SFA BILL ANALYSIS

Senate Fiscal Agency • Lansing, Michigan 48909 • (517) 373-5383

Senate Bill 949 (as enrolled)
Sponsor: Senator Dick Posthumus
Senate Committee: Commerce and Technology
House Committee: Insurance

PUBLIC ACT 350 of 1990

Date Completed: 2-15-91

RATIONALE

More and more insurance companies have been contracting with managing general agents to sell policies, manage a portfolio, and make financial commitments on behalf of the insurer. The agents often handle special lines of coverage for the insurer, such as coverage for recreational water parks, and have greater management powers than the company's insurance agents. For example, managing general agents may review applications for insurance coverage, appoint subagents to handle accounts, and place "reinsurance" with other insurers. (If a risk is too great for a single company to assume, other companies are asked if they would like to participate in or "reinsure" the risk). Contracting with managing general agents reportedly can be an attractive alternative for insurers to establishing regional offices. Since managing general agents are not currently regulated by statute, however, contracting with them apparently can create problems and expose insurers to increased risk. Reportedly, several insolvencies among insurers, including one in Michigan, can be attributed to managing general agents who assumed too much risk for the insurance companies for which they wrote business or who placed reinsurance with undercapitalized reinsurers. In order to protect insurers and their clients, it has been suggested that regulatory controls for managing general agents and for the insurers who contract with them be specified in statute.

In a related matter, it has been suggested that additional regulatory controls are needed to protect policyholders and claimants from the prospect of limited liability pools encountering financial difficulties. Generally, a limited liability pool is a type of small insurance company with a special set of financial regulations and serves a special market. Such pools may be formed by business and professional groups, nonprofit organizations, and others if the Insurance Commissioner determines that liability coverage is not readily available for certain kinds of insureds. Among the pools currently operating are two that offer liquor liability coverages to bars, bowling alleys, and other liquor retailers subject to the dram shop Act. The Governor's Insurance Task Force in 1988 reportedly recommended the adoption of additional regulations to increase the supervision of these pools by the Insurance Bureau.

CONTENT

The bill would amend the Insurance Code to provide for the regulation of managing general agents; allow individual disability insurance policies to contain a coordination-of-benefits provision; and provide for additional regulation of limited liability pools. The bill would take effect on June 1, 1991. An insurer could not use the services of a managing general agent on and after that date, unless such use were in compliance with the bill.

The term "managing general agent" would mean a person who does both of the following:

-- Negotiates and binds ceding reinsurance contracts on behalf of an insurer or manages all or part of the insurance business of an insurer, including the management of a separate division, department, or underwriting office.

- -- Acts as an agent for such insurer who, with or without the authority, either separately or together with affiliates, produces, directly or indirectly, and underwrites an amount of gross direct written premium of not less than 5% of the policyholder surplus as reported in the last annual statement of the insurer in any one quarter or year and adjusts or pays claims in excess of an amount determined by the Insurance Commissioner or negotiates reinsurance on behalf of the insurer.

"Managing general agent" would not include an employee of the insurer, a United States manager of the United States branch of an alien insurer, or an underwriting manager who manages all the insurer's insurance operations, is under common control with the insurer, and is subject to Chapter 13 of the Insurance Code (which regulates holding companies), and whose compensation is not based on the volume of premiums written.

Licensure

The bill would prohibit a person from acting as a managing general agent unless he or she were licensed as an agent in Michigan. The Insurance Commissioner could require a managing general agent to maintain an errors and omissions policy and a bond in an amount acceptable to the Commissioner for the protection of the insurer.

Contract Provisions

The bill specifies that no person acting as a managing general agent could place business with an insurer unless there was a written contract between the parties stipulating the responsibilities of each party, or the division of responsibilities, and containing the following provisions:

- -- That the insurer could terminate the contract upon written notice to the managing general agent. The insurer could suspend the underwriting authority of the agent during the pendency of any dispute regarding the cause for termination.
- -- That the agent would have to render accounts to the insurer detailing all transactions and would have to remit all funds due to the insurer on at least a monthly basis.
- -- That funds collected for the account of the insurer would have to be held by the agent in a fiduciary capacity in a Federally insured financial institution. The account would have to be used for all payments on behalf of the insurer. The agent could retain no more than three months' estimated claims payments and allocated loss adjustment expenses.
- -- That separate records of business written by the agent would have to be maintained by the agent for one year after each examination of the insurer by the Commissioner or licensing authority. The insurer would have access to and the right to copy all books, accounts, and records related to its business, and the Commissioner would have access to and the right to copy all books, records, and accounts of the agent.
- -- That the contact could not be assigned in whole or in part by the managing general agent.
- -- That the agent would be subject to appropriate underwriting guidelines, including the basis of the rates to be charged, the maximum annual premium volume, maximum limits of liability, applicable exclusions, territorial limitations, the types of risks that could be written, policy cancellation provisions, and the maximum policy period.

If the contract permitted the managing general agent to settle claims on behalf of the insurer, all of the following would apply:

- -- All claims would have to be reported to the insurer in a timely manner.
- -- All claims files would be the joint property of the insurer and the agent.
- -- A copy of the claim file would have to be sent to the insurer upon request or as soon as it became known that the claim involved a coverage dispute, was open for more than six months, could exceed the agent's claims settlement authority, could exceed an amount determined by the Commissioner or the limit set by the insurer (whichever was less), or was closed by payment of an amount set by the Commissioner or the insurer

(whichever was less).

- -- Any settlement authority granted to the agent could be terminated upon the insurer's written notice to the agent or upon termination of the contract. The insurer could suspend any settlement authority granted to the managing agent during the pendency of any dispute regarding the cause for termination.

If the contract provided for a sharing of interim profits by the agent and the agent had the authority to determine the amount of the interim profits by establishing loss reserves or controlling claim payments, or in any other manner, the contract would have to provide that the interim profits could not be paid to the managing general agent until one year after they were earned for property insurance business and five years after they were earned for casualty insurance business and not until the insurer had on file an independent financial examination of the agent and obtained the opinion of an actuary on the adequacy of the loss reserves.

Prohibited Activities

The contract also would have to provide that the managing general agent could not do any of the following:

- -- Bind reinsurance or retrocessions on behalf of the insurer, except that the managing general agent could bind facultative reinsurance contracts pursuant to obligatory facultative agreements if the contract with the insurer contained reinsurance underwriting guidelines including, for both reinsurance assumed and ceded, a list of reinsurers with which such automatic agreements were in effect, the coverages and amounts or percentages that could be reinsured, and commission schedules.
- -- Commit the insurer to participate in insurance or reinsurance syndicates.
- -- Appoint any agent without assuring that the agent was lawfully licensed to transact the type of insurance for which he or she was appointed.
- -- Without prior approval of the insurer pay or commit the insurer to pay a claim over a specified amount, net of reinsurance, that could not exceed 1% of the insurer's policyholder's surplus as of December 31 of the last completed calendar year.
- -- Collect any payment from a reinsurer or commit the insurer to any claim settlement with a reinsurer, without prior approval of the insurer. If prior approval were given, a report would have to be forwarded promptly to the insurer.
- -- Permit its agent to serve on the insurer's board of directors.
- -- Jointly employ an individual who was employed with the insurer.
- -- Appoint another managing general agent to perform its duties under the bill.

Duties of Insurers

An insurer would have to comply with all of the following:

- -- Have on file an independent financial examination, in a form acceptable to the Commissioner, of each managing general agent with which it had done business.
- -- If a managing general agent established loss reserves for the insurer, annually obtain the opinion of an actuary attesting to the adequacy of loss reserves established for losses incurred and outstanding on business produced by the managing general agent. This requirement would be in addition to any other required loss reserve certification.
- -- Periodically, and not less than semiannually, conduct an on-site review of the underwriting and claims processing operations of the managing general agent.
- -- Provide that binding authority for all reinsurance contracts or participation in insurance or reinsurance syndicates would rest with an officer of the insurer who was not affiliated with the managing general agent.
- -- Within 30 days of entering into or terminating a contract with a managing general agent, provide written notification of the appointment or termination to the Insurance Commissioner. Notices of appointment of a managing general agent would have to include a statement of duties specifying that the applicant was a licensed agent and was expected to perform on behalf of the insurer, specify the lines of insurance

for which the applicant was to be authorized to act, and provide any other information the Commissioner requested.

-- Review each quarter its books and records to determine if an agent had become a managing general agent. If the insurer determined that an agent had become a managing general agent, the insurer would have to notify promptly the agent and the Commissioner of this determination, and the insurer and agent would have to comply fully with the provisions of the bill within 30 days.

Except in regard to relationships governed by Chapter 13 of the Insurance Code, the insurer could not appoint to the board of directors an officer, director, employee, agent, or controlling shareholder of the insurer's managing general agents.

Penalties for Violations/Scope of the Bill

The bill specifies that the acts of the managing general agent would be considered to be the acts of the insurer on whose behalf it was acting, and a managing general agent could be examined as if it were the insurer. If the Commissioner found after an administrative hearing that a person had violated any provision of the bill, the Commissioner could order revocation or suspension of the agent's license, a maximum civil fine of $25,000 for each separate violation, and restitution by the managing general agent to reimburse the insurer, the rehabilitator, the liquidator of the insurer, or the guaranty associations for any losses incurred by the insurer or the guaranty associations because of a violation of the bill. ("Guaranty association" would mean the Property and Casualty Guaranty Association and the Life and Health Insurance Guaranty Association created under the Code.) Such a decision, determination, or order of the Commissioner would be subject to judicial review pursuant to the Administrative Procedures Act.

These provisions would not affect the right of the Commissioner to impose any other penalties provided for in the Insurance Code. Further, the bill specifies that nothing contained in the bill would be intended to or would in any manner limit or restrict the rights of policyholders, claimants, and auditors.

The bill provides that the Commissioner could adopt reasonable rules and regulations for the implementation and administration of its provisions.

Coordination of Benefits

The bill would amend Chapter 34, which deals primarily with individual disability insurance policies, to allow an insurance policy to contain a coordination-of-benefits provision that specified the following:

-- Benefits under the policy could be limited if other valid coverage were available for the same loss on an expense-incurred basis. If the insurer were not notified in writing of other coverage or if other coverage were obtained later, the insurer's policy would be liable only for the amount of a covered claim that exceeded the benefits payable by the other coverage.
-- Benefits paid or payable by a primary insurer would be applied to satisfy any deductibles, coinsurance, and copayments with the policy.
-- Payments by a primary insurer would not be applied to reduce the policy maximum limits on this policy. If more than one policy covered the same loss and the other policy had a similar coordination-of-benefits provision, each insurer would have to pay an equal share.
-- The policy would be secondary to workers' compensation coverages, automobile personal protection benefit plans that did not have coordination-of-benefit provisions, and Medicare, as permitted by Federal law. (The term "other coverage" would not include Medicaid, hospital daily indemnity plans, specified disease-only policies, or limited occurrence policies that provided only for intensive care or coronary care at a hospital, first aid outpatient medical expenses resulting from accidents, or specified accidents such as travel accidents.)
-- The Commissioner would have to report to the Legislature one year and two years after the effective date of the bill on what, if any, cost savings had accrued to policy holders and insurers because of the coordination-of-benefits provisions.

Limited Liability Pools

The bill would amend Chapter 65, which deals with limited liability pools, to require that a limited liability pool certify annually the loss reserves of the pool by an actuary approved by the Commissioner. The rates charged by a limited liability pool would have to be filed in accordance with provisions in the Code that pertain to the review and effective date of casualty insurance rate filings, and would be subject to the prior approval of the Commissioner.

A limited liability pool would be required to put in writing all underwriting rules used by the insurer, and to file its underwriting rules with the Commissioner prior to their use in Michigan.

"Underwriting rules" would mean the written statements, guidelines, or criteria of a limited liability pool, that described the standards under which the limited liability pool issued, refused to issue, renewed, refused to renew, or limited coverage for liability insurance under this chapter.

A limited liability pool would be allowed to reinsure all or any portion of its potential liability with reinsurers licensed to transact insurance in this State or approved by the Commissioner. A limited liability pool could not reinsure directly or indirectly all or any portion of its potential liability with an insurer not authorized to transact insurance in this State without approval of the Commissioner.

Finally, the bill would require limited liability pools to maintain at all times a contingency reserve equal to at least two-sevenths of the total premium income for the preceding calendar year but not less than $300,000. Currently, the Code requires the reserve to be at least one-tenth of the total premium income (with the $300,000 minimum).

MCL 500.6534 et al.

FISCAL IMPACT

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

ARGUMENTS

Supporting Argument
The bill would provide for much needed managerial controls over managing general agents to help ensure the financial integrity of the insurers who contract with them and protect the interests of the insurers' clients.

Supporting Argument
The bill would help close a loophole that permits people covered under more than one insurance policy to collect twice for the same loss. The bill would permit companies offering individual disability (health) insurance policies to include a coordination-of-benefits provision specifying the order of payment for a loss covered under more than one policy or plan.

Supporting Argument
The bill would improve the supervision of the financial condition of limited liability pools by the Insurance Bureau. An analysis from the Bureau (11-27-90) says: "Because limited liability pools may be formed to write the most risky, least predictable types of insurance, because they are small insurers, and because they have very little margin for error, these pools require more supervision than other insurers which have a larger surplus and smaller ratio of premiums written to surplus." Limited liability pools do not have to meet the same financial standards as commercial insurance companies, so it is possible for groups (financially unable to form regular insurance companies) to form them to provide a kind of coverage that otherwise would not be available. Obviously, it is important that they remain solvent, so that the rights of policyholders and claimants are protected. (Limited liability pools are members of the guaranty fund that regular property-casualty insurance companies constitute, and the fund must pay claims in case of a pool's insolvency.)

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

A8990\S949EA
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.