SFA BILL ANALYSIS

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

Senate Bill 971 (as enrolled)
Sponsor: Senator Dick Posthumus
Senate Committee: Commerce and Technology
House Committee: Insurance

PUBLIC ACT 349 of 1990

Date Completed: 1-29-91

RATIONALE

Reportedly, one of the major problems facing corporations today is the difficulty of funding post-retirement health care benefit liabilities. The problem appears to be most acute for older established companies that have post-retirement liabilities with present values ranging from $150 million to $1 billion. The actual cash costs of such liabilities will be significantly greater since many of the health care benefits will be used in the future after the employees retire. To date, companies have been financing their health care benefits on a pay-as-you-go basis. Beginning in 1992, however, as a result of action taken by the National Financial Accounting Standards Board, corporations will have to begin recording their liabilities against their earnings. In other words, a corporation will have to estimate as accurately as possible the entire value of health care benefits that it expects to pay in the future, calculate the present value of those benefits commitments, and record a portion of that total liability against its current earnings. If corporations cannot find a way to finance those liabilities then, they may be forced to reduce the benefits offered. Since the liabilities may last anywhere from 40 to 70 years, depending on the age of the retiree and whether there is coverage for dependents, the options for dealing with the cost of the benefits apparently are limited. For many companies, the most attractive financing option that evidently is available is the use of some form of corporate life insurance owned by either the corporation or a "501(c)(9) trust", i.e., a type of trust that may be established by an employer to pay for certain welfare benefits for employees. Such coverage, which can insure the lives of all of the corporation's employees, provides the corporation or trust with tax advantages that make it attractive to use as a financing mechanism. For example, the death benefits from such policies are not taxable, nor are any loans or cash withdrawals made against a policy. Further, any interest paid on loans against the policy is tax-deductible.

One rub in this, however, is that Michigan apparently has no statutory provisions concerning insurable interest, and case law reportedly provides only that a third party (e.g., a corporation or trust) has an insurable interest if it has a "reasonable expectation" of pecuniary loss in the event of the death of an insured person. If the insured is a "key" or management employee there is an automatic presumption that there will be a pecuniary loss upon the employee's death and an insurable interest is granted. That presumption, however, either does not apply or is more difficult to apply if the employee is not considered a "key" employee. Because it evidently is very difficult to get all parties to agree on the definition of "reasonable expectation" of pecuniary loss for nonmanagement employees, many corporations do not consider purchasing individual life insurance policies on their employees as a means of funding health care liabilities. Moreover, Section 500.4404 of the Insurance Code specifically precludes employers from being beneficiaries of employer-provided group life insurance coverage for employees. It has been suggested, therefore, that employers be allowed by statute to have an insurable interest in, and insure, the lives of their employees.

CONTENT

The bill would amend the Insurance Code to provide that an employer has an insurable interest in, and, with the consent of the insured, could insure the lives of its directors, officers, managers, nonmanagement employees, and retired employees on an individual or group basis for the benefit of the employer or an employer-sponsored trust established for the benefit of the employees and officers. An employer could insure the lives of its nonmanagement and retired employees, however, only if those persons consented to be insured and the coverage were limited to an amount reasonably commensurate with the employer's projected unfunded liabilities to nonmanagement employees and retired employees for welfare benefit plans, calculated according to accepted actuarial principles. An employer could not retaliate in any manner against a nonmanagement or retired employee for refusing consent to be insured.

The proceeds of any policy or certificate issued would be exempt from the claims of any creditor or dependent of the insured.

"Employer" would mean an individual, sole proprietorship, partnership, firm, corporation, association, or any other legal entity, that has one or more employees and is legally doing business in this State.

Proposed MCL 500.2210

FISCAL IMPACT

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

ARGUMENTS

Supporting Argument

The bill would provide a crucial financing mechanism for corporations faced with substantial long-term, post-retirement health care liabilities. Since the bill would require that the amount of the insurable interest be commensurate with projected unfunded liabilities and calculated according to accepted actuarial principles, the problems that currently make the use of life insurance an unacceptable financing mechanism--defining "reasonable expectation" of pecuniary loss and determining whether there is an insurable interest and who is a "key" employee--would no longer exist.

Opposing Argument

The bill states only that the insurance would be for the benefit of the employer or an employer-sponsored trust; there is no restriction on the use of the insurance proceeds. Therefore, the company could use the proceeds simply to improve its financial position rather than to fund post-retirement health care benefits. To ensure that the proceeds were used to finance the benefits, the only beneficiary of the insurance policy should be a trust established for the benefit of the employees.

Response: For a variety of financial and tax reasons, establishing a trust to fund post-retirement health care benefits may not be the best option for a particular company. Further, it is highly unlikely that the company would use the proceeds simply to improve its financial position since there presumably are other ways in which the company could accomplish that task, but few mechanisms it can use to fund the post-retirement health care liabilities.

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