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BILL ANALYSIS

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Senate Bill 177 (as introduced 3-4-15)
Sponsor: Senator Joe Hune
Committee: Insurance

Date Completed: 10-28-15

CONTENT

The bill would amend Chapter 13 (Holding Companies) of the Insurance Code to do the following:

-- Require the controlling person of a domestic insurer seeking to divest its controlling interest to file with the Director of the Department of Insurance and Financial Services (DIFS) a confidential notice at least 30 days before ceding control, and give a copy of the notice to the insurer.
-- Require the DIFS Director to determine the instances in which a person seeking to divest or to acquire a controlling interest in an insurer was required to file for approval of the transaction.
-- Provide, as a rule, that the information contained in such a filing would be confidential until the transaction concluded.
-- Require certain controlling people to file an annual enterprise risk report with the DIFS Director, provide information that allowed the Director to evaluate enterprise risk to the insurer, and ensure that all subsidiaries within the person's control in the insurance holding company system would provide such information.
-- Create an exception to a requirement that the Director approve a proposed acquisition of a domestic insurer in the case of an acquisition that was likely to be hazardous or prejudicial to the insurance-buying public.
-- Authorize the Director to hold a public hearing to receive evidence and to hear parties affected by a merger or acquisition involving a domestic insurer.
-- Require a statement regarding corporate governance and internal control procedures to be included in the information required in the registration statement filed with the Director by an insurer that is a member of a holding company system.
-- Require financial statements of or within an insurance holding company system, if requested by the Director, to be included in financial reports certain insurers must file with the Director.
-- Delete a felony penalty for an ultimately controlling person of an insurer who misrepresents financial information provided to the Director.
-- Require the ultimate controlling person of an insurer subject to registration to file with the Director an annual enterprise risk report that identified the material risks within the insurance holding company system that could pose enterprise risk to the insurer.
-- Provide that the enterprise risk report would not be subject to subpoena or discovery, would not be admissible in evidence in a private civil or administrative action, and would not be subject to the Freedom of Information Act (FOIA).

-- **Expand the types of transactions between a domestic insurer and a person in its holding company system for which the insurer must notify the DIFS Director in advance.**
-- **Allow the Director to order a registered insurer to produce records, books, or other information not in the insurer's possession if necessary to determine the insurer's financial condition or legality of conduct and the insurer could obtain access to it.**
-- **Specify that information provided by an insurer in connection with its registration statement would not be subject to FOIA, not subject to discovery, and not admissible in evidence in a private civil or administrative action.**
-- **Allow the Director to share information, including confidential and privileged documents, with other regulatory agencies, the National Association of Insurance Commissioners (NAIC), and law enforcement authorities, if they agreed to maintain the confidentiality and privileged status of the information and had verified the legal authority to maintain confidentiality.**
-- **Allow the Director to share confidential and privileged information regarding an enterprise risk report with insurance commissioners of other states who agreed not to disclose the information.**
-- **Authorize the Director to receive information, including otherwise confidential and privileged information, from the NAIC and from regulatory and law enforcement officials of other jurisdictions, and require the Director to maintain as confidential or privileged any document, material, or information received with notice or the understanding that it was confidential or privileged.**
-- **Provide that information in the possession or control of DIFS or the NAIC under Chapter 13 would be confidential and privileged, would not be subject to FOIA, would not be subject to subpoena, and would not be subject to discovery or admissible as evidence in a private civil or administrative action.**
-- **Require the Director to enter into agreements with the NAIC governing sharing and use of information provided under Chapter 13.**
-- **Authorize the Director to participate in a supervisory college for a domestic insurer that was part of an insurance holding company system with international operations to determine the insurer's financial condition, business strategy, risk management, risk exposures, governance processes, regulatory position, or legality of conduct.**

Merger, Acquisition, & Divestiture of Controlling Interest

Under the Code, a person other than the issuer may not make a tender offer for or a request or invitation for tenders of, or enter into an agreement to exchange securities for, seek to acquire, or acquire, in the open market or otherwise, a voting security of a domestic insurer if, after consummation of the agreement, the person would be in control of the insurer. A person may not enter into an agreement to merge with or otherwise to acquire control of a domestic insurer or any person controlling a domestic insurer unless, at the time an offer, request, or invitation is made or an agreement is entered into, or before the acquisition if no offer or agreement is involved, the person has filed with the DIFS Director and has sent to the insurer, which has sent to its shareholders, a statement containing the required information and the offer, request, invitation, agreement, or acquisition has been approved by the Director.

Under the bill, if a person had not filed the required statement, a controlling person of a domestic insurer seeking to divest its controlling interest in any manner would have to file with the Director a confidential notice of the proposed divestiture at least 30 days before the cessation of control. The controlling person also would have to give a copy of the notice to the insurer. The Director would have to determine the instances in which the person or people seeking to divest or to acquire a controlling interest in an insurer were required to file to obtain approval of the transaction. The information would have to remain confidential until

conclusion of the transaction, unless the Director determined that confidential treatment would interfere with enforcement.

If the DIFS Director determined that a person violated Section 1311 (which contains the provisions discussed above) and the violation prevented the full understanding of the enterprise risk of the insurer by affiliates or by the insurance holding company system, the violation could serve as an independent basis for disapproving dividends or distributions and for placing the insurer under an order of supervision under Chapter 81 (Supervision, Rehabilitation, and Liquidation).

(Under the Code, a domestic insurer includes a person controlling a domestic insurer and any foreign insurer whose written insurance premium in Michigan for each of the last three years exceeds the premiums written in its state of domicile and whose written premium in Michigan was at least 20% of its total written premium in each of the last three years.)

The bill would require a person required to file a statement with the Director to file an annual enterprise risk report (described below) for as long as control existed. Additionally, the person would have to provide information to the Director upon request as necessary to evaluate enterprise risk to the insurer, and ensure that all subsidiaries within the person's control in the insurance holding company system would provide such information.

The Code requires the Director to approve a merger or other acquisition of control of a domestic insurer unless the Director determines from information furnished to him or her that certain conditions exist. The bill would include among these conditions that the acquisition was likely to be hazardous or prejudicial to the insurance-buying public.

The bill would authorize the Director to hold a public hearing to receive evidence and to hear parties affected by a merger or acquisition. A hearing would have to be held within 30 days after the required statement was filed. The Director would have to provide notice of the hearing to the person filing the statement at least 20 days in advance. The person would have to give at least seven days' notice of the hearing to the insurer and to any other people designated by the Director. If the proposed acquisition of control would require the approval of more than one insurance commissioner, the hearing could be held on a consolidated basis upon request of the person filing the statement or as determined by the Director. The Director could opt out of a consolidated hearing and would have to notify the person who filed the statement within 10 days after receiving the statement. A hearing conducted on a consolidated basis would have to be held within the U.S. before the commissioners of the states in which the insurers were domiciled.

In connection with a change of control of a domestic insurer, a determination by the Director that the person acquiring control would have to maintain or restore the insurer's capital to the level required by the Code would have to be made within 60 days after the date of notification of the change of control.

Registration

Under the Code, subject to specific exceptions, an insurer that is a member of an insurance holding company system and is authorized to do business in Michigan annually must register with the DIFS Director. An insurer subject to registration must file a registration statement on a form containing prescribed information. The bill would include among the required information statements that the insurer's board of directors oversaw corporate governance and internal controls and that the insurer's officers and senior management had approved, implemented, and continued to maintain and monitor corporate governance and internal control procedures.

Financial Reports

If a person ultimately or intermediately controlling an insurer is registered on a national stock exchange or is otherwise required to make periodic reports to the U.S. Securities and Exchange Commission (SEC) or other instrumentality of a state or the government of the U.S. or of a foreign nation or jurisdiction regulating the person's financial conduct, the insurer must file the reports with the DIFS Director in addition to other information required by the Director. Under the bill, if requested by the Director, the insurer would have to include financial statements of or within an insurance holding company system, including all affiliates. The insurer could satisfy the request by giving the Director the most recently filed parent corporation financial statements that had been filed with the SEC.

Currently, if the person ultimately controlling the insurer is an individual or group of individuals or a person who is not required to make such financial reports, the person must file under oath with the DIFS Director information disclosing the person's financial position. A person who knowingly misrepresents the financial information provided to the Director is guilty of a felony punishable by a maximum fine of $5,000 and/or imprisonment for up to five years. The filing of a financial position form is not required under specified circumstances. The bill would delete all of these provisions.

Enterprise Risk Report

Under the bill, except as otherwise provided, the ultimate controlling person of an insurer subject to registration would have to file an annual enterprise risk report with the DIFS Director or jurisdiction designated by the Director. The report would have to be appropriate to the nature, scale, and complexity of the operations of the insurance holding company system and, to the best of the ultimate controlling person's knowledge and belief, would have to identify the material risks within the system that could pose enterprise risk to the insurer. "Enterprise risk" would mean an activity, circumstance, event, or series of events involving one or more affiliates of an insurer that, if not remedied properly, is likely to have a material adverse effect upon the financial condition or liquidity of the insurer or its insurance holding company system as a whole, including anything that would cause the insurer to be hazardous to policyholders, creditors, and the public.

The report would not be subject to subpoena or discovery, would not be admissible in evidence in a private civil or administrative action, and would not be subject to the Freedom of Information Act.

The ultimate controlling person of an insurer subject to registration could request an exemption from the enterprise risk report requirement. The person would have to file with the Director a written statement discussing the reasons why the person should be exempt. The Director could grant the exemption if, after review of the statement, he or she found that compliance would create an undue financial or organizational hardship on the ultimate controlling person.

The ultimate controlling person of an insurance holding company system subject to registration would not have to file an annual enterprise risk report if all of the following conditions were met:

-- The person had owned a controlling interest in the voting securities of an insurer since January 1, 2000.
-- The person was exempt from taxation under Section 501(c)(3), 501(c)(5), or 501(c)(8) of the Internal Revenue Code (described below), was organized as a charitable purpose corporation under the Nonprofit Corporation Act, or was a charitable trust registered under the Supervision of Trustees for Charitable Purposes Act.

-- The DIFS Director had not approved the person's petition for disclaimer of affiliation or had disallowed such a disclaimer.
-- The insurer in which the ultimate controlling person owned a controlling interest was registered under the Code and was a wholly domestic insurer with a maximum of 10% of its written premium covering risks outside of Michigan.

(Sections 501(c)(3), 501(c)(5), and 501(c)(8) of the Internal Revenue Code, respectively, refer to nonprofit corporations and community chests, funds, and foundations; labor, agricultural, or horticultural organizations; and fraternal beneficiary societies, orders, or associations.)

Failure to File

The Code provides that the failure to file a registration statement or an amendment to a registration statement as required within the time specified for the filing is a violation of Chapter 13. The bill also would include the failure to file a summary of the registration statement as well as an enterprise risk report.

Transaction Modification

Under the Code, a domestic insurer and a person in its holding company system may not enter into certain types of transactions with each other unless the insurer notifies the DIFS Director of its intention to enter into the transaction at least 30 days in advance and the Director has not disapproved it within that time period. The bill would include the following among the transactions subject to this condition:

-- A tax allocation agreement.
-- A cost-sharing agreement.
-- A guarantee that was quantifiable and exceeded the lesser of 0.5% of the insurer's admitted assets or 10% of surplus as of December 31 of the preceding year.
-- A direct or indirect acquisition of, or investment in, a person who controls the insurer or an affiliate of the insurer, if the amount of the transaction plus the insurer's present holdings in investment exceeded 2.5% of surplus.

The 30-day notification requirement would not apply to a direct or indirect acquisition of, or investment in, a subsidiary acquired under Chapter 13, or a nonsubsidiary insurance affiliate that was subject to the Code

A guarantee that was not quantifiable would be subject to prior approval of the DIFS Director.

The 30-day notification requirement also would apply to the modification of an existing transaction. The insurer would have to notify the Director of the reason for the modification and its financial impact on the insurer.

The bill would require an insurer to notify the Director informally of a termination of any of the specified transactions within 30 days after the transaction terminated.

Access to Information

The Code authorizes the DIFS Director to order a registered insurer to produce records, books, or other information papers in the possession of the insurer or its affiliates as necessary to determine the insurer's financial condition or legality of conduct. The bill specifies that the insurer's financial condition would include enterprise risk to the insurer by the ultimate controlling party, by combination of entities within the insurance holding company system, or by the insurance holding company system on a consolidated basis. Additionally, the bill would allow the Director to order a registered insurer to produce information not in its possession if

the insurer could obtain access to it under a contractual relationship, statutory obligation, or other method. If the insurer could not obtain the requested information, the insurer would have to give the Director a detailed explanation of the reason why, as well as the identity of the holder of the information. If the Director determined that the explanation was without merit, he or she could require the insurer, after notice and hearing, to pay a civil fine of $1,000 for each day's delay, or could suspend or revoke the insurer's license.

Except as otherwise provided, information, documents, and document copies obtained by or disclosed to the Director or any other person in the course of an examination or investigation described above and the information reported in connection with the filing of a registration statement is confidential, is not subject to subpoena, and may not be made public by the Director or any other person, except to insurance departments of other states, without the written consent of the insurer to which it pertains. The Director may, however, disclose the information after giving the insurer and its affected affiliates notice and opportunity to be heard, if the Director determines that the interests of policyholders, shareholders, or the public will be served by publication of the information. The bill provides that such information also would not be subject to the FOIA or subject to discovery, or admissible in evidence in a private civil or administrative action. The bill would prohibit the Director or a person who received documents, materials, or other information while acting under the Director's authority or with whom the information was shared under the Code from testifying in a private civil or administrative action concerning confidential documents, materials, or information obtained in relation to an enterprise risk report and information reported with regard to a registration statement**.**

The bill would allow the Director to share documents, materials, or other information, including the confidential and privileged documents, with other state, Federal, and international regulatory agencies; the National Association of Insurance Commissioners; and state, Federal and international law enforcement authorities, including members of a supervisory college, if the regulator, NAIC, or law enforcement authority agreed in writing to maintain the confidentiality and privileged status of the document, materials, or information and had verified the legal authority to maintain confidentiality in writing.

The Director could share confidential and privileged documents, material, or information reported in an enterprise risk report with insurance commissioners of other states that had statutes or regulations pertaining to the confidentiality of the information substantially similar to Michigan's and who had agreed in writing not to disclose the information. The Director could receive documents, materials, or information, including otherwise confidential and privileged documents, materials, or information, from the NAIC and from regulatory and law enforcement officials of other foreign or domestic jurisdictions, and would have to maintain as confidential or privileged any document, material, or information received with notice or the understanding that it was confidential or privileged under the laws of the source jurisdiction. The disclosure or sharing of information, a document, or other material to the Director or other person would not be a waiver of an applicable privilege or claim of confidentiality.

The bill provides that documents, materials, or other information in the possession or control of DIFS or the NAIC under Chapter 13 would be confidential and privileged, would not be subject to FOIA, would not be subject to subpoena, and would not be subject to discovery or admissible as evidence in a private civil or administrative action. The Director would have to enter into written agreements with the NAIC governing sharing and use of information provided under Chapter 13. An agreement would have to specify procedures and protocols regarding the confidentiality and security of information shared with the NAIC and its affiliates and subsidiaries, including procedures and protocols for sharing by the NAIC with other state, Federal, or international regulators. The agreement also would have to provide that the DIFS Director owned the information shared with the NAIC and its affiliates and subsidiaries, and that the NAIC's use of the information was subject to the Director's direction. Additionally,

the agreement would have to provide for prompt notice to be given to an insurer whose confidential information in the NAIC's possession was subject to a request or subpoena to the NAIC for disclosure or production, and require the NAIC and its affiliates and subsidiaries to consent to intervention by an insurer in a judicial or administrative action.

The bill specifies that the Director's sharing of information under Chapter 13 would not be a delegation of regulatory authority or rule-making. The Director would be solely responsible for the administration, execution, and enforcement of the provisions of Chapter 13.

Supervisory College

The bill would permit the DIFS Director to participate in a supervisory college for a domestic insurer that was part of an insurance holding company system with international operations to determine the insurer's financial condition, business strategy, risk management, risk exposures, governance processes, regulatory position, or legality of conduct. The Director could participate in a supervisory college with other regulators, including state, Federal, and international regulatory agencies, charged with the supervision of the insurer or its affiliates. The Director's authority would include initiating a supervisory college; clarifying membership and participation of other supervisors in the college; clarifying the functions of the college and roles of other regulators, including establishing a groupwide supervisor; coordinating ongoing college activities; and establishing a crisis management plan.

The insurer would be liable for and would have to pay the reasonable expenses for the Director to participate in the supervisory college, including reasonable travel expenses, if the Director considered it appropriate to require the insurer to pay these costs.

The bill would authorize the Director to enter into agreements providing the basis for cooperation and sharing of confidential information with state, Federal, and international regulatory agencies that regulated the domestic insurer or affiliates within the insurance holding company system. This provision would not delegate to the supervisory college the Director's authority to regulate or supervise the insurer or its affiliates within its jurisdiction.

Failure to File Registration Statement

Under the Code, an insurer that does not file a registration statement as required without just cause must pay a penalty of $1,000 for each day's delay, up to a maximum of $50,000 to be recovered by the DIFS Director and paid into the General Fund. The Director may reduce the penalty if the insurer demonstrates that the penalty would cause financial hardship to the insurer. The bill specifies that the penalty would be a civil fine.

MCL 500.1301 et al. Legislative Analyst: Julie Cassidy

FISCAL IMPACT

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

Fiscal Analyst: Glenn Steffens