

Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

SFA**BILL ANALYSIS**

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

Senate Bill 639 (as enrolled)
Sponsor: Senator Bill Bullard, Jr.
Committee: Financial Services

Date Completed: 12-11-01

RATIONALE

In the event an insurance company becomes insolvent, the Insurance Code dictates how the insurer's estate is to be disbursed. Chapter 81 of the Code establishes nine classes that group disbursements according to priority, with the highest priority disbursements under Class 1. Every claim in each class must be paid in full, or adequate funds must be retained for its payment, before the members of the next class receive payment. Currently, items in Class 2 include all claims under policies for losses incurred, including third party claims, all claims against the insurer for liability for bodily injury or for injury to or destruction of tangible property that are not under policies, and all claims of a guaranty association or foreign guaranty association. Class 3 includes all claims made by the Federal government. Because of a 1993 United States Supreme Court ruling (described in **BACKGROUND**, below), the Office of Financial and Insurance Services (OFIS) reasons that Federal government claims should be paid before bodily injury and property destruction claims not under other policies. Furthermore, the OFIS thinks it would be prudent to remove from Class 2 claims arising from reinsurance contracts.

CONTENT

The bill would amend the Insurance Code by moving claims for "bodily injury or for injury to or destruction of tangible property not under policies" from the Class 2 distribution category to the Class 4 distribution category in Chapter 81 of the Code. Class 4 currently includes debts due to employees to the extent that they were not paid in Class 1, do not exceed \$1,000, and represent payment for services performed within one year before the filing of the petition for liquidation. Officers and directors are exempt from this benefit.

The bill further specifies that obligations of an insolvent insurer arising out of reinsurance contracts would not be included in Class 2.

MCL 500.8142

BACKGROUND

In April 1986, the Court of Common Pleas for Franklin County, Ohio, declared the American Druggists' Insurance Company insolvent. The court directed that the company be liquidated, and it appointed Ohio's Superintendent of Insurance to serve as liquidator. The United States government then filed claims in excess of \$10.7 million, asserting that its claims were entitled to first priority under Federal statute, 31 U.S.C. 3713, which states, "A claim of the United States Government shall be paid first when...a person indebted to the Government is insolvent and...an act of bankruptcy is committed." Ohio argued that its state laws escaped Federal preemption under the McCarran-Ferguson Act of 1945, which recognizes the primary and legal authority of states to regulate the business of insurance. In *United States Department of Treasury v Fabe* (SO8 U.S. 491), the United States Supreme Court ultimately held that the Ohio priority statute is *not* preempted by Federal law if the costs of administering the liquidation and the claims of the policyholder take priority over the Federal government; these two costs, the Court held, are considered part of the business of regulating insurance. The Court further found, however, that Ohio's ranking of other, additional categories of claims above those filed by the United States was subject to Federal statute.

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

To comply with the United States Supreme Court ruling, this State must place claims made by the Federal government in Class 3 of Michigan's insolvent insurer priority statute. The costs and expenses of administering the liquidation would remain in Class 1, and claims under policies for losses incurred, including death proceeds, annuity proceeds, and investment values, would remain in Class 2, ahead of Federal claims. If this is not done, it is possible that the Commissioner of the Office of Financial and Insurance Services might be held liable for any claims pressed by the United States government. It would be prudent public policy to change State statute if doing so would avoid future court action and protect a public official from personal liability.

Legislative Analyst: C. Layman

FISCAL IMPACT

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

Fiscal Analyst: M. Tyszkiewicz

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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.