

Legislative Analysis



CORPORATE GOVERNANCE ANNUAL DISCLOSURE MODEL ACT

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House Bill 6520 (H-3) as passed by the House
Sponsor: Rep. Lana Theis
Committee: Insurance
Complete to 12-7-18

Analysis available at
<http://www.legislature.mi.gov>

(Enacted as Public Act 520 of 2018)

BRIEF SUMMARY: House Bill 6520 would create a new chapter in the Insurance Code to require all insurers domiciled in the State of Michigan to write a Corporate Governance Annual Disclosure (CGAD) once a year and submit it to the director of the Department of Insurance and Financial Services (DIFS).

FISCAL IMPACT: Any costs for DIFS arising from the bill would be administrative in nature and would likely be supported by existing departmental appropriations. (See **Fiscal Information**, below, for further details and discussion.)

THE APPARENT PROBLEM:

Corporate governance is defined as the structures, policies, and processes through which a firm is managed and controlled. Its key aspect is defining who has the power to manage and represent an organization and who is to be held accountable for its actions. For the sake of effectively regulating corporations, some would argue that it is necessary for corporations to provide some level of transparency to the government agencies to which they are held accountable. In the insurance industry specifically, there is pressure for insurance providers to keep regulators informed of their firms' financial solvency. At the same time, some corporations have expressed concern that doing so may reveal sensitive business information to the public or their competitors. Legislation has been proposed to provide for annual corporate governance disclosures with procedures to balance transparency and confidentiality.

THE CONTENT OF THE BILL:

The bill would require an insurer, or the insurance group of which it is a member, to submit a CGAD to the Director no later than June 1, 2020 and each June 1 thereafter. The CGAD would have to be signed by the insurer or insurance group's CEO or corporate secretary attesting that the insurer or group had implemented the corporate governance practices and that a copy of the disclosure had been provided to the insurer's board of directors or the appropriate committee of the insurer's board of directors. If the insurer were a member of an insurance group, then it would submit the CGAD to the lead state of the insurance group in accordance with the lead state's laws and requirements.

The bill would require insurers and insurance groups to provide information regarding the corporate governance of their firm to a level that reflected their overall governing system.

The bill would encourage the insurer to make the CGAD disclosures according to one of the following three criteria, while indicating which criterion was used:

- The level at which the insurer's or insurance group's risk appetite was determined.
- The level at which the earnings, capital, liquidity, operations, and reputation of the insurer were overseen and supervised collectively.
- The level at which legal liability for the failure of general corporate governance duties would be placed.

The bill states that the review of the CGAD and any additional requests for information would have to be made through the lead state in accordance with the laws and requirements of the lead state. In addition, the bill would consider other documents provided to the Director that provided information substantially similar to the information required as sufficient for the CGAD requirements as long as those documents were cross-referenced for the information that they include.

The bill would give the insurer or insurance group discretion over their responses to the CGAD inquiries as long as the CGAD gave the Director sufficient understanding of the insurer's or insurance group's corporate governance, structure policies, and practices. To this end, the Director could request additional information in order to gain that level of understanding. The CGAD would have to be prepared as prescribed by the Director, and documentation and supporting information related to the CGAD would have to be maintained and made available to the Director upon request.

Confidentiality of information disclosed

Any information disclosed to the Director in compliance with the bill would be considered proprietary and to contain trade secrets. As such, the Director would have to treat it as confidential and privileged and would not be required to disclose it under the Freedom of Information Act (FOIA), under subpoena, or as evidence in any private civil suit. The Director would be able to use this information to fulfill the extent of his or her duties but could not make the information public without the written consent of the insurer or insurance group. This requirement would extend to anyone who received this information while acting under the authority of the Director or anyone else with whom this information could be shared.

In addition, except as otherwise specified in the bill, the Director would be allowed to share the information described with other parties—such as other financial regulatory agencies, NIAC, or third-party consultants—only if the recipient submitted a written agreement to uphold the confidentiality of the information. The Director would be able in turn to receive any such information from those parties with notice or the understanding that it was confidential and privileged. The sharing or disclosure of any of the information handled as part of the bill would not be considered a delegation of regulatory authority or rule-making or a waiver of an applicable privilege or claim of confidentiality.

Third-party consultants

The bill would allow the Director to retain third-party consultants—such as attorneys, actuaries, and accountants—at the insurer's or insurance group's expense to assist the

Director in reviewing the CGAD and related information or the insurer's or insurance group's compliance with the bill. Such a person would be under the direction and control of the Director and thus act in a purely advisory capacity. These consultants would be subject to the same confidentiality standards and requirements as the Director. The consultant would need to verify to the Director and notify the insurer or insurance group in writing that he or she was free of any conflict of interest and had procedures in place to identify and monitor compliance with any conflict that may arise after engagement and to comply with the standards and requirements of confidentiality. Any written agreement with the NAIC and/or a third-party consultant over the sharing and use of the insurer's or insurance group's information would need to contain all of the following:

- A requirement for the expressed consent of the insurer or insurance group before making any of the insurer's or group's information public.
- Specific procedures and protocols for keeping the insurer's or insurance group's information confidential and secure.
- Procedures and protocols specifying that the NAIC could share information only with other state regulators in states in which the insurer or insurance group had domiciled insurers, along with the recipient's agreement in writing to maintain the confidentiality and privileged status of the insurer's information.
- A provision specifying that ownership of such shared information would remain with DIFS and that the use of the information was subject to the direction of the Director with written notice to the insurer or insurance group.
- A provision prohibiting the NAIC or a third-party consultant from storing the information shared under the bill in a permanent database after the underlying analysis was completed, and requiring the NAIC or consultant to promptly return or destroy all CGAD-related information provided by the insurer or insurance group.
- A provision requiring the NAIC or third-party consultant to notify the director and insurer or insurance group in writing about any subpoena, request for disclosure, or request for production of the insurer's CGAD-related information.
- A requirement that the NAIC or third-party consultant consent to the insurer's or insurance group's intervention in any judicial or administrative action that would require the NAIC or third-party consultant to disclose the insurer's confidential information.

Penalty for failure to submit CGAD

An insurer or insurance group that failed to submit the CGAD by June 1 without just cause would, after written notice and hearing, be required to pay a civil fine of \$1,000 for each day's delay, which would be recovered by the Director and paid into the state's general fund. The maximum civil fine charged for failure to submit the CGAD would be \$75,000. The Director could reduce or waive the penalty if the insurer demonstrated that the penalty would cause the insurer financial hardship or that there is just cause for the delayed filing. The Director could grant a 90-day extension for filing the CGAD upon written request.

Inseverability of Section 1761

The bill states that if a court ruled in a final decision that Section 1761—the section upholding the confidentiality of the insurer's information in the case of legal action—was

invalid, then the entire chapter would be rendered void, as this section is to be considered absolutely vital and thus inseverable from the rest of the bill.

Judicial Construction

Finally, the bill states that a court could not apply a principle from the American Law Institute's "Restatement of the Law, Liability Insurance" in ruling on an issue an action brought in a court in this state, unless the principle were clearly expressed in the common law or in a statute or case law precedent of this state.

The bill would take effect January 1, 2020.

Proposed MCL 500.1751 et seq.

BACKGROUND INFORMATION:

The bill would incorporate a model act¹ from the National Association of Insurance Commissioners (NAIC) into Michigan statute. The model act is an NAIC accreditation requirement effective January 1, 2020. It had been adopted in 24 states as of June 30, 2018.²

FISCAL INFORMATION:

Any costs for DIFS arising from the bill would be administrative in nature and would likely be supported by existing departmental appropriations. The bill stipulates that the Director of DIFS may obtain the assistance of external experts to assist in reviewing the requisite CGAD filings, but the costs of such services would be recovered from insurers. The bill would establish a civil fine for insurers that fail to file CGAD, at a rate of \$1,000 for each day's delay, with a maximum civil fine of \$75,000. Revenues from the civil fine would be deposited to the state's general fund. The bill would have no impact on local units of government.

ARGUMENTS:

For:

Supporters of the bill argue that better understanding of insurers' corporate government structures and risk management practices will help regulators provide more effective oversight on an ongoing basis.

Against:

No arguments against the bill were offered in committee.

¹ Corporate Governance Annual Disclosure Model Act:

https://www.naic.org/documents/committees_e_isftf_corp_governance_related_cgad_model_act_140728.pdf?19

² See https://www.naic.org/documents/cmte_legislative_liaison_brief_corp_governance.pdf

POSITIONS:

The Michigan Department of Insurance and Financial Services testified in support of the bill. (11-29-18).

The following organizations indicated their support for the bill (11-29-18):

- Michigan Council of Life Insurers
- Insurance Alliance of Michigan

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