



**House  
Legislative  
Analysis  
Section**

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## INSURANCE COMPANY SOLVENCY

House Bill 5214 (Substitute H-3)  
Sponsor: Rep. Alvin Hoekman

House Bill 5215 (Substitute H-4)  
Sponsor: Rep. Mary C. Brown

First Analysis (2-19-92)  
Committee: Insurance

### ***THE APPARENT PROBLEM:***

The National Association of Insurance Commissioners (NAIC) has developed a number of model laws and regulations for state regulators to use in overseeing the financial solvency of insurance companies. This has been done, regulators say, partly in response to what has been termed "a rash of insolvencies of major insurance carriers in the last few years," including some heavily publicized problems among life insurers with large investments in so-called junk bonds. The NAIC has called for states to adopt certain minimum standards and uniform procedures for the effective financial regulation of insurance companies and will certify states that do so. (According to insurance specialists, as more states become certified, companies based in uncertified states could be at a competitive disadvantage.) Michigan regulators say this state already has the majority of the required standards in some form (including older model acts) but needs to update them and incorporate new NAIC model provisions into the Insurance Code. The state's insurance bureau, working with representatives of the insurance industry, has put together a comprehensive revision of Michigan's financial regulation statutes that aims at recognizing the realities of today's insurance marketplace and giving regulators the tools they need to protect policyholders, creditors, and the general public from insurance company insolvencies.

### ***THE CONTENT OF THE BILLS:***

House Bills 5214 and 5215 are part of a four-bill package, along with Senate Bills 691 and 692, that represents a comprehensive revision of Insurance Code provisions regarding the financial regulation of insurance companies. House Bill 5214 would add a new Chapter 10 to the code (MCL 500.1001 - 500.1025) requiring that insurance companies undergo an annual audit by an independent public

accountant and file an audited financial report with the insurance commissioner each year. House Bill 5215 is the central bill in the package and contains a great many amendments to the code (MCL 500.150 et al.), including the incorporation of provisions from several model acts developed by the National Association of Insurance Commissioners (NAIC), including the model holding company act; an act to identify and deal with companies considered to be in hazardous financial condition; and a third requiring insurance companies to submit financial statements to the NAIC's insurance regulatory information system or IRIS. Following is a brief summary of some the provisions in House Bill 5215.

\* The bill would specify that a domestic, foreign, or alien insurer could not be authorized to do business in the state or continue to be authorized to do business if the insurer is not or does not continue to be "safe, reliable, and entitled to public confidence." Those terms, which are basic to the bill, would be given specific definitions. Further, the bill says that every like insurer would at all times be subject to the same standards and requirements concerning financial conditions and would have to be in substantial compliance with those standards no matter where the company is based. (The term "domestic" refers to Michigan-based companies, "foreign" to out-of-state companies, and "alien" to companies from other countries.)

\* Provisions from the NAIC model holding company act would allow regulation of transactions within holding companies (e.g., the transfer of assets from one entity to another and fees and charges among entities) that could adversely affect the interests of policyholders or are aimed at avoiding regulatory reviews. The acquisition of a holding company that controls a domestic insurer (and not,

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as now, just the acquisition of a domestic insurer) would require the approval of the insurance commissioner. Certain foreign insurers doing a large portion of their business in the state would be considered domestic companies for the purposes of the holding company chapter. The prior approval of the insurance commissioner would be required for sales, purchases, exchanges, loans or extensions of credit, or investments involving five percent or more of an insurer's assets between a domestic controlled insurer and any person in the holding company system. Certain other transactions would require prior notification of the commissioner and would be subject to disapproval. Further, there would be limitations on the payment of "extraordinary dividends" by companies that are part of holding companies.

\* The bill specifies that even though a domestic insurance company may be owned or controlled by another entity, the company's officers and directors would not be relieved of any obligation or liability to which they would otherwise be subject by law and that the company would have to be managed so as to assure its separate operating identity.

\* NAIC model provisions would be adopted regarding the factors that can be used (along with other "relevant standards") in determining whether the continued operation of an insurer is safe, reliable, and entitled to public confidence or is considered hazardous to policyholders, creditors, or the public. Some 18 factors are adopted from the model, including such things as the value of an insurer's asset portfolio; whether a reinsurance program offers sufficient protection; the size of operating losses in relation to capital and surplus; the size of contingencies, liabilities, and guarantees; the age and collectibility of receivables; the competence, fitness, and character of company officials; whether the company has filed misleading or materially false financial statements; the rapidity of growth; cash flow and liquidity; evaluations of rating organizations; and others. A number of existing standards from the code are also incorporated into this section. Model provisions would also be adopted specifying the powers of the commissioner to act in determining the condition of an insurance company and to force companies to take actions in response to any determination. The commissioner, for example, could require a company to: reduce, suspend, or limit the volume of business being accepted or renewed; reduce liabilities by means of reinsurance; reduce general

insurance and commission expenses; increase capital and surplus; suspend or limit the payment of dividends; limit or withdraw from certain kinds of investments; document the adequacy of premium rates; and file financial reports in addition to the annual report.

\* The insurance commissioner, the bureau, and employees and agents of the bureau would be granted immunity from liability for actions and omissions by them in the performance of their powers and duties as provided in the governmental immunity act. The state would provide a defense and indemnify them for any judgments "if the commissioner and his or her employee and agent had a reasonable basis for believing that he or she was acting within the scope of his or her authority at the time of the alleged conduct."

\* Information and testimony furnished to the insurance bureau and the bureau's work papers, correspondence, memoranda, reports, records, and other written or oral information related to an examination report or investigation would be withheld from public inspection and would be confidential. It would not be subject to subpoena and could not be divulged to anyone except as specified in the code (to the governor and attorney general, state and federal regulators, law enforcement officials, in connection with enforcement actions, and to persons authorized by the Ingham County Circuit Court). A person appointed or acting under the insurance code who disclosed any fact or information that is confidential would be guilty of a misdemeanor punishable by a fine of not more than \$1,000 or imprisonment of not more than one year, or both. A conviction would automatically remove the person from his or her position or office.

\* In investigating an insurer, the commissioner would be able to compel the attendance and testimony of witnesses and the production of records and could sign subpoenas. If a commissioner's order or subpoena was not followed, he or she could request the Ingham County Circuit Court to issue an order requiring compliance.

\* The bill would specifically grant the commissioner the authority to require an insurer to make larger than usual deposits with the state treasurer as a condition of transacting insurance in the state based on the actual and anticipated premium volume of the company and the characteristics of and degree

of risk inherent in the business written by the company. (The usual deposit amount is \$300,000 and is held by the state treasurer for the benefit of policyholders. The commissioner has required larger deposits in the past, but the bill specifically recognizes the authority.) Deposits made by alien insurers could, under the bill, include securities issued by affiliates without current limitations. The commissioner would also be able to require a special deposit from an "eligible unauthorized insurer" or surplus lines insurer. (These companies are not admitted to do business in the state but provide coverages not available from companies operating in the state.)

\* Certain types of insurance could be identified as presenting an unusually high risk and hazard, and the commissioner could limit the companies permitted to engage in such transactions to those companies "of a sufficient degree of financial strength."

\* The bill would clarify, in Sections 402a and 402b, what transactions of insurance require a certificate of authority.

\* The Insurance Code's provisions would be enforced, generally speaking, through administrative remedies found in the Administrative Procedures Act. Violations would be subject to civil fines and criminal penalties have been removed. Further, appeals of insurance commissioner decisions would be pursuant to the APA, and the bill would specify how stays of orders could be obtained and how stay orders could be appealed. Proceedings to suspend, revoke, or limit an insurer's certificate of authority would be initiated by granting a company the opportunity to show compliance pursuant to the APA, and insurers subsequently would be entitled to a contested case hearing.

\* Insurers applying for an initial certificate of authority would have to possess and maintain at least \$1.5 million in capital and surplus.

\* The bill contains several provisions regarding surplus lines insurers; that is, companies not authorized to transact insurance but that provide coverages not available from companies operating in the state. It would prohibit placing insurance with a surplus lines carrier in order to get a lower rate than is available from an authorized insurer. Currently, there is a rebuttable presumption that certain kinds of coverages are available (and thus

should not be purchased from unauthorized insurers), among them "any coverage available from three or more authorized insurers, unless the authorized insurers quote a premium and terms not competitive with the premium and terms quoted by an unauthorized insurer." That language would be deleted and be replaced by a provision referring to "any coverage which, after a diligent search, is available from an insurer authorized to transact business in Michigan pursuant to rates and forms on file with the commissioner."

### ***FISCAL IMPLICATIONS:***

The Insurance Commissioner testified before the House Insurance Committee that the Insurance Bureau does not have the resources to implement the provisions of these bills. (2-13-92)

### ***ARGUMENTS:***

#### ***For:***

The bills modernize the state's regulation of the financial soundness of insurance companies, incorporating several model acts developed by the National Association of Insurance Companies (NAIC). They provide new analytical tools for state insurance regulators so that they can make informed judgments based on statutory standards on whether companies are safe, reliable, and entitled to public confidence. In general, the bills augment and enhance current regulatory activities. Immunity is provided the insurance commissioner and his or her employees or agents, and the confidentiality of materials concerning company investigations is safeguarded. The regulation of holding companies is brought up to date, in recognition that these entities have been the source of many problems, particularly as regards the transfer of assets from one element of a holding company to another to the detriment of policyholders and creditors. Transactions within holding companies will be more closely regulated under these bills. The bills also place new responsibilities on the accounting profession by requiring of insurance companies annual audited financial statements by independent certified public accountants. The provisions found in these bills, and two companion bills, will enable Michigan to meet NAIC standards for certification as a state with the proper solvency regulatory framework.

***POSITIONS:***

The Insurance Commissioner testified in support of these bills. (2-13-92)

The Life Insurance Association of Michigan has indicated its support for the bills. (2-13-92)

The Michigan Insurance Federation has testified in support of the bills. (2-13-92)