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**House Bill 4407 (Substitute S-3)****Sponsor: Representative Burton Leland****House Committee: Colleges and Universities****Senate Committee: Commerce and Technology****Date Completed: 6-4-87****RATIONALE**

The State's colleges and universities have not escaped the liability insurance problems that have afflicted physicians, restaurants, municipalities, and others in recent years. The story is a familiar one: sharply rising premiums combined with some forms of coverage becoming unavailable at any cost. Adequate coverage for trustees and officers has become particularly difficult to obtain. Colleges increasingly are relying on self-insurance while paying more for what reduced insurance coverage remains obtainable. Wayne State University's premium for primary coverage general liability insurance increased 143% from 1984-85 to 1985-86, for example. The cost of umbrella coverage for amounts in excess of that covered by the primary coverage increased 475% for protection that decreased from \$25 million to \$10 million. The school's efforts to obtain coverage for athletic events have been unsuccessful; it conducts those events without insurance and requires participants to sign a waiver.

One proposed method of solving the problems of insurance cost and availability, especially in a time when many schools are having to self-insure, is to form an insurance pool that enables participants to distribute the risk among themselves, encourages them to undertake efforts to reduce risks, provides them with more financial control than is otherwise to be expected in the fluctuating commercial insurance market, and, perhaps most importantly, enables participants to obtain adequate "excess" insurance (i.e., insurance that applies when losses exceed a given amount in a given period) at affordable rates.

Some contend that the State constitution grants State colleges and universities sufficient autonomy to form a pool without specific statutory authority. Although the schools have sought the Attorney General's opinion on whether legislative approval is needed to form a pool, they also have asked for legislation sanctioning the formation of a State colleges and universities insurance pool. The matter is urgent to them, because eight of the 13 schools (excluding the University of Michigan at Ann Arbor and Saginaw Valley State College, which have opted not to participate) will have to renew or replace their current coverages by July 1, 1987.

**CONTENT**

House Bill 4407 (S-3) would create the "State Colleges and Universities Self-Insurance Act" to authorize colleges and universities, with certain restrictions, to create an actuarially sound group self-insurance pool and to specify the powers of the Commissioner of Insurance with respect to the pool. The pool could only provide coverages for the following categories of risks: casualty, property, automobile, surety and fidelity, umbrella and excess coverages, and medical

malpractice risks. The pool would be expressly prohibited from providing coverages for life; health; other personal lines of coverages; workers' compensation; medical malpractice risks relating to surgical, inpatient, overnight care, or care provided in a hospital; or coverages used to satisfy the indemnification reserve fund requirements of Public Act 315 of 1977 (MCL 390.1121-390.1131). The pool would not be a member of the property and casualty guaranty association created under Chapter 79 of the code.

**Higher Education Self-Insurance Pool**

The bill would authorize the governing boards of two or more baccalaureate-granting institutions to "create an actuarially sound group self-insurance pool to provide coverage for risks" of the participating institutions. The pool would have to be formed as a nonprofit corporation. Each institution participating in the pool would exercise equal powers and have equal representation on the pool's governing body, which would consist of one qualified representative appointed by each institution's governing board. Each representative annually would have to submit a written report regarding the pool's financial condition to the governing body of his or her respective institution.

The bill would allow the creation of only one higher education self-insurance pool, which would be formed and governed by an agreement between the participating institutions. Participation would be available to each institution that agreed to the terms and conditions of the pool's participation agreement. Amounts received for risks covered by the pool could be segregated into separate funds or accounts. The participation agreement would have to contain all of the following:

- The manner and method of determining the initial and subsequent financial contributions required of participating institutions.
- The manner and method of establishing the coverages provided by the pool.
- The terms and conditions of withdrawal from and dissolution of the pool.
- The rights of and obligations imposed on participating institutions.
- Other provisions considered necessary or appropriate by the participating institutions.

In addition, the pool created pursuant to the bill would be required to do all of the following:

- Establish initial and subsequent financial contributions based upon actuarial recommendations.
- Operate effective risk management and loss control programs for and by participating institutions.

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- Establish and maintain reserves expected to be sufficient, together with authorized assessments to meet the financial obligations of the pool to the participating institutions.
- File audited financial statements certified by an independent certified public accountant detailing the pool's financial position, operating results, and risk management programs, with each participating institution and the Commissioner of Insurance, within 120 days after the end of the pool's fiscal year.
- File a certification by an independent actuary that the reserves, together with authorized assessments, were sufficient to meet the financial obligations of the pool to its participating institutions, with each participating institution and the Commissioner, within 120 days after the end of the pool's fiscal year.

The pool would have only those powers granted to it by the bill and by its participation agreement, and could bind its participating institutions only to the extent provided in the agreement. The pool could not engage in a business or activity except for providing coverages for risks of its participating institutions.

The assets of the pool would have to be invested consistent with prudent investment practices, and the investments would have to be disclosed annually to all participating institutions. The creation of the pool and any liabilities created under the pool could not be considered obligations of the State. All financial records of the pool would have to be made available to the Auditor General or a certified public accountant appointed by the Auditor General.

#### Powers of the Commissioner

The Commissioner could perform examinations of the pool to assure that the pool was in sound financial condition and was operating in accordance with the requirements of the bill. Examinations would have to be conducted in the same manner as for casualty insurers. After conducting an examination, the Commissioner could make recommendations to the pool regarding the pool's financial condition. The pool would have to respond to any such recommendations and detail any corrective actions taken, within 120 days after receiving the recommendations. If the Commissioner determined that the pool's response or proposed corrective actions were inadequate, the Commissioner would be authorized to take the same actions as are authorized by the Insurance Code for casualty insurers, including the appointment of a receiver. Except for the specified powers granted to the Commissioner, the pool would not be considered an insurer subject to the Insurance Code, and its operation could not be considered the transacting of an insurance or surety business or the making of insurance or surety contracts.

### **SENATE COMMITTEE ACTION**

The Senate Committee on Commerce and Technology recommended adoption of a substitute (S-3) to the bill. Where the House-passed version of the bill would require a written report from each member of the pool's governing body to his or her higher education institution, the Senate substitute to the bill specifies that the report would have to be one "regarding the financial condition of the pool".

In addition, the Senate substitute removed a qualifier on a provision that would allow the Insurance Commissioner to perform examinations of the pool. The House-passed version of the bill would allow such examinations only if the pool failed to provide the Commissioner with audited financial statements that would be required under the proposed Act. Also, the Senate substitute would require the Commissioner to take the same action that the Commissioner is authorized to take for a casualty insurer under the Code, if the Commissioner determined that the

pool's responses to or proposed corrective actions regarding his or her recommendations were inadequate. The House-passed version of the bill, however, merely would require the Commissioner to report his or her findings, together with the pool's response, to the governing boards of the participating institutions, the Legislature, and the Governor, if the pool's responses were considered inadequate.

### **FISCAL IMPACT**

The bill would have a negligible impact, if any, on State appropriations for higher education since the self-insurance pool simply would replace existing insurance mechanisms for any of the participating institutions. Insurance cost savings or increases would depend on which schools chose to become part of the self-insurance pool and the liability levels of the participating institutions. There would be no fiscal impact on local governments.

The bill would result in an indeterminate increase in expenditures for the Department of Licensing and Regulation, Insurance Bureau. The amount of the increase would depend on the extent of financial examinations required. Currently, the Insurance Bureau is required to examine insurers every three to five years. An average examination requires approximately 1,000 hours of examiner time at roughly \$33 per hour, or \$33,000. Insurers are charged for the cost of their examination but it is unclear whether this bill would allow the self-insurance pool to be charged examination fees. There would be no fiscal impact on local governments.

### **ARGUMENTS**

#### ***Supporting Argument***

The bill would provide the regulatory framework for Michigan's State colleges and universities to form an insurance pool, and enjoy the advantages of better coverage available at better prices. Cost savings would be realized through risk sharing, successful efforts to reduce risks, and availability of excess insurance coverage at a better price. The bill would safeguard the pool by emphasizing actuarial soundness throughout, requiring regular evaluations, and providing for a degree of Insurance Commissioner oversight. Although some may wish to evaluate the effects of recent liability law reforms before taking action, the need for relief is immediate. There is no time to wait and see how the insurance market reacts to previous statutory changes.

#### ***Opposing Argument***

The bill should include financial safeguards, such as maintaining minimum levels of reserves. If the pool failed to maintain adequate reserves to pay claims, or failed to maintain adequate aggregate excess coverage for when the pool's resources were exhausted in a given fiscal period, or in some other way suffered from faulty planning or management, the pool's losses (which could be many millions of dollars) would have to be made up by the State colleges and universities who joined it. The Legislature would have to divert taxpayer money to the schools if education were not to suffer. The State has a strong and legitimate interest in ensuring that the pool is properly run. Empowering the Commissioner to examine the pool and to take specified corrective actions is not enough. Problems could be avoided if the bill included minimum capitalization requirements.

**Response:** The bill contains sufficient safeguards to ensure the pool's financial stability. Governing board members would have to report annually to their educational institution, and the pool would be subject to examinations by the Commissioner. If the pool failed to respond adequately to the Commissioner's

recommendations, then he or she could take a number of corrective actions, including the appointment of a receiver. Further, the fact that the ultimate financial burden would rest with the State does not derive from this bill; that would be the case regardless of whether the bill were enacted.

### ***Opposing Argument***

It is unnecessary to involve the Insurance Commissioner and to invoke provisions of the Insurance Code. State colleges and universities are subject to regular oversight by the Legislature through the appropriations process, and the governing boards of those institutions are not about to jeopardize good relations with the Legislature by insufficiently attending to the need to hire good managers and expert actuaries for the pool. The institutions are in a unique position not only by virtue of their dependence on the Legislature, but also through their constitutionally-granted authority to manage their own affairs. Reports to the Commissioner and Commissioner examination of inadequate reports, without authority for implementing sanctions, would be sufficient to ensure the pool's stability.

### ***Opposing Argument***

The bill would be unfair to insurance companies by forcing the private sector to compete with a publicly-funded program *partially exempt from the regulation imposed on commercial insurance companies.*

**Response:** If the insurance were reasonably available from the private sector, there would be no need for the bill. Commercial insurance companies have largely abandoned this market.

### ***Opposing Argument***

The bill fails to attack the root of the problem, which is exorbitant jury awards. Legislation should place constraints on the suits themselves. It would be more effective to place limits on collections, prohibit interest on judgments, and specifically require suits to be brought in the Court of Claims, where there is no jury.

**Response:** An important element of the pool would be an active program of risk reduction and loss management through education of its participants, who would have strong incentive to improve because their money would be at stake in the pool. Such efforts would reduce vulnerability to lawsuits. It would be unfair to injured parties to limit arbitrarily the amount they could collect, and such proposals are outside the scope of this bill.

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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.