comprised the group's membership and were covered by its insurance, or had as its sole owner and member an organization owned by persons who were covered by the group's insurance.

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- Its members were engaged in similar or related businesses or activities with respect to potential liability exposure.
- It was organized for, and its activities were limited to, the provision of either group liability insurance or reinsurance with respect to another risk retention group's liability.
- Its name included the phrase "risk retention group".

A purchasing group would be a group that met all of the following criteria:

- One of its purposes was the purchase of liability insurance on a group basis.
- Its members were engaged in similar or related businesses or activities with respect to potential liability exposure.
- It purchased insurance only for group members and only to cover their similar or related liability risks.
- It was domiciled in Michigan.

Risk Retention Groups

An application form for insurance from a risk retention group chartered and/or operating in Michigan, and the front and declaration pages of a policy that was issued by a group, would have to contain the following notice in 10-point type:

NOTICE

This policy is issued by your risk retention group. Your risk retention group may not be subject to all of the insurance laws and regulations of your state. State insurance insolvency guaranty funds are not available for your risk retention group.

A risk retention group chartered and/or operating in Michigan could not do any of the following:

- Solicit or sell insurance to someone who was not eligible for group membership.
- Solicit or sell insurance if the risk retention group were in a "hazardous financial condition" or were "financially impaired". ("Hazardous financial condition" would mean that a group was unlikely to be able to meet obligations to

policyholders with respect to known claims and reasonably anticipated claims or to pay other obligations in the normal course of business, although not yet financially impaired or insolvent.)

- Have an insurance company as an owner or member, unless all members of the group were insurance companies.
- Issue a policy with terms that provided, or could be construed to provide, coverage that was generally prohibited by law or declared unlawful by a final and binding decision of an appellate court that had considered the matter.

A risk retention group that violated the bill would be subject to fines and penalties applicable to licensed insurers. A risk retention group that operated in Michigan before January 1, 1990, would have to comply with the bill's requirements pertaining to submittal of information to the Commissioner by February 1, 1990.

A risk retention group that did not have a certificate of authority from the Commissioner would have to pay a tax of 2% on direct business for a risk located within Michigan. The group would have to report to the Commissioner the net direct premiums written for that business.

In-State Risk Retention Groups. In order 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 insurer. A Michigan-chartered group would have to comply with all laws, rules, regulations, and requirements applicable to domestic insurers. Its certificate would have to be limited to providing liability insurance. In applying for a charter, a risk retention group would have to provide to the Commissioner, in summary form, all of the following:

- The identities of the group's initial members and of those who organized the group or who would provide administrative services or control or influence the group's activities.
- The amount and nature of the group's initial capitalization.
- The coverages that would be afforded and the states in which the group

intended to operate.

Prior to offering insurance in this State, a Michigan-chartered risk retention group would have to submit to the Commissioner, for his or her approval, a plan of operation or feasibility study. Within 10 days of any change in such a plan or study, the group would have to submit a revision. A group could not offer any additional kinds of liability insurance until a revision of the plan or study received the Commissioner's approval.

Out-Of-State Risk Retention Groups. Before offering insurance in this State, a risk retention group not chartered in Michigan would have to submit all of the following to the Insurance Commissioner:

- A statement that identified any state in which the group was chartered as a liability insurer, the date on which it was chartered, and its principal place of business.
- A copy of the group's plan of operation or feasibility study and revisions of the plan or study submitted to its chartered state; revisions would have to be submitted at the time they were submitted to the chartering state. (The submission requirement, however, could not apply with respect to any line of liability insurance that was defined in the Federal Liability Risk Retention Act before the 1986 amendments to that Act and was offered by a group that was chartered and operating for at least three years before that date.)
- A copy of the group's financial statement submitted to the chartering state. (The statement would have to be submitted by March 1 of each year and would have to be certified by an independent public accountant and contain a "statement of opinion on loss and loss adjustment expense reserves made by a member of the American Academy of Actuaries or a qualified loss reserve specialist".)
- A \$25 registration fee and a statement of registration that designated the Commissioner as its agent for the purpose of receiving service of legal documents or process.

The group also would have to submit a copy of

its most recent examination, and, upon the Commissioner's request, any examination of the group that was certified by the Commissioner or public official who conducted the examination. Also upon request of the Commissioner, the group would have to submit a copy of any audit performed on it, and other information that the Commissioner considered necessary to determine the group's financial condition or verify its continuing qualification as a risk retention group.

A risk retention group that did business in Michigan, but was not chartered in this State, would have to submit to an examination of its financial condition by the Commissioner, if the chartering state's commissioner did not initiate such an examination within 60 days after a request to do so by the Michigan Insurance Commissioner. The bill specifies that such examinations "should be coordinated with examination requests in other states to avoid unjustified repetition and conducted in an expeditious manner in accordance with generally accepted auditing standards".

A group that operated in Michigan, but was not chartered in this State, and the group's agents and representatives would have to comply with Chapter 20 of the Code, which deals with unfair and prohibited trade practices and frauds. Such a group also would have to comply with a lawful order that was issued in a voluntary dissolution proceeding or in a delinquency proceeding that was commenced by the Commissioner, if there were a finding of financial impairment after an examination of the group's financial condition.

Purchasing Groups

Before doing business in Michigan, a purchasing group would have to provide the Insurance Commissioner with all of the following:

- The name of the purchasing group through which it was purchasing liability insurance, the U.S. state in which the purchasing group was domiciled, and the names of all other U.S. states in which the group was doing or intended to do business.
- The specific types and classifications of liability insurance that the group

intended to purchase.

- The identity of any insurance company from which the group intended to purchase insurance and the domicile of those companies.
- The method by which, and the person through whom, insurance would be offered to the group's members whose risks were resident or located in Michigan.
- The officer or person responsible for the purchasing group.
- Other information that the Commissioner required to verify that the group was qualified under the bill.

A purchasing group would have to notify the Commissioner of any changes in any of the above items, within 10 days of the change. A group annually would have to notify the Commissioner of its intention to continue to operate in Michigan.

A purchasing group and any of its insurers that had not submitted a registration fee would have to submit a \$25 registration fee and a statement of registration that designated the Commissioner as their agent for the purpose of receiving service of legal documents or process. A purchasing group that paid the registration fee and submitted a statement of registration would have to furnish information as requested by the Commissioner that verified that the group qualified as a purchasing group, determined the locations of the group members, and determined appropriate tax treatment. The registration fee and statement requirements would not apply to a purchasing group that met all of the following:

- It had been a purchasing group under the Federal Liability Risk Retention Act before October 27, 1986, and had only purchased insurance that was authorized under the Federal Act before that date.
- It was domiciled in a U.S. state before April 1, 1986, and on and after September 25, 1981.
- Before September 25, 1981, it had purchased insurance from an insurance carrier licensed in a U.S. state and continued to do so after that date.

A purchasing group that operated in Michigan before January 1, 1990, would have to comply with the bill's requirements pertaining to

submittal of information to the Commissioner by February 1, 1990.

A purchasing group that operated in Michigan could buy insurance for risks resident or located in Michigan only from a risk retention group chartered in a U.S. state, an insurer authorized in Michigan, or an eligible unauthorized insurer unless such a purchase was effected under Chapter 19 of the Code, which deals with surplus lines of insurance. A purchasing group that obtained such coverage would have to inform in writing each of its members who had a risk in this State that the risk was not protected by an insurance insolvency guaranty fund in Michigan and that the risk retention group or insurer may not be subject to all of Michigan's insurance laws and regulations. The bill would prohibit a purchasing group from buying insurance that provided for a deductible or self-insured retention unless the deductible or retention was the sole responsibility of each individual member of the group.

Premium and other taxes paid for coverage of risks in this State by a purchasing group or any members of such a group would have to be imposed at the same rate and subject to the same interest, fines, and penalties as those applicable to premium and other taxes paid for similar coverages from similar insurance sources by other insureds.

Other Provisions

Property and Casualty Guaranty Association. A risk retention group chartered and/or operating in Michigan could not join or contribute to the Property and Casualty Guaranty Association established under Chapter 79 of the Code, or other similar associations or mechanisms in Michigan. A group, its insureds, and claimants against those insureds could not receive benefits from the Association for claims arising under the group's insurance policies.

A purchasing group that obtained coverage from an insurer not authorized in Michigan or a risk retention group could not be covered by the Association or similar associations or mechanisms. A purchasing group that obtained coverage from an insurer authorized in Michigan, on risks resident or located in this

State could be covered by the Property and Casualty Guaranty Association.

Motor Vehicle Coverage. A risk retention group that was chartered and/or operating in Michigan and offered automobile insurance coverage under Chapter 31 of the Code, would have to participate in the Michigan Automobile Insurance Placement Facility created under Chapter 33 of the Code.

Agents/Brokers. Acting or aiding in the solicitation, negotiation, or procurement of liability insurance from a risk retention group would be prohibited unless the person, firm, association, or corporation doing so were licensed under either Chapter 12 (which deals with the licensing of agents, solicitors, adjusters, and counselors) or Chapter 19 (which deals with surplus lines) of the Code. A person, firm, association, or corporation engaging in such activity for a purchasing group would have to be licensed under Chapter 12 if seeking coverage from an authorized insurer or Michigan-chartered risk retention group, or under Chapter 19 if seeking coverage from an insurer not authorized in Michigan.

The Code's residence requirement would not apply to an agent or broker for a risk retention group or purchasing group. Licensure of a nonresident under Chapter 19, however, would be for the limited purpose of soliciting, negotiating, or procuring liability coverage from a risk retention group not chartered in Michigan.

Demonstration of Financial Responsibility. If a State or local law required a demonstration of financial responsibility as a condition for a license or permit to undertake certain activities, and the requirement could not be satisfied by obtaining insurance from an insurer not authorized to do business in this State, then the requirement could not be satisfied by purchasing coverage from a risk retention group not chartered and authorized in Michigan.

Powers of the Insurance Commissioner. The bill would grant the Commissioner the use of any powers established under the Code, as long as they were not preempted specifically by the Federal Liability Risk Retention Act. For risk retention groups, the Commissioner's injunctive authority would be restricted by a requirement

that an injunction be issued by a court of competent jurisdiction.

The Commissioner could promulgate rules relating to risk retention groups as were "necessary or desirable" to carry out the bill's provisions.

MCL 500.456 et al.

SENATE COMMITTEE ACTION

The Senate Committee adopted amendments to change the bill's effective date from July 1, 1989, to January 1, 1990, and to revise dates for the submission of information. A committee amendment also provides that a purchasing group that operated in Michigan could purchase insurance for risks located in Michigan only from a risk retention group chartered in a state, from an insurer authorized in this state, or from an eligible surplus lines insurer; the House-passed version had provided that such a group could not purchase insurance from a risk retention group that was not chartered in a state, or from an insurer not authorized in this state, unless the purchase were from a surplus lines insurer.

FISCAL IMPACT

The bill would have a net fiscal impact of approximately \$50,000 annual revenue to the State, \$9,625 one-time revenue to the State, and no fiscal impact on local government.

The bill would require all risk retention groups and purchasing groups chartered out of state and conducting business in Michigan to register with the Insurance Bureau and pay a \$25 one-time registration fee. The Insurance Bureau estimates that there are approximately 50 risk retention groups and 335 purchasing groups chartered out of state that are currently conducting business in Michigan. The fiscal impact would be $385 \text{ businesses} \times \$25 \text{ registration fee} = \$9,625$ in one-time fees that would be generated by the bill.

The bill, by requiring the registration of the risk retention and purchasing groups chartered out of state, would enable the Insurance Bureau to monitor compliance with tax laws requiring that risk retention groups and purchasing groups chartered out of state pay 2% sales tax on the premiums of policies sold

in Michigan. The Insurance Bureau estimates that an additional \$50,000 in sales taxes would be collected due to the ability to monitor these groups.

The bill would require the Insurance Bureau to examine all risk retention and purchasing groups that would not be examined by their home state. The cost of these exams and the fees charged would offset each other for no net fiscal impact.

ARGUMENTS

Supporting Argument

The bill would provide 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-1980s 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).

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.