Legislative Analysis

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Senate Bill 1029 as enacted
Public Act 421 of 2018
Sponsor: Sen. Joe Hune
House Committee: Insurance
Senate Committee: Insurance
Complete to 2-7-19

BRIEF SUMMARY: Senate Bill 1029 would amend the Insurance Code by adding Chapter 55 (Domestic Stock Insurer Division) to provide conditions and procedures under which a domestic stock insurer could divide into two or more new insurers.

FISCAL IMPACT: Senate Bill 1029 would have a neutral net fiscal impact on the Department of Insurance and Financial Services (DIFS) and no fiscal impact on other units of state and local government. (See ***Fiscal Information***, below, for further discussion.)

THE APPARENT PROBLEM:

Currently, insurance providers are not allowed to divide into one or more separate entities in the state of Michigan. Insurance providers may wish to divide as a way of restructuring their company or facilitating a strategic transaction. By failing to provide a framework for such a division, some have argued that Michigan hinders the flexibility of insurance providers in deciding their corporate structure, thus making Michigan a less attractive business environment.

THE CONTENT OF THE BILL:

Generally speaking, the bill would do the following:

- Require a domestic stock insurer wishing to divide to file with the Department of Insurance and Financial Services (DIFS) a plan of division describing the insurers resulting from the division, whether the dividing insurer will survive the division, and the allocation of the assets, shares, and liabilities of the insurers.
- Prescribe the rights and responsibilities of shareholders concerning a division.
- Require that a plan of division must be approved by the director of DIFS after a hearing and consideration of issues involving financial stability, shareholder interests, policyholder interests, and the public interest generally.
- Provide that the dividing insurer would pay the expenses of the director in connection with the above proceedings.
- Require the confidentiality of certain private financial information.
- Provide for a certificate of division, a public document describing the division and its effectiveness, after the adoption and approval of a plan of division and the issuance of a final order by the director approving the plan.
- Specify how a division takes effect, including provisions concerning the insurers' assets, liabilities, certificates of authority, articles of incorporation and bylaws, shares and shareholder rights, policyholder rights, security agreements, pending legal actions, and similar areas of concern.

The bill is more particularly described as follows:

Plan of division

Senate Bill 1029 would allow a domestic stock insurer to divide into two or more resulting insurers under a plan of division that must include all of the following:

- The names of the insurer that would be divided and of the new insurers.
- The proposed articles of incorporation and bylaws of the new insurers.
- Any proposed amendments to the dividing insurer's articles of incorporation or bylaws.
- How the assets and liabilities of the dividing insurer will be allocated among the new insurers, with a reasonable description of those liabilities.
- How shares in the new insurers will be distributed to the dividing insurer or its shareholders.
- Whether and how shares in the dividing insurer would be canceled or converted into other forms of value.
- All other terms and conditions of the division, including those required by the laws of this state or by the bylaws and articles of incorporation of the dividing insurer.

A plan of division would be approved by the board of directors and shareholders of the dividing insurer and in accordance with its articles of incorporation and bylaws.

A dividing insurer could amend a plan of division in accordance with procedures set forth in that plan or, if the plan has no such procedures, in a manner determined by the dividing insurer's board of directors. If the amendment would change the distribution of shares or other forms of value, change the articles or bylaws of any resulting insurer in a way that would require shareholder approval, or otherwise adversely affect shareholders of the dividing insurer, a shareholder who was entitled to vote on or approve the plan of division would also be entitled to vote on the amendment.

A dividing insurer could also abandon a plan of division without shareholder action, in accordance with procedures set forth in that plan or, if the plan has no such procedures, in a manner determined by the dividing insurer's board of directors.

Director approval

A division could not take effect without being having been approved by the director of DIFS. The dividing insurer would have to file its plan of division with the director, who would then conduct a public hearing on the plan. Within 10 business days after filing the plan of division with the director, the dividing insurer would also have to provide reasonable notice of the filing to each reinsurer that is a party to a reinsurance contract allocated in the plan of division.

The director would be required to approve a plan of division unless he or she found any of the following:

- The division would substantially lessen competition in the state's insurance market or would likely be hazardous or prejudicial to the insurance-buying public.
- The terms of the plan are unfair and unreasonable to the dividing insurer's policyholders or shareholders or would not adequately protect the interests of the dividing insurer's policyholders who may become policyholders of the resulting insurer.

- The division is being made to hinder, delay, or defraud the dividing insurer's policyholders or other creditors.
- An acquiring party of a resulting insurer has plans to liquidate it, sell its assets, consolidate or merge it, or make other changes to its business or corporate structure or management that are unfair and unreasonable to its policyholders and not in the public interest.
- An acquiring party of a resulting insurer has a financial condition that could jeopardize the insurer's financial stability or prejudice the interests of policyholders or shareholders.
- A resulting insurer's operations would be controlled by persons whose competence, experience, and integrity are such that the division would not be in the interest of the resulting insurer's policyholders or the general public.
- A resulting insurer would be insolvent after the division or left with unreasonably small assets in relation to the business in which it would engage.
- A resulting insurer would be unable to satisfy the requirements for obtaining a certificate of authority.
- The division would violate the Uniform Voidable Transactions Act. The bill would prescribe how to treat the dividing and resulting insurers in applying that act.

The director could not approve a division undertaken in conjunction with the divestiture of one of the resulting insurers until the potential acquiring party had received the necessary approvals under section 1315 or 7604 of the Code, as applicable.

All information and materials provided to or obtained by the director in connection with a plan of division would be confidential until notice is given of the public hearing required above. After notice of the public hearing, the domestic insurer could request and receive confidentiality for any business, financial, and actuarial material that is not part of the plan of division or incorporated by reference in the plan. However, the director could, after notice and hearing, make information available under the Freedom of Information Act if he or she determines that the public interest in having the information available outweighs the interest of the insurer in keeping the information confidential.

The dividing insurer would have to pay the expenses of the director in connection with the proceedings described above, including costs of hiring outside professionals and experts. The dividing insurer could allocate these expenses as liabilities in the plan of division.

Upon approval of a plan of division, the director would have to issue an order approving the plan that is accompanied by findings of fact and conclusions of law. When the plan is approved by the director in a final order and all relevant appeals related to that order have been exhausted, the requirements described above regarding the allocation of some or all of the liabilities of the dividing insurer are conclusively satisfied.

The director could establish additional procedures regarding his or her review of a plan of division.

Certificate of division
Upon adoption and approval of a plan of division as described above, an officer or authorized representative of the dividing insurer would have to sign a certificate of division, which would be a public document that must set forth all of the following:

- The name of the dividing insurer.
- Whether the dividing insurer will survive the division.
- The name of each new insurer created by the division.
- The effective date of the division. (A division would be effective when the relevant certificate of division is filed with DIFS, unless a later effective date is specified in the plan of division. However, the effective date could not be more than 90 days after the director's approval of the plan of division.)
- A statement that the division was approved by the director.

A division that becomes effective upon the filing of a certificate of division would not be an assignment of any insurance policy, annuity, or reinsurance agreement or any other type of contract.

A dividing insurer could abandon a plan of division after having filed a certificate of division with DIFS by filing with DIFS a signed notice of abandonment. The notice of abandonment would be effective on the date it is filed.

Division effectiveness, allocation of assets and liabilities
A dividing insurer surviving the division would continue after the division took effect; its bylaws and articles of incorporation would have to be amended, if applicable, as provided in the plan of division. A dividing insurer not surviving the division would cease to exist, subject to state requirements regarding the surrender of a certificate of authority.

Each new insurer would come into existence holding the capital, surplus, and other assets allocated to it by the plan of division as a successor to the dividing insurer, automatically, by operation of law and not by transfer. The new insurer's articles of incorporation and bylaws would become effective, and the director of DIFS would have to issue a certificate of authority to the new insurer if it satisfied state requirements regarding the formation and licensure of new domestic stock insurers.

If capital, surplus, and other assets of the dividing insurer were allocated by the plan of division, they would vest in the applicable resulting insurer as provided in the plan. If capital, surplus, and other assets of the dividing insurer were not allocated by the plan of division, they would vest in the dividing insurer if it survived the division or, if it did not, equally in the resulting insurers as tenants in common. [The bill further provides that "Otherwise, it vests as provided in this section without transfer, reversion, or impairment." What "Otherwise" and "it" refer to is unclear.]

The shares in and any securities of each new insurer would be distributed to the dividing insurer, if it survived the division, or pro rata to shareholders of the dividing insurer who did not assert any appraisal rights that they may have under the bill (see **Shareholders**, below).

Except as provided in the dividing insurer's articles of incorporation or bylaws, the division would not give rise to any rights that a shareholder, domestic stock insurer director, or third

party would have upon a dissolution, liquidation, or winding up of the dividing insurer. The allocation to a new insurer of capital, surplus, or other assets that are collateral covered by a financing statement would not be effective until a new financing statement naming the new insurer as a debtor took effect.

Liens, security interests, and other charges on the capital, surplus, or other assets of the dividing insurer would not be impaired by the division, notwithstanding any otherwise enforceable allocation of liabilities of the dividing insurer. If the dividing insurer were bound by a security agreement under Article 9 of the Uniform Commercial Code that provided for the security interest to attach to after-acquired collateral, each resulting insurer would be bound by that security agreement.

Liabilities (including policy liabilities) of the dividing insurer would be allocated among the resulting insurers as specified in the plan of division. A resulting insurer would be liable for the allocated liabilities as successors to the dividing insurer, automatically, by operation of law, and not by transfer or assumption. Any liabilities of the dividing insurer that are not allocated by the plan of division would be the joint and several responsibility of the resulting insurers. Each resulting insurer would also be responsible for liabilities that it issued, undertook, or incurred in its own name after the division. A resulting insurer would not be responsible for liabilities incurred by, or allocated under the plan of division to, another resulting insurer.

A division would be treated as if it were a merger for purposes of a contract or evidence of indebtedness of the dividing insurer (except an insurance policy, annuity, or reinsurance agreement) that was issued or incurred before the effective date of the bill and that requires the consent of the obligee to a merger or treats the merger as a default and does not provide that a division of the insurer does not require the consent of the obligee. If it were discovered, after a division, that the act of undertaking a division itself breached a contractual obligation of the dividing insurer, all of the resulting insurers would be jointly and severally liable for that contractual breach, but the breach would not affect the validity or effectiveness of the division, including the allocation of liabilities under the plan of division.

An allocation of a policy or other liability would not affect the rights of a policyholder or creditor under other law with regard to the policy or liability, except as provided in the plan of division and specifically approved by the director. However, those rights would be available only against a resulting insurer that is responsible for the policy or liability. An allocation of a policy or other liability would not release or reduce the obligation of a reinsurer, surety, or guarantor of the policy or liability.

The common law doctrine of successor liability or any similar theory of liability applicable to transferees or assignees of property would not operate to hold a resulting insurer liable for liabilities other than those allocated to it under the plan of division or as described above.

Shareholders

A record shareholder of a dividing insurer that did not survive the division would be entitled to dissent from the division and obtain payment of the fair value of that shareholder's shares in the manner, and to the extent, provided in sections 1762 to 1774 of the Business Corporation Act, unless the shares were converted into or canceled solely for cash or for shares that, on the record date fixed to vote on the plan of division, are listed on a national securities exchange or are designated as a national market system security on an interdealer quotation system by the

National Association of Securities Dealers. Section 1762 of the Business Corporation Act would apply to the shareholder in the same manner as it would apply to a merger of a domestic corporation.

Plan of merger or consolidation
A dividing insurer could adopt and execute a plan of merger on behalf of a resulting insurer in order to facilitate the merger of the resulting insurer with another company simultaneously with the effectiveness of a division. The dividing insurer could, on behalf of the resulting insurer, execute, deliver, and file documents, plans, certificates, or resolutions. If requested by the dividing insurer, the director of DIFS could waive provisions for a merger or consolidation of domestic stock insurers otherwise required by section 7604 of the Code and could issue final approval of the merger or consolidation as part of his or her approval of a plan of division as described above.

Proposed MCL 500.5500 et seq. and MCL 500.7604

FISCAL INFORMATION:

Senate Bill 1029 would have a neutral net fiscal impact on the Department of Insurance and Financial Services (DIFS) and no fiscal impact on other units of state and local government. Under the bill, DIFS would be tasked with processing plans of division and notices of abandonment and with approving divisions after reasonable notice and a public hearing. The approval process for insurance divisions would include DIFS's consideration of assets, liabilities, and cash flows of the relevant insurer. These responsibilities would likely lead to an increase in departmental costs. However, the bill stipulates that expenses incurred by the DIFS director in reviewing proposed divisions under the bill must be paid by the dividing insurer, resulting in a neutral fiscal impact for DIFS.

BRIEF DISCUSSION:

Proponents of the bill argued that, by creating a single state review process that provides flexibility for companies, the bill would give insurers a new tool and Michigan a competitive edge in how companies are structured, to an extent that might even encourage redomiciling. Concerns were raised that a company might try to use the division process to spin off a bad book of business from a healthy portion. Proponents argued that the director of DIFS must look specifically at the fiscal health of the new companies in reviewing the division plan and would not approve the creation of a less stable company.

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