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BILL



ANALYSIS

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House Bill 5292 (Substitute H-1 as passed by the House)
Sponsor: Representative Leslie Mortimer
House Committee: Insurance
Senate Committee: Banking and Financial Institutions

Date Completed: 3-16-06

CONTENT

The bill would amend the Insurance Code to revise provisions pertaining to the Michigan Property and Casualty Guaranty Association. The bill would do all of the following:

- Allow the Association to bring an action against a representative of an insolvent insurer to obtain custody and control of claims information necessary for the Association to carry out its duties.
- Revise the definition of "insolvent insurer".
- Specify that covered claims would not include the portion of a claim that exceeded \$5 million, other than for a worker's compensation claim or a personal protection claim under motor vehicle insurance (which would replace the current cap of one-twentieth of 1% of the aggregate premiums written by member insurers in the preceding calendar year).
- Specify that covered claims would not include obligations for any first- or third-party claim by or against an insured whose net worth exceeded \$25 million.
- Revise provisions pertaining to the payment of covered claims.
- Extend to administrative proceedings a provision requiring a stay of court proceedings for six months after the date a receiver is appointed.
- Include a guaranty association or foreign guaranty association among third parties to whom the Commissioner of the Office of Financial and Insurance Services (OFIS) may advise of the existence of a supervision order.
- Specify that any guaranty association or foreign guaranty association would have standing to appear and could intervene or otherwise appear and participate in a court proceeding concerning the rehabilitation or liquidation of an insurer.
- Regulate the use of collateral held under a deductible agreement by or for the benefit of, or assigned to, an insurer or the receiver, in delinquency proceedings.
- Require a receiver promptly to bill a policyholder for reimbursement of deductible amounts paid in claims by a guaranty association or foreign guaranty association, if the insurer had not contractually agreed to allow the policyholder to fund its own claims.
- Allow a receiver to deduct reasonable actual expenses, up to 3% of the collateral or total deductible reimbursement actually collected by the receiver, from reimbursements owed to a guaranty association or foreign guaranty association or collateral to be returned to a policyholder.
- Revise provisions relating to the disbursement of assets after the final determination of an insurer's insolvency, and allow a guaranty association or foreign guaranty association to file with the court an application for disbursement of assets if the liquidator failed to do so

within 120 days of a final determination of insolvency.

- Prohibit a liquidator from offsetting the amount to be disbursed to a guaranty association or foreign guaranty association by any special or statutory deposits or any other asset of the insolvent insurer, except to the extent those had been paid to the association for the purpose of satisfying its claims.**

(Chapter 79 of the Code, which is known as the Michigan Property and Casualty Guaranty Association Act, created an association of all property and casualty insurance companies in Michigan, with membership in the association being a condition of transacting business in the State. The Michigan Property and Casualty Guaranty Association pays covered claims to policyholders and claimants when an insurance company becomes insolvent.)

Control & Custody of Information

Section 7918 of the Code sets forth general powers of the Association. The bill would amend this section to allow the Association to bring an action against any third party administrator, agent, attorney, or other representative of an insolvent insurer to obtain custody and control of all claims information, including all files, records and electronic data related to an insolvent company that were appropriate or necessary for the Association, or a similar association in another state, to carry out its duties under the Code. Under the bill, the Association would have the absolute right, through emergency equitable relief, to obtain custody and control of all claims information in the custody or control of the third party administrator, agent, attorney, or other representative of the insolvent insurer, regardless of where the information was physically located.

In bringing the action, the Association would not be subject to any defense, lien, or other legal or equitable ground for refusal to surrender claims information that could be asserted against the liquidator of the insolvent insurer. If litigation were necessary for the Association to obtain custody of the claims information requested and it resulted in the relinquishment of claims information to the Association after refusal to provide the information in

response to a written demand, the court would have to award the Association its costs, expenses, and reasonable attorney fees incurred in bringing the action.

The bill specifies that Section 7918 would not affect the rights and remedies that the custodian of the claims information had against the insolvent insurers, as long as those rights and remedies did not conflict with the rights of the Association to custody and control of the claims information under the Act.

Insolvent Insurer

The Code defines "insolvent insurer" as an insurer for which a domiciliary receiver has been appointed by a final order in Michigan or a reciprocal state for the liquidation of the insurer and that has been a member insurer. The date on which the order becomes final is the date on which the receiver is appointed for the purposes of Chapter 79. ("Member insurer" means an insurer required to be a member of the Association.)

Under the bill, "insolvent insurer" instead would mean an insurer that has been a member insurer and against whom a final order of liquidation has been entered with a finding of insolvency by a court of competent jurisdiction in the insurer's state of domicile. The date on which the order became final would be the date on which all appeals of the finding of insolvency were exhausted. If the finding of insolvency in the order of liquidation were not appealed, the order would be considered final on the date the order was issued.

Covered Claims Exclusions

The Association must pay "covered claims" to policyholders and claimants when an insurance company becomes insolvent. "Covered claims" means obligations of an insolvent insurer that meet all of the following:

- Arise out of the insolvent insurer's insurance policy contracts issued to residents of Michigan or payable to residents of Michigan on behalf of insureds of the insolvent insurer.
- Were unpaid by the insolvent insurer.
- Are presented as a claim to the receiver in Michigan, or to the Association, on or before the last date fixed for the filing of

claims in the domiciliary delinquency proceedings.

- Were incurred or existed before, at the time of, or with 30 days after the date the receiver was appointed.
- Arise out of policy contracts of the insolvent insurer issued for all kinds of insurance except life and disability insurance.
- Arise out of insurance policy contracts issued on or before the last date on which the insolvent insurer was a member insurer.

Covered claims do not include various obligations listed in the Code, including obligations to an insurer, insurance pool, underwriting association, or a person who has a net worth greater than one-tenth of 1% of the aggregate premiums written by member insurers in Michigan in the preceding calendar year. The bill would delete that exclusion. Instead, covered claims would not include any amount due any reinsurer, insurer, insurance pool, underwriting association, health maintenance organization (HMO), health care corporation, or self-insurer as subrogation recoveries, contribution, indemnification, or other obligation. A claim for any amount due any of those entities could not be brought against a person insured under a policy issued by the insolvent insurer unless the claim exceeded the Association's obligation limitations directly (described below).

The Code also provides that covered claims do not include the portion of a claim, other than a worker's compensation claim, that is in excess of one-twentieth of 1% of the aggregate premiums written by member insurers in Michigan in the preceding calendar year. The bill would delete that exclusion. Instead, covered claims would not include the portion of a claim, other than a worker's compensation claim or a claim for personal protection insurance benefits under motor vehicle insurance, that exceeded \$5 million. This cap would have to be adjusted annually to reflect the aggregate annual percentage change in the consumer price index (CPI) since the previous adjustment, rounded to the nearest \$10,000. The effective date of the adjustment would have to be January 1 of each year and apply to claims made on or after that date. The claim cap in effect at the time of payment of a claim would apply.

The bill also specifies that covered claims would not include obligations for any first-party or third-party claim by or against an insured whose net worth exceeded \$25 million on December 31, or on the last date of the insured's fiscal period if other than December 31, of the year immediately preceding the date the insurer became insolvent. In determining net worth on that date, an insured's net worth would include the aggregate net worth of the insured and all of its subsidiaries and affiliates as calculated on a consolidated basis. The \$25 million net worth limit would have to be adjusted annually to reflect the aggregate annual percentage change in the CPI since the previous adjustment, rounded to the nearest \$10,000. The effective date of the adjustment would be January 1 of each year.

In addition, under the Code, covered claims do not include obligations to refund unearned premiums above the first \$500 of unearned premiums from each person from any one insolvent insurer. The maximum amount of unearned premiums that constitute a covered claim must be adjusted annually to reflect changes in the cost of living under rules prescribed by the OFIS Commissioner. The bill specifies that a refund in an amount less than \$50 could not be made for unearned premiums.

As used in these provisions, "consumer price index" would mean the CPI for all urban consumers in the U.S. city average, as most recently reported by the U.S. Department of Labor's Bureau of Labor Statistics, and as certified by the OFIS Commissioner.

Payment of Covered Claims

Section 7931 of the Code governs the payment and discharge of covered claims. The bill would delete a requirement that the Association pay and discharge covered claims for the amount by which each covered claim exceeds \$10.

The Code provides that, if damages or benefits are recoverable by a claimant or insured under an insurance policy other than a policy of the insolvent insurer, or from the Motor Vehicle Accident Claims Fund or a similar fund, the damages or benefits recoverable are a credit against a covered claim payable under Chapter 79. Under the bill, that provision would apply if damages or

benefits were recoverable under an insurance policy other than a policy of the insolvent insurer, or under a worker's compensation self-insured program of a self-insured entity. The claimant, insured, or self-insured entity first would have to exhaust all coverage provided by any policy or self-insured program.

In addition, under the Code, if damages against an insured who is not a Michigan resident are recoverable by a claimant who is a Michigan resident from any insolvency fund or its equivalent in the state where the insured is a resident, the damages recoverable are a credit against a covered claim payable under Chapter 79. The bill would delete the reference to an insolvency fund and refer instead to any insurance guaranty association or fund.

The bill specifies that, to the extent that the Association's obligation was reduced by Section 7931, the liability of the person insured by the insolvent insurer's policy also would be reduced in the same amount.

Stay of Proceedings

Under the Code, all proceedings in any Michigan court of law to which the insolvent insurer is a party, or in which the insurer is obligated to defend or has assumed the defense of a party, must be stayed for six months after the date a receiver is appointed, and for any additional time as determined by the court that has jurisdiction over the proceedings, to permit proper defense of all pending causes of action. Under the bill, this requirement would apply to all proceedings in any court or administrative tribunal, including worker's compensation proceedings.

Confidentiality Obligations

Under Chapter 81 (Supervision, Rehabilitation, and Liquidation) of the Code, except as otherwise provided, in all delinquency proceedings and judicial review of those proceedings, all records of the insurer, other documents, OFIS files, and court records and papers, as far as they pertain to or are part of the record of the proceedings, are confidential and must be held by the court clerk in a confidential file unless the court, after hearing arguments from the parties in chambers, orders otherwise or the insurer requests that the

matter be made public. Without compromising the confidentiality of the records of the Commissioner, OFIS, or supervisor, however, the Commissioner or his or her supervisor may advise third parties of the existence of a supervision order and of the supervisor's authority if considered necessary to further the insurer's compliance with the supervision order. "Third parties" means all of the following:

- Debtors and creditors of the insurer and its affiliates.
- Persons who hold or control assets of the insurer and its affiliates.
- Reinsurers of the insurer and its affiliates.
- Insurance regulatory officials.
- Law enforcement agencies.

The bill would add to that list representatives of a guaranty association or foreign guaranty association that could become obligated as a result of the insolvency of the insurer. Confidentiality obligations of a guaranty association or foreign guaranty association to the receiver would end upon the entry of an order of liquidation with a finding of insolvency against the insurer.

Guaranty Association Standing

The bill would delete a provision giving a guaranty association or foreign guaranty association standing to appear in a court proceeding concerning the liquidation of an insurer if the association is or may become liable to act as a result of the liquidation. The bill specifies that any guaranty association or foreign guaranty association would have standing to appear and could intervene as a party as a matter of right or otherwise appear and participate in any court proceeding concerning the rehabilitation or liquidation of an insurer, if the association were liable or could become liable to act as a result of the liquidation. The exercise by any guaranty association or its designated representative of this right to intervene would not constitute grounds to establish general personal jurisdiction by Michigan courts. The intervening guaranty association or foreign guaranty association would be subject to the court's jurisdiction only for the limited purpose for which it intervened.

Use of Collateral Held under Deductible Agreement

Under the bill, notwithstanding any other law or contract to the contrary, any collateral held by or for the benefit of or assigned to the insurer or, subsequently, the receiver, in order to secure the obligations of a policyholder under a deductible agreement, could not be considered an asset of the estate and would have to be maintained and administered by the receiver as provided in the bill. If collateral were so held, it would have to be used to secure the policyholder's obligation to fund or reimburse claims payment within the agreed deductible amount.

If a claim that was subject to a deductible agreement and secured by collateral were not covered by an guaranty association or foreign guaranty association and the policyholder were unwilling or unable to take over the handling and payment of the noncovered claims, the receiver would have to adjust and pay the noncovered claims using the collateral, but only to the extent the available collateral after allocation was sufficient to pay all outstanding and anticipated claims. If the collateral were exhausted and the insured were not able to provide funds to pay the remaining claims within the deductible after all reasonable means of collection against the insurer had been exhausted, the receiver's obligation to pay the claims from the collateral would terminate and the remaining claims would have to be made against the insurer's estate subject to compliance with other provisions in Chapter 81 for the filing and allowance of those claims. If the liquidator determined that the collateral was insufficient to pay all additional and anticipated claims, the liquidator could file a plan, subject to court approval, for equitably allocating the collateral among claimants.

To the extent that the receiver held collateral provided by a policyholder to secure a deductible agreement and to secure other policyholder obligations to pay the insurer amounts that would become assets of the estate, the receiver would have to allocate the collateral equitably among those obligations and administer the collateral allocated to the deductible agreement. For collateral allocated to obligations under the deductible agreement, if the collateral secured reimbursement

obligations under more than one line of insurance, the collateral would have to be allocated equitably among the various lines based upon the estimated ultimate exposure within the deductible amount for each line. The receiver would have to inform the guaranty associations and foreign guaranty associations of the method and details of all the allocations.

Regardless of whether there was collateral, if the insurer contractually agreed to allow the policyholder to fund its own claims within the deductible amount pursuant to a deductible agreement, the receiver would have to allow the funding arrangement to continue and, where applicable, enforce the arrangement to the fullest extent possible. The funding of these claims by the policyholder within the deductible amount would act as a bar to any claim for that amount in the liquidation proceeding, including any claim by the policyholder or the third-party claimant. This funding arrangement would extinguish both the obligation of any guaranty association to pay those claims within the deductible amount, and the obligations of the policyholder or third-party administrator to reimburse the guaranty association. No charge of any kind could be made against any guaranty association on the basis of the policyholder funding of claim payments made pursuant to such an arrangement.

If the insurer had not contractually agreed to allow the policyholder to fund its own claims within the deductible amount, to the extent a guaranty association or foreign guaranty association was required by applicable State law to pay any claims for which the insurer would have been entitled to reimbursement from the policyholder under the terms of the deductible agreement and to the extent the claims had not been paid by a policyholder or third party, the receiver promptly would have to bill the policyholder for reimbursement and the policyholder would be obligated to pay the reimbursement amount to the receiver for the benefit of the guaranty association or foreign guaranty associations that paid the claims. Neither the insurer's insolvency nor its inability to perform any of its obligations under a deductible agreement would be a defense to the policyholder's reimbursement obligation under the agreement. The receiver promptly would have to reimburse the guaranty association or foreign guaranty

association for claims paid that were subject to the deductible when the policyholder reimbursements were collected. If the policyholder failed to pay the amounts due within 60 days after the bill for the reimbursement was due, the receiver would have to use the collateral to the extent necessary to reimburse the guaranty association or foreign guaranty associations, and could pursue other collections efforts against the policyholder. If more than one guaranty association or foreign guaranty association had a claim against the same collateral and the available collateral, after allocation, along with billing and collection efforts, were together insufficient to pay each guaranty association in full, the receiver would have to prorate payment to each guaranty association and foreign guaranty association based on the relationship the amount of claims each association had paid bore to the total of all claims paid by the those associations.

The receiver would be entitled to deduct from reimbursements owed to a guaranty association or foreign guaranty association for collateral to be returned to a policyholder reasonable actual expenses incurred, not to exceed 3% of the collateral or the total deductible reimbursements actually collected by the receiver. For claim payments made by a guaranty association or foreign guaranty association, the receiver promptly would have to provide the association with a complete accounting of the receiver's deductible billing and collection activities. If the receiver failed to make a good faith effort, within 120 days of receipt of claims payment reports, to collect reimbursements due from a policyholder under a deductible agreement based on claim payments made by the association or foreign association, the association could pursue collection from the policyholders directly on the same basis as the receiver, and with the same rights and remedies, and would have to report any amounts collected from each policyholder to the receiver. To the extent that a guaranty association or foreign guaranty association paid claims within the deductible amount, but was not reimbursed either by the receiver or by policyholder payments from the guaranty association's or foreign guaranty association's own collection efforts, the association would have a claim in the insolvent insurer's estate for unreimbursed claims payments.

The receiver would have to adjust the collateral being held as the claims subject to the deductible agreement were run off, as long as adequate collateral was maintained to secure the entire estimated ultimate obligation of the policyholder plus a reasonable safety factor. The receiver would have to make these adjustments periodically, but would not be required to adjust collateral more than once a year. The guaranty association and any foreign guaranty association would have to be informed of all such collateral reviews. Once all claims covered by the collateral had been paid and the receiver was satisfied that no new claims could be presented, the receiver would have to release any remaining collateral to the policyholders.

These provisions would apply to all delinquency proceedings open and pending on the bill's effective date.

Disbursement of Assets

Under the Code, within 120 days of a Michigan court's final determination of an insurer's insolvency, the liquidator must apply to the court for approval of a proposal to disburse assets out of marshaled assets. If the liquidator determines that there are insufficient assets to disburse, the application may be considered satisfied by a filing by the liquidator stating the reasons for the determination. Under the bill, the liquidator would have to apply to the court for approval to make early access disbursements out of marshaled assets, and the liquidator's report could be given instead.

Under the bill, if the estate at any time obtained sufficient assets to support an early access disbursement, the liquidator would have to file an application for a proposal to make early access disbursements within 60 days of the estate's obtaining those assets. If, within 120 days of a final determination of insolvency, the liquidator failed to file an application with the court for approval of a proposal to make early access disbursements or, alternatively, failed to file a report with the court supporting the determination that the estate would not have sufficient assets, any guaranty association or foreign guaranty association that could become obligated to pay claims as a result of the insolvency could file the application. An application filed by an

association would have to be reviewed by the court and, if the proposal met the requirements for an application, it would have to be approved by the court. Upon court approval of the guaranty association or foreign guaranty association proposal, the liquidator would have to begin making early access disbursement in accordance with the proposal.

Under the Code, a proposal for asset disbursement must include a provision for reserving amounts for the payment of expenses of administration and the payment of claims of secured creditors, to the extent of the value of the security held, and claims falling within priorities established in Sections 8142(1) and 8142(2) of the Code. The bill specifies that, when a reserve for uncovered claims under Section 8142(2) was appropriate, the amount of estate assets to be reserved for those claims would have to be a percentage of the uncovered claims, equal in proportion to the percentage of assets distributed, or proposed for distribution, to the guaranty association or foreign guaranty association with respect to covered obligations at the time the reserve for uncovered claims was calculated. Reserves would have to be established based on the best available information at the time the distribution was calculated and modified from time to time as more refined information became available.

(Section 8142(2) specifies that, if it is provided by written agreement, statute, or rule 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 must 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 bill would prohibit the liquidator from offsetting the amount to be disbursed to any guaranty association or foreign guaranty association by any special or statutory deposits or any other asset of the insolvent insurer, except to the extent the deposit or asset had been paid to the association for the purpose of satisfying the association's claims. If a guaranty association or foreign guaranty association had received an early access distribution and later received a special or statutory deposit or any other asset of the insolvent insurer, the liquidator

could request the return of the early access funds up to the amount of the special or statutory deposit or other asset.

MCL 500.3503 et al.

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FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

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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.