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Senate Bill 495 (Substitute S-1 as passed by the Senate)  
Sponsor: Senator Dan Lauwers  
Committee: Finance, Insurance, and Consumer Protection

Date Completed: 10-8-24

### **RATIONALE**

Fraternal benefit societies are not-for-profit organizations that provide benefits and services to members, such as health insurance, life insurance, and annuities. According to testimony before the Senate Committee on Finance, Insurance, and Consumer Protection, there are over 40 fraternal benefit societies in Michigan with over 300,000 members. Testimony also indicates that a fraternal benefit society that falls into a hazardous financial condition can be very harmful to its members. Accordingly, it has been suggested that the Director of the Department of Insurance and Financial Service (DIFS) have more tools to address a failing fraternal benefit society and intervene in such a way to help that society succeed.

### **CONTENT**

**The bill would amend Chapter 81a (Fraternal Benefit Societies) of the Insurance Code to do the following:**

- **Specify that a society's assessment of a proportion of a deficiency upon its certificate owners would not take effect until 90 days after the date the Director of DIFS was notified of the assessment, unless the Director approved an earlier effective date.**
- **Allow the Director, if a domestic society had a regulatory or authorized control level event, to order the society to remedy the event.**
- **Specify that the order could include authorization to the society to negotiate an agreement to transfer all members, certificates, and other assets and liabilities of the society to another fraternal benefit society or other insurer.**
- **Allow the Director to grant an organization a limited certificate of authority under certain circumstances.**
- **Prescribe circumstances that would qualify a society for rehabilitation or liquidation upon petition of the Director of DIFS.**
- **Prohibit a society from assessing payment of shares after the Director filed a petition for liquidation of the society unless the Director determined that the assessment was for the purpose of satisfying certain obligations.**
- **Require the liquidator of a society to attempt to transfer policies or certificates of the liquidating society to a qualified fraternal benefit society.**

#### Benefit Contracts

Under Chapter 81a, each fraternal benefit society authorized to do business in Michigan must issue to each owner of a benefit contract a certificate specifying the amount of benefits provided. (Chapter 81a defines a fraternal benefit society as an incorporated society, order, or supreme lodge, without capital stock, including one exempted under Section 8199(1)(b) (i.e., orders, societies, or associations that admit to membership only individuals engaged in one or more crafts or hazardous occupations and the ladies' societies or ladies' auxiliaries to

those orders, societies, or associations) whether incorporated or not, conducted solely for the benefit of its members and their beneficiaries and not for profit, operated on a lodge system with ritualistic form of work, having a representative form of government, and that provides benefits in accordance with Chapter 81a.) The certificate, together with any attached riders or endorsements, the laws of the society, the application for membership, the application for insurance and declaration of insurability, if any, signed by the applicant, and all amendments to each, constitute the benefit contract, as of the date of issuance, between the society and the owner, and the certificate must state this.

A society must provide in its laws that if its reserves as to all or any class of certificates become impaired, its board of directors or corresponding body may require that the owner must pay to the society the amount of the owner's equitable proportion of the deficiency as determined by its board, and that if the payment is not made either of the following applies:

- It stands as an indebtedness against the certificate and draws interest not exceeding the rate specified for certificate loans under the certificates.
- In lieu of or in combination with the above provision, the owner may accept a proportionate reduction in benefits under the certificate.

The society may specify the manner of the election and which alternative is to be presumed if no election is made.

Under the bill, an assessment of a proportion of a deficiency would not take effect until 90 days after the date the Director was notified of the assessment, unless the Director approved an earlier effective date. The Director could disapprove an assessment of a proportion of a deficiency if the Director found that the assessment was not adopted in conformity with Chapter 81a or was contrary to the interests of the members of the society.

#### Order by the Director

Under the bill, if a domestic society had a regulatory or authorized control level event, as defined by the Director (see **BACKGROUND**), or if the society's continued operation were considered hazardous to policyholders, credits, or the public, under circumstances the Director determined would not be remedied promptly, the Director, in addition to taking any other action required or allowed by law, could order the society to remedy the risk-based capital control level event or hazardous condition. An order issued by the Director could include authorization to the society to negotiate an agreement to transfer all members, certificates, and other assets and liabilities of the society to another fraternal benefit society or other insurer through merger, consolidation, assumption, or other means.

(Generally, the Code allows DIFS to consider the following when determining whether an entity is hazardous to policyholders, creditors, or the public: findings reported in financial condition and market conduct reports; the sufficiency of asset portfolios; operating losses and general finances; association with other insolvent entities; and the fitness of management; among other things.<sup>1</sup>)

A transfer would constitute a novation of the transferring society's certificates that would be effective on the date of transfer.<sup>2</sup> The society would have to ensure the transfer was concluded

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<sup>1</sup> MCL 500.436a

<sup>2</sup> A substituted contract occurs when the parties replace the existing contract with a completely new one in satisfaction of the existing duties. A novation is a substituted contract in which a new

within the time agreed to by the Director and subject to the Director's approval. A transfer agreement would be fully approved by the domestic society upon a majority vote of the society's board of directors, notwithstanding Section 8177 and any other law, regulation, or rule that required notice to or approval by the society's members or supreme governing body. Any law of a society requiring notice to or approval by the society's members or supreme governing body would be suspended by the bill. The transferring society would have to provide notice to its members of the transfer by mail or in the society's official publication within 30 days after the Director approved the transfer. (Section 8177 generally prescribes circumstances under which a domestic society may consolidate or merge with another society.)

If the society sought to make a transfer to an organization that did not have a certificate of authority in Michigan, the Director could grant the organization a limited certificate of authority to service the existing certificates and fulfill all obligations owed to certificate holders following the transfer but not to otherwise transact insurance business in Michigan.

By order of the Director and notwithstanding any law or rule to the contrary and any laws of the society, the board of directors of the society could suspend or modify the qualifications for membership in the society as necessary to facilitate a transfer.

On the effective date of a transfer to an organization that was not a fraternal benefit society and in consideration for the transfer, each member of the society would be considered to agree that any terms of a certificate subjecting the certificate to the laws of the society or providing for the maintenance of the society's solvency, except to the extent of any outstanding lien not released by the terms of the transfer, would be void and the assuming organization would have to endorse the certificate accordingly.

#### Rehabilitation & Liquidation

Under the bill, any of the following would qualify as grounds for rehabilitation under Section 8112(a) or liquidation under Section 8117(a) or (b):

- Failure by a domestic society to comply with an order of the Director under the bill.
- Failure by a domestic society to remedy within the time specified by the Director a hazardous condition as determined by the Director.

(Section 8112(a) allows the Director to apply by petition to the circuit court of Ingham County for an order authorizing the Director to rehabilitate a domestic insurer or an alien insured domiciled in Michigan on the grounds that the insurer is in such condition that the further transaction of business would be hazardous financially to its policyholders, creditors, or the public. Section 8117(a) and (b) allow the Director to petition the circuit court for Ingham County for an order directing the liquidation of a domestic insurer or an alien insured domiciled in Michigan on any ground for an order of rehabilitation as specified in Section 8112, whether there has been a prior order directing the rehabilitation of the insurer, or on the grounds that the insurer is insolvent, respectively.)

Rehabilitation would be presumed to be futile, unless the Director reasonably believed that rehabilitation had a high probability of returning the society to long-term viability or would facilitate a transfer to another fraternal benefit society or insurer. If the rehabilitator sought to make a transfer to an organization that did not have a certificate of authority in the State,

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party is included in the substituted contract. Restatement (Second) of Contracts §§ 279, 280 (1981).

the Director could grant the organization a certificate within authority limited to servicing the existing certificate and fulfilling all obligations owed to certificate holders following the transfer but not otherwise transact insurance business in the State.

After the Director filed a petition for liquidation of a society, the society could not assess payment of shares of a deficiency unless the Director determined that the assessment was for the purpose of satisfying the obligations of the society to Class 1 or Class 2 creditors described in Sections 8142(1)(a) and (b). The society could not make an assessment for the purpose of any deficiency related to other claims including those described in Sections 8142(1)(c) through (i). (Under Section 8142(1)(a), a Class 1 creditor is one that makes claims for the costs and expenses of administration. Under Section 8142(1)(b), a Class 2 creditor is one that makes claims under policies for losses incurred, including third party claims, and all claims of a guaranty association or foreign guaranty association. Sections 8142(1)(c) through (i) prescribes Class 3 through 9 creditors' claims.)

Liquidation proceedings for a society would have to be conducted consistent with the purposes of Section 8101 in a manner designed to conserve assets, limit liquidation expenses, and avoid any assessment of shares of a deficiency.

The liquidator of a society would have to attempt to transfer policies or certificates of the liquidating society by way of assignment, assumption, or other means to a qualified fraternal benefit society, either domestic or foreign, or, if no qualified fraternal benefit society would accept the transfer, to an insurer authorized to transact life insurance business in Michigan. If the liquidator sought to make a transfer to an organization that did not have a certificate of authority in the State, the Director could grant the organization a certificate with authority limited to servicing the existing certificates and fulfilling all obligations owed to certificate holders following the transfer but not to otherwise transact business.

In determining whether a fraternal benefit society or insurer was qualified to accept a transfer, the liquidator would have to consider the solvency of the society or other insurer, among other things. A qualified fraternal benefit society or insurer would not be obligated to accept a transfer. On the effective date of a transfer to an insurer that was not a fraternal benefit society and in consideration for the transfer, each member of the society and owner of a policy or certificate being transferred would be considered to agree that any terms of the insurance policy or certificate that provided for the maintenance of the society's solvency or that subject the policy or certificate to the policies of the society would be void and to agree to any other changes to terms of the policy or certificate that were determined by the liquidator to be necessary to effectuate the transfer. The insurer accepting transfer would have to endorse the policy or certificate accordingly. Any transfer would be a novation of the policy or certificate that was effective on the date of transfer.

## **BACKGROUND**

An "authorized control level event" means any of the following events: a) the filing of a Risk-Based Control (RBC) Report or notification by the Director to the insurer of an Adjusted RBC Report, provided the insurer does not challenge the Adjusted RBC Report, which indicates that the insurer's total adjusted capital is greater than or equal to its Mandatory Control Level RBC but less than its Authorized Control Level RBC; b) notification by the Director to the insurer that he or she has, after a hearing, rejected the insurer's challenge to an Adjusted RBC Report that indicates the event described above; c) the failure of the insurer to respond, in a manner satisfactory to the Director, to a Corrective Order, provided the insurer has not challenged the Corrective Order; or d) if the insurer has challenged a Corrective Order, and the Director has, after a hearing, rejected the challenge or modified the Corrective Order, the

failure of the insurer to respond, in a manner satisfactory to the Director, to the Corrective Order subsequent to rejection or modification by the Director.<sup>3</sup>

In the event of an authorized control level event, the Director, with respect to an insurer, must take actions as appropriate under a regulatory action level event or, if the Director deems it necessary to be in the best interests of the policyholders and creditors of the insurer and of the public, take such actions necessary to cause the insurer to be placed under regulatory control under Chapter 81 (Supervision, Rehabilitation, and Liquidation) of the Code. If the Director takes those actions, the authorized control level event must be deemed sufficient grounds for the Director to act under Chapter 81, and the Director has the rights, powers, and duties with respect to the insurer as set forth in Chapter 81. If the Director acts under these provisions under an Adjusted RBC Report, the insurer is entitled to those protections as are afforded to insurers under the provisions of Section 437 of the Code pertaining to summary proceedings. (Section 437 governs proceedings for suspension, revocation, or limitation of an insurer's certificate of authority.)

MCL 500.8182 et al.

### **PREVIOUS LEGISLATION**

*(This section does not provide a comprehensive account of previous legislative efforts on this subject matter.)*

The bill is a reintroduction of Senate Bill 712 of the 2021-2022 Legislative Session which passed the Senate and was reported out of the House Committee on Rules and Competitiveness but received no further action.

### **ARGUMENTS**

*(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)*

#### **Supporting Argument**

According to the American Fraternal Alliance, an organization uniting fraternal benefit societies across all fifty states, a society that falls into a hazardous financial condition can be very harmful to its members who rely on the benefits provided by that society. Testimony indicated that the State can implement some regulatory requirements for ensuring that societies have sufficient reserves to protect against failure. If a society does become insolvent, measures can be implemented to streamline its liquidation and minimize costs and benefit losses for members. The bill would establish these regulatory requirements and streamlined processes.

### **FISCAL IMPACT**

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

Analyst: Nathan Leaman

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<sup>3</sup> Department of Insurance and Financial Services Bulletin 2013-21-INS.