



Romney Building, 10th Floor
Lansing, Michigan 48909
Phone: 517/373-6466

ASSETS IN SEPARATE ACCOUNTS/ NAIC OVERSIGHT

House Bill 5418 as enrolled
Public Act 279 of 1998
Second Analysis (1-19-99)

Sponsor: Rep. David M. Gubow
House Committee: Insurance
Senate Committee: Financial Services

THE APPARENT PROBLEM:

Section 925 of the Insurance Code allows a life insurance company to set up one or more "separate accounts" in connection with certain products used in pension, retirement, and profit-sharing plans and in connection with variable annuities. With variable annuities, the underlying assets fluctuate in value based on the investment results of a segregated portfolio of investments. The code says that the investments and liabilities of a separate account must at all times be clearly identifiable and distinguishable from the other investments and liabilities of the insurance company. Chapter 81 of the code deals with insurance company insolvencies and liquidations and addresses, among other things, how a company's assets are to be disbursed in the event of an insolvency. Section 8142 within the chapter spells out the priority of claims. The section does not, however, specifically address how the assets in separate accounts would be treated in the liquidation of an insurance company. Legislation addressing this has been proposed.

In another matter, the National Association of Insurance Commissioners describes itself as an organization of insurance regulators from the 50 states, the District of Columbia, and four territories that provides a forum for the development of uniform policies when such policies are appropriate. The NAIC says that it helps state regulators fulfill the primary responsibility of protecting insurance consumers, in particular through the regulation of financial and market conduct. In recent years, the NAIC has begun an accreditation program and adopted standards aimed at ensuring that state regulators "have adequate statutory and administrative authority to regulate an insurer's corporate and financial affairs, that they have the necessary resources to carry out that authority, and that the departments have in place organizational and personnel practices designed for

effective regulation." (See the organization's website at <http://www.naic.org/>) Towards that end, the NAIC produces model laws that states are expected to adopt. Critics of the NAIC say that there is increasing concern that the NAIC is threatening state sovereignty by taking on increased power. They point out that the NAIC accreditation program penalizes a state's insurance department and the insurance companies domiciled in the state if certain model laws are not adopted. This negates one virtue of the NAIC's role, which was to lessen calls for federal regulation of insurance. Recently, say representatives of the state's life insurance industry, the NAIC has tried to impose on Michigan companies investment methods different from those found in state law. Critics also say the organization carries out public functions delegated by the states without the kind of openness and accountability required of public policy making bodies. Legislation has been proposed by NAIC critics aimed at making sure that the responsibility for regulating insurance industry is primarily in the hands of state regulators and elected legislators, who represent the people of the state.

THE CONTENT OF THE BILL:

The bill would amend the Insurance Code to address the treatment of assets in separate accounts, and to address oversight of the NAIC.

- The bill would amend the Insurance Code to provide an exception from the standard set of claim priorities against an insolvent insurance company. It would specify that if a written agreement, statute, or rule provides that the assets in a separate account are not chargeable with liabilities arising out of any other business of the insurer, "that part of a claim that includes a separate account shall be satisfied out of the

assets in the separate account equal to the reserves maintained in the separate account under the separate account agreement." The remainder of the claim would be treated as a Class 2 claim against the insurer's estate to the extent that reserves had been established in the company's general account under statute, rule, or the separate account agreement. Class 2 claims include claims under policies for losses incurred, and the code says that all claims under life insurance and annuity policies, whether for death proceeds, annuity proceeds, or investment values, are to be treated as loss claims. The bill would specify that for the purposes of the section being amended, life insurance and annuity policies include, but are not limited to, individual annuities, group annuities, guaranteed investment contracts, and funding agreement contracts, issued by an insurance company. Class 2 claims also include claims of a guaranty association or foreign guaranty association. The term "insurer's estate" in the bill would be defined to refer to all of the assets of the insurer less any assets held in separate accounts. The following would not be considered assets held in separate accounts: 1) assets that represent money provided by the insurer initially to fund the special account; 2) assets that represent policy reserves properly allocable to the general account; and 3) general account investments held in the separate account.

- The bill also would impose reporting requirements on the National Association of Insurance Commissioners (NAIC) and specify that a Michigan insurer could not be required or compelled to pay a fee imposed by the NAIC, unless authorized by an order of Michigan's insurance commissioner.

Under the bill, the NAIC would have to report on or before October 1 of each year to the insurance commissioner and the standing committees in the Senate and House of Representatives dealing with insurance issues. The report would have to include: a summary of activities of the NAIC during the preceding year; a fiscal report for the preceding fiscal year and anticipated expenses and revenues for the current and succeeding fiscal years; a list of each proposed NAIC standard to be enacted, adopted, or followed for a state to receive or continue its status as an NAIC-accredited state; a description of the NAIC policies and procedures designed to ensure the organization conducts its deliberations and makes its decisions in meetings open to the public and in a manner that provides fair notice and an opportunity for affected persons to be heard; a statement that it is complying with the aforementioned policies and

procedures; and a detailed explanation of any non-compliance.

On or before March 15 each year, the standing committees on insurance issues in the Senate and House of Representatives would review the NAIC report. The committees could provide an opportunity for consumers, the commissioner and other state regulators, insurance companies, and other interested parties to be heard on NAIC-related matters and other regulatory issues. The committees could explore the feasibility of conducting legislative oversight hearings together with legislative committees from other states. The committees could transmit the record of the oversight review to the National Conference of Insurance Regulators, the NAIC, and the insurance commissioner on or before July 1 of each year.

The NAIC report and legislative oversight records would be among the items to be taken into account in determining whether domestic insurance companies need to pay any NAIC fee. Also to be considered would be a number of specified factors, including how such fees are used, on what they are based, the level of accountability of the NAIC, the effect of NAIC standards on state sovereignty and innovation, whether NAIC determines a state's accreditation status solely on the basis of its regulatory effectiveness, and whether NAIC proceedings and decision making are open and publicly accessible. In examining how fees are used by the NAIC, the commissioner would consider the degree to which any solvency-related revenue is used improperly to subsidize NAIC functions other than solvency oversight. The bill would define "solvency oversight" to refer to activity directly related to regulating the financial condition of an insurer and would specify that the term would not cover an activity related to market conduct regulation, market regulatory support, or general regulatory support.

Further, the bill would permit money in the Insurance Bureau Fund to be appropriated by the legislature to pay for legislators designated by the Senate Majority Leader and Speaker of the House of Representatives to participate in insurance activities coordinated by insurance and legislative associations, including the National Association of Insurance Commissioners and the National Council of Insurance Legislators. (Prior to this, money in that fund could be used only for regulatory purposes.)

MCL 500.225 et al.

FISCAL IMPLICATIONS:

The House Fiscal Agency and Senate Fiscal Agency have said that the bill would have no fiscal impact on the state or local units of government. (HFA Fiscal Note dated 1-26-98 and SFA floor analysis dated 2-26-98)

ARGUMENTS:**For:**

Proponents of the bill say that it clarifies the portion of the law dealing with how assets of an insolvent life insurance company are to be treated. It says that in the event of an insolvency, a variable annuity product could be funded only from the assets of the separate fund established by the insurer for that annuity product (and not from the general assets of the company) and that the assets of the separate fund would not be chargeable with liabilities arising out of other business of the company. The company's general assets and the assets in any separate account would be kept apart in dealing with claims against an insolvent insurer. If an insurance product had a combination of a variable annuity product and a life product, a claim on the life product could be submitted for payment from the general assets of the insurer and a claim based on the variable annuity would have to be paid from the separate fund supporting the annuity. Proponents say it is assumed that this is how the matter would be treated now, but there are no provisions in statute to address it.

For:

The bill would address concerns that the National Association of Insurance Commissioners is assuming too much regulatory power that traditionally has been left to individual states. The bill would require reporting by the NAIC to the state and would put in place a legislative oversight process. Also, companies domiciled in Michigan would not have to pay NAIC fees unless the state's insurance commissioner approved.

Response:

Can the state impose reporting requirements and regulations in this way on a private organization headquartered in another state? How will the requirements imposed on the NAIC be enforced?

Analyst: C. Couch

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.