

FRATERNAL BENEFIT SOCIETY SOLVENCY

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Senate Bill 495 (S-1) as passed by the Senate

Sponsor: Sen. Dan Lauwers

House Committee: Insurance and Financial Services

Senate Committee: Finance, Insurance, and Consumer Protection

Complete to 12-4-24

Analysis available at
<http://www.legislature.mi.gov>

SUMMARY:

Senate Bill 495 would amend the Insurance Code to provide procedures relating to the solvency of fraternal benefit societies domiciled in Michigan. The bill would require a society to notify the director of the Department of Insurance and Financial Services (DIFS) before assessing its members to make up for a shortfall in reserves, and it would allow the director to disapprove an assessment that is not in the interests of those members. The bill also would allow the director to order a society that has insufficient capital or has not responded satisfactorily to a corrective order to remedy that condition. The order could authorize the society to negotiate the transfer of its members, policies, and assets and liabilities to another fraternal benefit society or a commercial insurer, and the bill includes provisions that would facilitate such a transfer. A society that failed to remedy a hazardous condition would be subject to rehabilitation or liquidation. However, rehabilitation would be presumed futile unless the director reasonably believed it highly likely to return the society to long-term viability or facilitate a transfer to another society or insurer. The liquidator of a society would have to try to transfer the society's policies to another society or insurer.

Fraternal benefit societies are tax-exempt, nonprofit membership organizations that operate for a particular educational, charitable, religious, patriotic, or social purpose and that also offer financial products such as life insurance and annuities to their members.¹ Fraternal benefit societies must be operated on a lodge system (that is, with local chapters) and have a representative form of government.² They may have initiatory or other rituals. Society membership is based on some common bond, often that of religion (e.g., the Baptist Life Association), ethnic heritage (e.g., the Sons of Norway), or occupation (e.g., the Police and Firemen's Insurance Association). The largest fraternal benefit societies in the United States are the Knights of Columbus and Thrivent Financial, both of which have chapters in Michigan.

According to the American Fraternal Alliance, two fraternal benefit societies are domiciled in Michigan: the Gleaner Life Insurance Society and the Woman's Life Insurance Society.³

Under current law, a fraternal benefit society that has a shortfall in its capital reserves can assess its members proportionately in order to make up that deficiency. An unpaid assessment becomes a debt against the member's contract or the benefits paid under it.

¹ See: <https://www.irs.gov/charities-non-profits/other-non-profits/fraternal-societies>

Also: <https://www.irs.gov/pub/irs-tege/eotopicf04.pdf>

² "Fraternal benefit society," "operating on the lodge system," and "representative form of government" are defined in sections 8164, 8165, and 8166 of the Insurance Code, respectively.

³ See <https://static1.squarespace.com/static/60ff13a7b4c26d7bf72e587a/t/62101fca18f4161223ab98bb/1645223882510/Michigan.pdf>

In addition, like all insurers doing business in Michigan, fraternal benefit societies must file annual statements regarding their financial condition, using accounting practices, procedures, and reporting standards specified by the director of DIFS.⁴ These filings include a risk-based capital (RBC) report, which facilitates a regulatory measure of whether the society holds enough capital to fulfill its financial obligations to its members. As described by the National Association of Insurance Commissioners (NAIC):⁵

The RBC requirement is a statutory minimum level of capital that is based on two factors: 1) an insurance company's size; and 2) the inherent riskiness of its financial assets and operations. That is, the company must hold capital in proportion to its risk. RBC is intended to be a regulatory standard and not necessarily the full amount of capital that an insurer would need to hold to meet its objectives. [...]

Under the RBC system, regulators have the legal authority to take preventive and corrective measures. These measures vary depending on the capital deficiency indicated by the RBC result. Capital sufficiency is the ratio of total adjusted capital to RBC. There are four levels of regulatory intervention. If the ratio is at or above 200%, no regulatory intervention is needed. Below that ratio, interventions range from submission of action plans to a regulatory takeover of the management of the company. If the ratio is below 70%, a regulator is obligated to take over management of the company. These preventive and corrective measures are designed to provide for early regulatory intervention to correct problems before insolvencies become inevitable, thereby minimizing the number and adverse impact of insolvencies.

In general,⁶ the four levels of regulatory intervention described above, and the RBC ratios that trigger them, are as follows:

- Company action level (the ratio of total adjusted capital to RBC is below 200% but still 150% or greater).
- Regulatory action level (that ratio is below 150% but still at least 100%).
- Authorized control level (that ratio is below 100% but still at least 70%).
- Mandatory control level (that ratio is less than 70%).

There are other circumstances ("events") that can trigger one of these levels of regulatory intervention. For example, a fraternal benefit society is subject to company action level intervention if the ratio of its total adjusted capital to its RBC is below 300% (but still 150% or greater) and has a negative trend.

As indicated above, these levels of regulatory intervention can range from requiring the insurer to file a comprehensive financial corrective action plan (company action level), to allowing the director of DIFS to issue corrective orders (regulatory action level), to allowing the director to seek to place the insurer under regulatory control (authorized control level), to requiring the director to seek to do so (mandatory control level).

⁴ Michigan generally uses procedures and standards promulgated by the NAIC. See https://www.michigan.gov/-/media/Project/Websites/difs/Form/Insurance/Financial_Filing/Booklet_Life.pdf

See also <https://content.naic.org/cipr-topics/statutory-accounting-principles>

⁵ <https://content.naic.org/cipr-topics/risk-based-capital>

⁶ See DIFS Bulletin 2013-21-INS: https://www.michigan.gov/difs/-/media/Project/Websites/difs/Bulletins/2013/Bulletin_2013-21-INS.pdf

Under the bill, an assessment imposed by a fraternal benefit society on its members to make up a shortfall in reserves could not take effect until at least 90 days after the date the director of DIFS was notified of the assessment, unless the director approves an earlier effective date. The bill also would allow the director to disapprove an assessment that was not made in conformity with the Insurance Code or that is contrary to the interests of the members of the society.

Transfer of domestic fraternal benefit society in hazardous condition

In addition, if a *domestic* fraternal benefit society (one domiciled in Michigan) has a regulatory or ***authorized control level event***, as defined by the director, or if the continued operation of a domestic society is considered hazardous to policyholders, creditors, or the public under the code, under circumstances the director determines will not be promptly remedied, the director could order the society to remedy the risk-based capital control level event or hazardous condition. The order could authorize the society to negotiate an agreement to transfer all of its members, certificates (i.e., insurance policies), and other assets and liabilities to another fraternal benefit society or other insurer through merger, consolidation, assumption, or other means. These powers would be in addition to any other action of the director required or allowed by law.

Under DIFS Bulletin 2013-21-INS, an ***authorized control level event*** is defined as either of the following:

- The filing of an RBC report that indicates that the insurer's total adjusted capital is less than its authorized control level RBC but still not below its mandatory control level RBC (that is, its ratio of total adjusted capital to RBC is below 100% but still 70% or greater). This provision also applies to an adjusted RBC report that shows such a level of capital if the insurer does not challenge the adjusted report or its challenge is rejected after a hearing.
- The failure of the insurer to respond to a corrective order in a manner satisfactory to the director of DIFS. This provision also applies to a failure to satisfactorily respond to the rejection or modification of a challenged corrective order.

A transfer as described above would constitute a novation of the domestic fraternal benefit society's certificates (i.e., benefit contracts), effective on the date of transfer.⁷ The society would have to ensure that the transfer is concluded within the time ordered by the director of DIFS, and the transfer would be subject to the director's approval. The transfer agreement would be considered fully approved by the society upon a majority vote of its board of directors, notwithstanding section 8177 of the Insurance Code,⁸ and regardless of whether any other law, rule, or regulation (or bylaw or rule of the society itself) requires notice to or approval by the society's members or supreme governing body. The transferring society would

⁷ "Novation" means that the transferring society would be replaced in the certificates with the entity they are being transferred to. A novated agreement replaces the original, as though the contract were simply canceled and reissued with the new entity in place of the old.

⁸ Section 8177 governs the consolidation or merger of a domestic fraternal benefit society with another fraternal benefit society. Among other things, it requires a consolidation or merger to be approved by a 2/3 vote of the supreme governing body of each society and provides that the full terms and conditions of the consolidation or merger must be provided to all of the members of each society at least 60 days before that vote.

have to provide notice of the transfer to its members by mail or in its official publication no later than 30 days after approval of the transfer by the director of DIFS.

If the domestic fraternal benefit society sought to make a transfer as described above to an organization without a certificate of authority in Michigan, the director of DIFS could grant the organization a limited certificate of authority with authority limited to servicing the existing benefit contracts and fulfilling obligations owed under them after the transfer, but not to otherwise conduct insurance business in Michigan.

By order of the director of DIFS, the society's board of directors could suspend or modify the qualifications for membership in the society as necessary to facilitate a transfer described above, notwithstanding the society's bylaws or any law or rule to the contrary.

Upon the effective date of a transfer to an organization that is not a fraternal benefit society (i.e., to a commercial insurer) and in consideration for the transfer, each member of the society would be considered to agree that any terms of a certificate that subject it to the society's bylaws or provide for the maintenance of the society's solvency are void (except to the extent of any outstanding lien not released by the terms of the transfer), and the assuming organization would have to endorse the certificate accordingly.

Rehabilitation or liquidation of a domestic fraternal benefit society

Either of the following would qualify as additional grounds for rehabilitation or liquidation under the code:

- Failure by a domestic fraternal benefit society to comply with an order of the director of DIFS described above.
- Failure by a domestic fraternal benefit society to remedy within the time specified by the director of DIFS a hazardous condition as described above.

Rehabilitation under the code would be presumed to be futile unless the director of DIFS reasonably believes that it has a high probability of returning the society to long-term viability or that it would facilitate a transfer to another fraternal benefit society or insurer. If the rehabilitator seeks to make a transfer to an organization that does not have a certificate of authority in Michigan, the director of DIFS could grant the organization a certificate of authority with authority limited to servicing the existing certificates and fulfilling all obligations owed to certificate holders following the transfer but not to otherwise transact insurance business in Michigan.

After the director filed a petition for liquidation of a domestic fraternal benefit society under the code, the society could not assess payment of shares of a deficiency unless the director determined that the assessment was to satisfy the obligations of the society to Class 1 or Class 2 creditors described in section 8142(1)(a) and (b) of the code. The society could not make an assessment for the purpose of any deficiency related to other claims, including those described in section 8142(1)(c) to (i).⁹

Liquidation proceedings for a domestic fraternal benefit society would have to be conducted in a manner designed to conserve assets, limit liquidation expenses, and avoid any assessment

⁹ See section 8142: <http://legislature.mi.gov/doc.aspx?mcl-500-8142>

of shares of a deficiency. The liquidator 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 will accept the transfer, to an insurer authorized to transact life insurance business in Michigan. If the liquidator seeks to make a transfer to an organization that does not have a certificate of authority in Michigan, the director of DIFS could grant the organization a certificate of authority with authority limited to servicing the existing certificates and fulfilling all obligations owed to certificate holders following the transfer but not to otherwise transact insurance business in Michigan. In determining whether a fraternal benefit society or insurer is qualified to accept a transfer, the liquidator would have to consider the solvency of the fraternal benefit society or other insurer. A qualified fraternal benefit society or insurer would not be obligated to accept a transfer.

On the effective date of a transfer described above to an insurer that is 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 policy or certificate that provide for the maintenance of the society's solvency or that subject the policy or certificate to the policies of the society are void and to agree to any other changes to terms of the policy or certificate that are determined necessary by the liquidator to effectuate the transfer. The insurer accepting the transfer would have to endorse the policy or certificate accordingly.

Any transfer under the above provisions would be a novation of the policy or certificate that is effective on the date of transfer.

MCL 500.8182 and proposed MCL 500.8199b and 500.8199c

FISCAL IMPACT:

Senate Bill 495 would have no fiscal impact on any units of state or local government.

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations and does not constitute an official statement of legislative intent.