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BILL ANALYSIS

Senate Fiscal Agency

Lansing, Michigan 48909

(517) 373-5383

Senate Bill 568 (as passed by the Senate)
Sponsor: Senator Dan DeGrow
Committee: Commerce and Technology

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RATIONALE

A fraternal benefit society is a tax-exempt, nonprofit organization that serves a particular purpose, e.g., education, charity, or religion, and offers its members a variety of programs and services, including insurance and other benefits. To date, such charitable and benevolent organizations in Michigan have been regulated by Chapter 80 of the Insurance Code, which is based on the 1913 model fraternal benefit society bill that was drafted by the National Association of Insurance Commissioners and the National Fraternal Congress of America, and was last recodified in 1956. Although Chapter 80 has been amended sporadically since 1956 to deal with specific issues, some claim that its provisions generally are outdated and fail to specify a regulatory framework that allows fraternal benefit societies and the Insurance Commissioner the latitude to respond to changes in the industry, the market place, purposes of the societies, and the needs of society members. A new model fraternal code was adopted by the National Fraternal Congress of America in 1983 and some believe that Chapter 80 should be replaced by this more modern, uniform code.

CONTENT

The bill would repeal Chapter 80 of the Insurance Code, which governs the establishment and operation of fraternal benefit societies, and would recodify the provisions in a new Chapter 81. Many of the provisions currently pertaining to the tax-exempt status of fraternal societies

and their general powers and purposes, organizational structure, personal liability provisions, right to merge or consolidate, right to make investments and terms governing those investments; the powers and duties of the Insurance Commissioner in regulating the societies; and the licensing of such societies and their agents, would remain generally unchanged. The bill, however, would add new provisions to authorize fraternal societies to own subsidiary corporations and establish the separate accounts necessary for offering variable life insurance and annuities, provide societies with greater flexibility to determine the types of benefits they want to provide and to whom, and grant the societies parity with other insurers in their scope of operations. The bill would take effect January 1, 1990. A more detailed explanation of the changes the bill would make is provided.

Lodge Systems

The bill would require subordinate lodges to hold regular meetings at least once a month (rather than periodically) and specify that the meetings would be in furtherance of the purposes of the society.

Representative Form of Government

The bill would provide for two types of supreme governing bodies: 1) an assembly of delegates selected by the members that would elect a

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board of directors to conduct the business of the society between meetings of the assembly and 2) a board elected by the members that would have to meet at least quarterly to conduct the business of the society. The bill specifies that delegates to the assembly and the board of directors could be elected by mail, officers of the society would be elected by either the supreme governing body (the assembly) or the board of directors, and only benefit members would be eligible to serve on the governing body or the board.

Powers and Purpose

The bill would add "patriotic" to the list of purposes for which fraternal societies could operate, and specifically provides that fraternal societies could carry out their purposes indirectly through subsidiary corporations or affiliated organizations as well as directly through the society.

Location of Office

The bill would allow meetings of a supreme governing body to be held at any location determined by the body, require all minutes of the proceedings of a supreme governing body or board of directors to be in English, and allow a society to provide in its rules or laws for a grievance or complaint procedure for its members.

Personal Liability

The bill would add new language to provide for the indemnification and reimbursement of directors, officers, employees and agents of a fraternal society (or of an organization that a person was serving at the request of the society) for reasonable expenses incurred by, and liabilities imposed on, a person in connection with a civil, criminal, administrative, or investigative proceeding in which the person was involved.

Under the bill, a person could not be indemnified or reimbursed in relation to any matter in an action or proceeding if he or she were finally adjudged to be or have been guilty of breach of a duty as a director, officer, employee, or agent of the society or for any matter in an action or proceeding, or the threat thereof, that had been made the subject of a

compromise settlement, unless the person acted in good faith for what he or she believed was in the best interests of the society and had no reasonable cause to believe that his or her conduct was unlawful. The determination of whether a person acted in good faith or without reasonable cause could be made only by a court or the supreme governing body or board of directors by a majority vote of a quorum consisting of persons who were not parties to the action or proceeding. The termination of an action or proceeding by judgment, order, settlement, or conviction, or upon a plea of no contest, would not in itself create a conclusive presumption that the person did not meet the standard of conduct required in order to justify indemnification and reimbursement. This right of indemnification and reimbursement would not be exclusive of other rights to which the person could be entitled as a matter of law and would inure to the benefit of the person's heirs, executors, and administrators.

The bill also specifies that a society could purchase and maintain insurance on behalf of a person who was or had been a director, officer, employee, or agent of the society, or who had been serving at the request of the society as a director, officer, employee, or agent of any other firm, corporation, or organization against any liability asserted against the person and incurred by him or her in his or her official capacity or arising out of his or her status as such, whether or not the society had the power to indemnify the person against the liability under the bill.

Organization

The bill's provisions on the organization of fraternal societies are essentially the same as the Code's current provisions except that the bond that societies are required to file with the Insurance Commissioner would have to be at least \$300,000 and not more than \$1.5 million as required by the Commissioner. Further, the bill would require a society to collect at least \$150,000 in premiums (rates, dues, or other contributions payable under a certificate) before incurring any liability, issuing certificates or paying benefits. These provisions would apply, however, only to societies formed on or after January 1, 1990. For societies formed before January 1, 1990, the Code's current provisions requiring a bond of \$5,000 and aggregate

premiums of \$2,500 would still apply.

Amendments

Currently, the Code requires a fraternal society to file with the Insurance Commissioner certified copies of amendments of and additions to its constitution and laws within 90 days after their enactment; specifies that certified printed documents are prima facie evidence of their legal adoption; and allows societies to amend their articles and provides that such amendments are operative upon filing with the Commissioner or later as provided in the articles, laws or constitution.

The bill specifies that a domestic fraternal society could amend its laws by action of its supreme governing body at regular or special meetings, or by referendum by a vote of the voting members of the society, the delegates or representatives of voting members, or vote of local lodges. Voting could be done by mail. An amendment submitted for adoption by referendum could not be adopted unless, within six months from the date of submission, a majority of the members voting signified their consent to the amendment.

Amendments could not take effect unless approved by the Commissioner, who would be required to approve an amendment if it had been duly adopted and were not inconsistent with State law or the character, objects, and purposes of the society. The Commissioner would have 60 days after the amendment was filed to act on it, or it would be considered approved automatically. Within 90 days after an amendment was approved, it, or a synopsis of it, would have to be mailed to each society member or published in full in the society's official publication.

Nonprofit Organizations

The bill would add new language to allow societies to create, maintain, and operate, or establish organizations to operate, nonprofit institutions to further the purposes of the society. The nonprofit institution could furnish services free or at a reasonable charge. Any real or personal property owned, held, or leased by the society for purposes for which the society was organized would have to be reported in each annual statement.

Reinsurance

The Code addresses the issue of reinsurance only by specifying that if a society chooses to reinsure all or part of the risks of another fraternal benefit society, the written contract concerning the reinsurance must be approved by a vote of two-thirds of the members of the supreme legislative or governing body of each of the societies. The societies then have to submit the contract, together with their financial statements, to the Insurance Commission for approval.

The bill specifically would allow a domestic society, by a reinsurance agreement, to cede all or part of any individual risk to an authorized or approved insurer, other than another fraternal benefit society, with the power to make reinsurance. A society could not insure substantially all of its insurance in force without the Insurance Commissioner's written permission. A society could take credit for the reserves on such ceded risks to the extent reinsured but credit would not be allowed as an admitted asset or as a deduction from liability to a ceding society for reinsurance made, ceded, or renewed, or that otherwise became effective on or after January 1, 1990, "unless the reinsurance was payable by the assuming insurer on the basis of the liability of the ceding society under the contract reinsured without diminution because of the insolvency of the ceding society".

A society could reinsure the risks of another society in a consolidation or merger approved by the Commissioner.

Benefits

The bill would expand the Code's provisions specifying the types of benefits fraternal societies may offer to include endowment and annuity benefits, hospital, medical, or nursing benefits, and other benefits authorized for life insurers that would not be inconsistent with the bill's provisions. Further, the bill would delete the current requirements that members be 70 years of age to receive the benefits.

Beneficiaries

The bill would allow a society to provide for the

payment of funeral benefits to the extent that reasonably appeared to be due to a person who incurred the expense of the burial of a member, up to a maximum payment of \$1,000.

Further, the bill provides that if there were no lawful beneficiary to whom the proceeds were payable, the amount of the benefit, excluding funeral benefits paid to the person who incurred the funeral expenses, would be paid either to the personal representative of the deceased, insured, or owner of the certificate, if the owner were not the insured.

Benefit Contracts

The bill would amend the Code's provisions concerning benefit contracts by specifying that:

- All statements on an application for membership and insurance would be representations and not warranties, and any waiver of this provision would be void.
- Minors would be bound by the terms of their applications for, and certificates of, insurance and the society's rules and laws in the same manner as adults.
- Certificate holders would be allowed to accept a reduction in their benefits in lieu of having to contribute to cover deficiencies in a society's reserves.
- Benefit certificates would have to be filed with the Insurance Commissioner.

Nonforfeiture Benefits

The bill would add a new provision specifying that for certificates issued before January 1, 1991, the value of every paid-up nonforfeiture benefit and the amount of any cash surrender value, loan, or other option granted would have to comply with the law applicable before January 1, 1990.

For certificates issued on or after January 1, 1991, for which reserves were computed on the Commissioner's 1980 standard mortality table, or any more recent table made applicable to life insurers, every paid-up nonforfeiture benefit and the amount of any cash surrender value, loan, or other option granted could not be less than the corresponding amount determined in accordance with Michigan laws applicable to life insurers issuing policies containing like benefits

based on the tables.

Funds

The bill would allow a society, by resolution of its supreme governing body, to establish and operate separate accounts and issue contracts on a variable basis subject to all the provisions of law regulating life insurers establishing such accounts and issuing such contracts, including capital and surplus requirements. To the extent the society considered it necessary in order to comply with applicable Federal or State laws or rules, the society could adopt special procedures for the conduct of the business and affairs of a separate account, and could provide:

- For persons having beneficial interest in such an account.
- Special voting and other rights, including rights and procedures relating to investment policy, investment advisory services, selection of certified public accountants, and selection of a committee to manage the business and affairs of the account.

Further, the society could issue contracts on a variable basis to which the bill's provisions concerning open contracts and maintenance of solvency would not apply.

Valuation

The bill specifies that the standards of valuation for certificates issued before January 1, 1991, would be the standards provided by the laws applicable before January 1, 1990. The minimum standards for certificates issued on or after January 1, 1991, would be under valuation methods and standards applicable to life insurers issuing policies containing similar benefits and would be based on the 1980 standard ordinary mortality table (or more recent table) for life insurance certificates and on authorized tables for annuity and pure endowment certificates, total and permanent disability benefits, accidental death benefits, and noncancellable accidents and health benefits.

The Insurance Commissioner, however, could accept other standards of valuation if he or she found that the reserves produced would not be

less in the aggregate than computed according to the prescribed minimum valuation standard. The Commissioner could vary the standards of mortality applicable to all benefit contracts on substandard lives or other extra hazardous lives by any society authorized to do business in Michigan.

With the consent of the Insurance Commissioner of the state of its domicile, a society could establish and maintain reserves in excess of the required reserves, provided the contractual rights of any benefit member were not affected.

Reports

The bill would amend the Act's reporting requirements by allowing the Commissioner to extend the filing deadline, requiring each society to file an annual report on the valuation of its certificates in force, and specifying that a society that failed to file a report on time would be fined \$100 per day and would be prohibited from doing business until the report was filed.

Annual License

The bill would delete the Act's requirement that a society pay an annual license fee of \$5.

Licensing of Agents

The bill specifically would require agents of fraternal benefit societies to be licensed according to the licensing provisions of Chapter 12 of the Insurance Code, but would exempt officers, employees and members of a society who devote substantially all of their services to activities other than the solicitation of fraternal insurance contracts and who receive no commission or compensation for solicitation of such contracts.

The bill also specifies that the Code's requirement that fraternal societies be subject to Chapter 20 of the Code (unfair practices provisions) could not be construed to apply to the society's right to determine its membership eligibility requirements.

Penalties

The bill specifies that a willful violation of, or

neglect or refusal to comply with, the provisions of the bill would constitute a misdemeanor punishable by a fine of up to \$5,000, imprisonment for up to six months, or both. The Act currently specifies only a maximum fine of \$200 for such a violation or failure of compliance.

Judicial Review

The bill would add a new provision specifying that all the decisions and findings of the Insurance Commissioner made under the bill would be subject to judicial review.

Exemptions

The bill would add to the current list of organizations exempt from its requirements orders, societies or associations in existence and issuing benefits on July 1, 1945, that admit to membership only persons engaged in crafts or hazardous occupations in the same or similar lines of business, insuring only their own members and families, and their ladies' societies or auxiliaries.

Other Applicable Laws

Societies subject to the provisions of the bill also would be subject to the Code's provisions governing disability policies, life policies, annuity contracts and the suspension of certificates.

MCL 500.124 et al.

FISCAL IMPACT

The bill would have a minimal fiscal impact on State government and no fiscal impact on local government.

The bill would authorize a new fine of \$100 per day to be paid by any society that neglected to file an annual statement by the due date specified by the Commissioner of Insurance. The Insurance Bureau does not anticipate any late filings of annual statements since any society may receive an extension of up to two months on the filing due date.

The bill also would eliminate a \$5 annual license fee for all fraternal benefit societies. The \$420 annual revenue raised by this fee from the 84 fraternal benefit societies would be

lost, but the Insurance Bureau would experience savings to offset the loss since it would not have to check whether a society paid its license fee.

In addition, the bill would increase from \$200 to \$5,000 the maximum penalty for refusal to comply with the provisions of the bill for which a penalty is not prescribed elsewhere. The number of violations for which the fine would be imposed cannot be determined.

ARGUMENTS

Supporting Argument

According to the National Fraternal Congress of America, there are about 200 nonprofit fraternal benefit societies in the U.S. and Canada representing almost 10 million persons of various ethnic, religious and vocational backgrounds. In Michigan, the three domestic fraternal benefit societies and 75 member societies from other states licensed in Michigan have over 434,000 life insurance certificates and 40,000 accident and health certificates issued to their Michigan members. A modern uniform fraternal benefit societies code would make it much easier for such societies to respond to changes in their members' needs and in the types of programs, benefits, and services they traditionally offer and to coordinate their programs, benefits, and services with those offered by lodges in other states. The provisions of the bill also would help ensure that the Insurance Bureau had the authority and flexibility necessary to regulate properly a rapidly evolving industry. The new model fraternal code that was adopted by the National Fraternal Congress of America in 1983 and that is the blueprint for this bill has already been enacted (with minor modifications) in 18 states.

Legislative Analyst: L. Burghardt
Fiscal Analyst: J. Schultz

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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.