

Declaratory Ruling 88-9907-M

Operation of Self-Insurance -- certificates of authority

November 21, 1988

I. BACKGROUND

On November 2, 1988, Health Service Company (HSC) filed a request for a declaratory ruling and an accompanying brief. HSC is a Michigan nonprofit holding company for several health maintenance organizations. It proposes to establish a self-insurance trust fund for anticipated professional liability exposure. It asks the following question:

In operating the arrangement, is HSC required to obtain a certificate of authority as a domestic insurer pursuant to Chapter 50 of the Insurance Code of 1956, as amended (Code), MCLA 500.5000 et seq.; MSA 24.15000 et seq.?

The Commissioner of Insurance (Commissioner) is authorized to issue a declaratory ruling on this question pursuant to Section 63 of the Administrative Procedures Act of 1969, as amended (APA), MCLA 24.263; MSA 3.560(163), 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 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.

II. ISSUE

Before a person may act as an insurer in Michigan, the person must obtain a certificate of authority from the Commissioner. Section 120 of the 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:

- (1) The issuance or delivery of contracts of insurance to persons resident in this state, or
- (2) The solicitation of applications for such contracts, or
- (3) The collection of premiums, membership fees, assessments or other consideration for such contracts, or
- (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 HSC's question, it must be determined whether HSC and its subsidiaries will be transacting insurance by pooling their risks. If so, HSC 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 Co v Royal Drug Co*, 440 US 205, 211, 59 L Ed 2d 261, 268 (1979), reh den 441 US 917, 60 L Ed 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).

HSC is a nonprofit holding company for several health maintenance organizations. The 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 liability risk will not result in the transaction of insurance.

III. FINDINGS OF FACT AND CONCLUSIONS OF LAW

Based on 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. HSC is a Michigan nonprofit parent corporation that holds several health maintenance organizations. They seek to establish a single pool to provide coverage for anticipated professional liability exposure. Before doing so, they seek the security of a declaratory ruling as to whether they may do so without obtaining a certificate of authority as an insurance company. The standards and requirements of Sections 106, 120, 402, and 402a of the Code are at issue.
3. HSC and its affiliated organizations 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. In forming the single pool to provide malpractice coverage, HSC and its affiliated organizations 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 HSC, in operating the self-insurance trust, is not required to obtain a certificate of authority pursuant to the Code.

IV. RULING

I therefore enter this declaratory ruling that HSC, in operating the self-insurance trust, is not required to obtain a certificate of authority pursuant to Chapter 50 or other provisions of the Code.

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

The Commissioner specifically retains jurisdiction of the matters contained herein and the authority to issue such further ruling or rulings as he shall deem just, necessary, and appropriate.

Dhiraj N. Shah
Acting Commissioner of Insurance