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House Bill 5014 with committee amendment
First Analysis (9-20-95)

Sponsor: Rep. John Llewellyn
Committee: Insurance

THE APPARENT PROBLEM:

Section 1343 of the Insurance Code, added by Public Act 227 of 1994, provides that when a domestic (i.e., Michigan-based) insurance company that is a member of a holding company declares a shareholder dividend, the company must report the dividend to the insurance commissioner within 5 days after declaring the dividend and at least 10 business days (beginning from the date of receipt by the commissioner) before the payment. The act also says the commissioner may enter an order prohibiting the payment of the dividend if he or she determined that the insurer's surplus as regards policyholders is not reasonable in relation to outstanding liabilities and is not adequate to its financial needs so that it will not continue to comply with specified code provisions. Life insurance company representatives say that while it is appropriate for the insurance commissioner to have prior approval authority over extraordinary dividends, no such authority should apply to ordinary dividends. They say that requiring prior approval for ordinary dividends would have the unfortunate effect of making it harder, and more expensive, for Michigan stock insurance companies to attract equity capital. An industry representative has said that "investors, lenders, and credit agencies are extremely wary of corporations whose ability to pay ordinary dividends is unpredictable or severely limited by regulation." For example, according to industry officials, a company might pledge ordinary dividends when borrowing. If the dividends are subject to approval by the insurance commissioner, banks will charge higher interest. The industry says the Insurance Code provides the commissioner with the general authority to limit or suspend dividends if a company is in financial difficulty, and so the provision granting prior approval authority over ordinary dividends of sound companies is unnecessary.

THE CONTENT OF THE BILL:

The bill would amend the Insurance Code to remove a provision permitting the insurance commissioner to enter an order prohibiting the payment of an ordinary shareholder dividend by a domestic insurer that is a member of a holding company. Instead, the same provision would be inserted in a subsequent paragraph applying to <u>extraordinary</u> dividends of insurers.

The provision says the commissioner may enter an order prohibiting the payment of the dividend if he or she determined that the insurer's surplus as regards policyholders is not reasonable in relation to outstanding liabilities and is not adequate to its financial needs so that it will not continue to comply with specified code provisions.

(The code says that an extraordinary dividend or distribution includes any dividend or distribution of cash or other property, whose fair market value together with that of other dividends or distributions made within the preceding 12 months exceeds the greater of 10 percent of the insurer's surplus as regards policyholders as of December 31 of the immediately preceding year, or the net gain from the operations of the insurer, if the insurer is a life insurer, or the net income, if the insurer is not a life insurer, not including realized capital gains, for the 12-month period, but does not include pro rate distributions of any class of the insurer's own securities.)

MCL 500.1403

FISCAL IMPLICATIONS:

The bill has no cost or revenue impact, according to the House Fiscal Agency. (Fiscal Note dated 9-18-95)

ARGUMENTS:

For:

Life insurance industry officials have said that the current prior approval provision for ordinary dividends is unnecessary and potentially harmful. It could put Michigan's domestic insurers at a competitive disadvantage. An industry spokesperson has said:

> Ordinary dividends are different from extraordinary dividends because they are in amounts below a prescribed statutory threshold, low enough to preclude them from being a threat to an insurer's solvency. A requirement of prior approval for all dividends would render the pay out of earnings and excess surplus always subject to regulatory discretion. This would necessitate disclosure in the financial statements of publicly traded insurance companies and would inevitably result in increased cost and reduced availability of capital. Equity investors, lenders, and credit agencies are extremely wary of corporations whose ability to pay ordinary dividends is unpredictable or severely limited by regulation.

The commissioner, says the industry, has general authority to limit or suspend dividends under the code when a company's surplus is not reasonable compared to its liabilities or if the commissioner determines the company has ceased to be safe, reliable, and entitled to public confidence.

POSITIONS:

The Life Insurance Association of Michigan supports the bill. (9-19-95)