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BILL



ANALYSIS

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Senate Bill 937 (Substitute S-1 as reported)
Sponsor: Senator Joe Hune
Committee: Insurance

(as passed by the Senate)

Date Completed: 3-13-12

RATIONALE

Public Act 217 of 2004 amended Chapter 81 (Supervision, Rehabilitation, and Liquidation) of the Insurance Code to address the rights and duties of parties related to netting agreements or qualified financial contracts with insurers that are insolvent or subject to formal delinquency proceedings. (A netting agreement provides for the netting or liquidation of qualified financial contracts or present or future payment obligations or entitlements among the parties to the agreement. A qualified financial contract is a commodity contract, forward contract, repurchase agreement, securities contract, or swap agreement, or a similar agreement as determined by the Commissioner of Financial and Insurance Regulation.) Under the provisions added in 2004, a person cannot be prevented from exercising a contractual right to terminate a netting agreement or qualified financial contract with an insurer that is subject to proceedings under Chapter 81, and a receiver cannot avoid a transfer of money or property in connection with such an agreement or contract if the transfer was made before the delinquency proceeding began. It has now been suggested that these provisions might not adequately protect the interests of banks that make loans to insurance companies.

This issue was raised by Federal regulators with respect to loans made by the Federal Home Loan Bank of Indianapolis (FHLBI). The FHLBI is owned on a cooperative basis by Indiana and Michigan financial institutions, including commercial banks, credit unions, savings banks, and insurance companies, and is regulated by the Federal Housing Finance Agency. Activities of the

FHLBI include making loans to its members. It has been pointed out that this source of credit to insurers might be in jeopardy, because Federal regulators believe that there is some ambiguity in Michigan's statute regarding the ability of a receiver to prevent or delay the FHLBI from executing on its security if an insurer-borrower is in receivership.

CONTENT

The bill would amend Chapter 81 of the Insurance Code to revise provisions under which a person cannot be prevented from terminating a netting agreement or qualified financial contract with an insurer that is subject to a delinquency proceeding, or exercising certain contractual rights under related security agreements, and a receiver may not avoid a transfer in connection with such an agreement or contract that was made before a delinquency proceeding began. Under the bill, these provisions would apply to a security agreement with a state- or federally chartered financial institution.

Currently, a person may not be stayed or prohibited from exercising a contractual right to terminate, liquidate, or close out any netting agreement or qualified financial contract with an insurer because of the commencement of a formal delinquency proceeding under Chapter 81 or the insolvency, financial condition, or default of the insurer at any time, if the right is enforceable under applicable law other than the Code.

A person also may not be stayed or prohibited from exercising a right under a pledge, security, collateral, or guarantee agreement or similar security arrangement or credit support document relating to a netting agreement or qualified financial contract. Under the bill, instead, a person could not be stayed or prohibited from exercising a right under either of the following:

- A pledge, security, collateral, reimbursement, or guarantee agreement or any similar security agreement with a state- or federally chartered financial institution organized under the laws of any state or the United States.
- A pledge, security, collateral, reimbursement, or guarantee arrangement or any similar agreement or credit enhancement relating to at least one netting agreement or qualified financial contract.

Currently, a receiver may not avoid a transfer of money or other property in connection with a netting agreement or qualified financial contract or a pledge, security, collateral, or guarantee agreement or any similar document relating to a netting agreement or qualified financial contract that is made before the commencement of a formal delinquency proceeding under Chapter 81.

Under the bill, instead, a receiver could not avoid a transfer of money or other property in connection with any of the following that was made before the commencement of a formal delinquency proceeding under Chapter 81:

- A netting agreement or qualified financial contract.
- A pledge, security, collateral, reimbursement, or guarantee agreement or any similar security agreement with a state- or federally chartered financial institution organized under the laws of any state or the United States.
- A pledge, security, collateral, reimbursement, or guarantee arrangement or any similar security agreement or credit enhancement relating to a netting agreement or qualified financial contract.

MCL 500.8115a

BACKGROUND

The Federal Home Loan Bank of Indianapolis is one of 12 regional federally chartered banks initially created in 1932 under the Federal Home Loan Bank Act. Congress created this system of banks to provide liquidity to local lending institutions for the purpose of financing housing and economic development in their communities.

The FHLBI makes loans, or advances, almost exclusively to its members on the security of mortgages and other collateral pledged by the borrowing members. Under the Federal law, the FHLBI must obtain and maintain security interests from its members in acceptable collateral to secure all advances at all times that they are outstanding, in order to protect against losses.

Each Federal Home Loan Bank is limited to lending to entities within its respective jurisdiction. Only Michigan and Indiana fall under the jurisdiction of the FHLBI. As of September 30, 2011, the FHLBI had a total of 415 members, including 26 insurance companies from Michigan and 195 other Michigan members.

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

The FHLBI is a critical source of capital for its members. As of September 30, 2011, the FHLBI's outstanding advances totaled \$17.05 billion, including \$9.53 billion to Michigan members. Of that amount, advances to Michigan insurers totaled \$3.09 billion. Insurers' ability to obtain FHLBI loans might be at risk, however, unless Michigan's statute is amended. Unlike banks, insurance companies are subject to laws that vary from state to state, and Federal regulators apparently believe that Michigan's statute might not adequately protect the FHLBI. Although Chapter 81 of the Insurance Code does not expressly authorize a court to stay a secured lender from executing on its security, the Code also does not expressly protect general secured lenders from the issuance of such a stay. If a receivership court issued a stay of undetermined length against the FHLBI's realization of its security, the value of the

security could diminish during the period of the stay, leaving the FHLBI exposed.

Although published Michigan decisions evidently show no instance in which such a stay has occurred, lending institutions might be reluctant to make advances to Michigan-based insurance companies if there is any perceived exposure due to the Code's ambiguity. Potentially, Federal regulators could pressure the FHLBI to discontinue or limit its lending to Michigan insurers.

The FHLBI's loan volume to insurance companies reportedly has grown from zero in 2004 to 38.6% of the bank's current total loan advances. At the same time, commercial banks have not been a significant source of liquidity to insurers in Michigan. Thus, access to loans from the FHLBI is an important factor in maintaining the State's insurance industry.

The bill would help retain this source of credit by providing assurance that the FHLBI or another financial institution could execute on its security if an insurer that had borrowed money from the bank were in receivership.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

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

Fiscal Analyst: Josh Sefton

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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.