Declaratory Ruling 86-8263-M

Certificate of insurance for self-insured parent corporations and subsidiaries

March 14, 1986

I. BACKGROUND

On August 2, 1985, Mid-Michigan Health Care Systems, Inc., filed a request for a declaratory ruling and an accompanying brief. These documents are attached. Mid-Michigan is the parent corporation of three wholly owned nonprofit hospital corporations. It proposes to establish a self-insurance trust fund to accommodate anticipated hospital professional liability exposure. It asks the following questions:

> In operating the arrangement, is Mid-Michigan required to obtain a certificate of authority as a domestic insurer pursuant to Chapter 50 of the Insurance Code of 1956?

The Commissioner is authorized to issue a declaratory ruling on this question pursuant to Section 63 of the Administrative Procedures Act of 1969, as amended (the APA), MCLA 24.279; MSA 3.560(179), which provides:

> On request of an interested person, an agency may issue a declaratory ruling as to the applicability to an actual state of facts of a statute administered by the agency or of a rule or order of the agency. An agency shall prescribe by rule the form for such a request and procedure for its submission, consideration and disposition. A declaratory ruling is binding on the agency and the person requesting it unless it is altered or set aside by any court. An agency may not retroactively change a declaratory ruling, but nothing in this subsection prevents an agency from prospectively changing a declaratory ruling. A declaratory ruling is subject to judicial review in the same manner as an agency final decision or order in a contested case.

Mid-Michigan supplemented its request from time to time with reports of decisions of the United States Tax Court and the United States Court of Claims. It also recently reported that Mid-Michigan and its three wholly owned nonprofit hospital corporations use a consolidated balance statement.

II. ANALYSIS

Before a person may act as an insurer in Michigan, the person must obtain a certificate of authority from the Commissioner of Insurance. Section 120 of the Insurance Code of 1956, as amended (Code), MCLA 500.120; MSA 24.1120, provides:

> No person shall transact an insurance or surety business in Michigan, or relative to a subject resident, located, or to be performed in Michigan, without complying with the applicable provisions of this code.

Section 402 of the Code, MCLA 500.402; MSA 24.1402, states:

> No person shall act as an insurer and no insurer shall issue any policy or otherwise transact insurance in this state except as authorized by a subsisting certificate of authority granted to it by the Commissioner pursuant to this code.

Examples of transacting insurance are included in Section 402a of the Code, MCLA 500.402a; MSA 24.1402a, which provides:

> The following constitute transactions of insurance in this state, whether effected by mail or otherwise:
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> (1) The issuance or delivery of contracts of insurance to persons resident in this state, or
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> (2) The solicitation of applications for such contracts, or
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> (3) The collection of premiums, membership fees, assessments or other consideration for such contracts, or
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> (4) The doing or proposing to do any act in substance equivalent to any of the foregoing.

Furthermore, insurer is broadly defined in Section 106 of the Code, MCLA 500.106; MSA 24.1106, which states:

> "Insurer" as used in this code means any individual, corporation, association, partnership, reciprocal exchange, inter-insurer, Lloyds organization, fraternal benefit society, and any other legal entity, engaged or attempting to engage in the business of making insurance or surety contracts.

To answer Mid-Michigan's question, it must be determined whether Mid-Michigan and its subsidiaries will be transacting insurance by pooling their risks. If so, Mid-Michigan must secure a certificate of authority. Since there is no definition of insurance in the Code, it is instructive to examine court decisions in this regard.

The United States Supreme Court, in Group Life and Health Insurance Company v Royal Drug Co., 440 US 205, 211, 59 LEd 2d 261, 268 (1979), reh den 441 US 917, 60 LEd 2d 389 (1979), has analyzed the nature of insurance as follows:

> The primary elements of an insurance contract are the spreading and underwriting of a policyholder's risk. "It is characteristic of insurance that a number of risks are accepted, some of which involve losses, and that such losses are spread over all the risks so as to enable the insurer to accept each risk at a slight fraction of the possible liability upon it." 1 G.Couch, Cyclopedia of Insurance Law s 1:3 (2d ed 1959). See also R. Keeton, Insurance Law, s 1.2(a)(1971) ("Insurance is an arrangement for transferring and distributing risk".) 1 G.Richards, The Law of Insurance s 2 (W. Freedman 5th ed. 1952).

Although expressed in different terms, Michigan cases similarly recognize that transference of risk is an essential element of insurance. See, for example, Resenhous v Seeley, 72 Mich 603 (1888); Nash v New York Life Ins Co, 272 Mich 680 (1935); Michigan Hospital Services v Sharpe, 339 Mich 357 (1954); and City of Roseville v Local 1614, 53 Mich App 547 (1974).

Mid-Michigan is a nonprofit holding company of three nonprofit hospitals. The four organizations are so financially intertwined that they utilize a consolidated financial statement. This close integration, which produces essentially one financial entity, precludes the existence of an essential element of insurance -- the transference of risk from one person to another. Thus, their pooling of medical malpractice liability risk will not result in the transaction of insurance.

Having concluded that there is no transference of risk, and thus that there is no transaction of insurance, it is not necessary to address the related issue of whether there is a sufficient distribution of risk to constitute insurance.

III. FINDINGS OF FACT AND CONCLUSIONS OF LAW

Based upon the foregoing considerations, it is FOUND and CONCLUDED that:

1. The Commissioner has authority to issue this declaratory ruling pursuant to Section 63 of the APA.

2. Mid-Michigan is a nonprofit parent corporation that holds three wholly owned nonprofit hospital corporations. They seek to establish a single pool to provide malpractice coverage. Before doing so, they seek the security of a declaratory ruling as to whether they may do so without seeking a certificate of authority as an insurance company. The standards and requirements of Chapter 50 and Sections 106, 120, 402, and 402a of the Code are at issue.

3. Mid-Michigan and its three wholly owned nonprofit hospital corporations are so financially intertwined that they utilize a consolidated financial statement. This indicates that, in many substantial respects, they constitute one integrated financial entity.

4. The primary elements of an insurance contract are the spreading and underwriting of a policyholder's risk. By the act of underwriting, there is a transference of risk from one entity to another.

5. n forming the single pool to provide malpractice coverage, Mid-Michigan and its three wholly owned nonprofit hospital corporations will not be engaging in the transference of risk because they are, essentially, one financial entity.

6. The Commissioner should issue a declaratory ruling stating that Mid-Michigan, in operating its proposed arrangement, is not required to obtain a certificate of authority as a domestic insurer pursuant to Chapter 50 of the Code.

IV. RULING

I therefore enter this declaratory ruling that Mid-Michigan, in operating its proposed arrangement, is not required to obtain a certificate of authority as a domestic insurer pursuant to Chapter 50 of the Code.

This ruling is limited to facts which were presented by Mid-Michigan and the statutory sections identified by Mid-Michigan.

Herman W. Coleman
Commissioner of Insurance