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SFA



BILL ANALYSIS

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Senate Bill 991 (as enrolled)
Sponsor: Senator Alan Sanborn
Senate Committee: Financial Services
House Committee: Insurance and Financial Services

PUBLIC ACT 492 of 2002

Date Completed: 7-17-02

RATIONALE

In the late 1970s and early 1980s, the Legislature passed a series of bills that extensively reformed the statutes governing home and automobile insurance. Some of these reforms constituted what is commonly called the "Essential Insurance Act", and created underwriting rules and rating standards for all home and auto insurance companies conducting business in Michigan. The underwriting rules must be based on specific, listed criteria. These standards and rules addressed Michigan citizens' need to find and purchase adequate car and home insurance. Because it had been more than 20 years since the legislation was enacted, Michigan insurance companies believed that some of the provisions should be updated.

CONTENT

The bill amended the Insurance Code to revise certain eligibility requirements for insurance policies. Specifically, the bill:

- Renders ineligible for home insurance any person who has been denied a claim based on evidence of arson or fraud.**
- Increases the minimum required insured value for a home repair cost policy from \$7,500 to \$15,000, and a replacement policy from \$15,000 to \$35,000.**
- Specifies that a dwelling in a physical condition that clearly presents an extreme likelihood of a significant loss is ineligible for insurance.**
- Includes as a criterion for establishing underwriting rules an insured's failure to correct a physical condition that presents a risk of repeated loss.**

- Establishes as a criterion for underwriting rules in home or auto insurance an insured's or applicant's threats, harassment, or assault on an insurance employee.**
- Requires the Michigan Basic Property Insurance Association (the "pool") to offer HO-3 and repair cost premiums and policies equivalent to those provided by a licensed rating organization.**

Under the Code, a person is ineligible for home insurance if he or she has successfully been denied, within the last five years, a claim under a home insurance policy based on evidence of arson, conspiracy to commit arson, fraud, or conspiracy to commit fraud, committed by or on behalf of the person. Previously, the amount of the denied claim had to exceed \$2,000 and had to be greater than either 15% of the amount of insurance in force, if the claim was under a repair cost policy; or 10% of the amount of insurance in force if the claim was under a replacement cost policy. The bill deleted the \$2,000 claim requirement, as well as the percentage amounts of the denied claim.

Prior to enactment of the bill, a person was ineligible for home insurance under the Code, if he or she sought to buy a repair cost policy on a dwelling with an insured value of less than \$7,500, or who sought to buy a replacement policy on a dwelling with an insured value of less than \$15,000. The bill increased those amounts to \$15,000 and \$35,000, respectively. The Code further rendered ineligible a person who insured or sought to insure a dwelling that did not meet minimum standards of insurability as

established by the Commissioner of the Office of Financial and Insurance Services. The bill instead makes ineligible for insurance a person who insures or seeks to insure a dwelling that has physical conditions that clearly present an extreme likelihood of a significant loss under a home insurance policy.

The bill also deleted, from the homeowner's underwriting rules criteria, the physical conditions of a house that clearly present an extreme likelihood of a significant loss under the liability coverages of a home insurance policy. This criterion applied only to new policies.

The bill establishes a new basis for underwriting rules in both home and automobile insurance: one or more incidents involving a threat, harassment, or physical assault by the insured or applicant for insurance on an insurer employee, agent, or agent employee while acting within the scope of his or her employment, as long as a report of the incident was filed with a law enforcement agency.

The Code establishes the Michigan Basic Property Insurance Association, or the pool, which covers property owners who are ineligible for insurance provided by a private insurer. The premium for basic property insurance of any risk by the pool must be equal to the rate for identical insurance established by a rating organization for identical insurance, plus a uniform surcharge approved by the Commissioner. Previously, the Code referred to "the principal rating organization". The bill instead refers to "a licensed" rating organization.

Under the Code, rates charged in each territory by the pool for home insurance are required to be equal to the weighted average of the 10 voluntary market insurer groups with the largest premium volume in the State. Rating territories for home insurance established by the pool must be the same as those used by the largest number of insurers by premium volume writing home insurance in the State. Any change in the rates of those insurers that would produce a change in excess of 5% in the HO-2 pool rates for any territory must be reflected as soon as reasonably practicable in the HO-2 pool rates. The bill retains these provisions, but specifies

that any change in the rates for an HO-2 form replacement cost policy in excess of 5% must be reflected as soon as practicable. (An HO-2 form replacement cost policy is known as a "named peril" policy, which insures holders against specific, named hazards, such as fire, theft, or windfall damage.)

The Code requires that the pool offer certain policies to its insureds. Previously, the pool had to offer HO-2 replacement cost policies and repair cost policies equivalent to the same policies filed and in effect in the State for the principal rating organization. The bill instead requires that the HO-2 and repair policies be equivalent to ones filed and in effect for a licensed rating organization. In addition, the bill adds to the list of mandatory policies offered by the pool an HO-3 form replacement cost policy equivalent to an HO-3 policy filed and in effect for a licensed rating organization. (An HO-3 policy, known as an "all perils" policy, insures holders against all perils except those specifically exempted.) Under the bill, rates established by the pool for HO-3 policies may not be based on the weighted average methodology used to calculate other rates charged by the pool. Instead, rates must be calculated to generate an amount sufficient to cover the expected losses and expenses the pool will likely incur related to the HO-3 replacement cost policy during the period for which the premium is applicable. The premium must include an amount to cover incurred but not reported losses for the period, and must be adjusted for any excess or deficient premiums from previous periods. Excesses or deficiencies from previous periods must be fully adjusted in a single period, or over several periods in a manner provided for in the plan of operation.

The bill further requires the Commissioner, by July 1, 2005, to submit to the Senate and House standing committees on insurance issues a written report on the effect the bill has had on home insurance premiums in this State.

MCL 500.2103 et al.

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 home and auto insurance market has changed in the past couple decades, and it is time to update the law's essential insurance provisions. The bill reflects current market conditions by increasing the minimum required insured value for coverage of a home and making a person ineligible for home insurance if a previous claim has been denied due to arson or fraud, regardless of the dollar amount or percentage level of the denied claim. In addition, the bill enables insurance companies to control their losses by allowing insurers to refuse to cover or renew those insureds who do not maintain their property at an acceptable level. Reducing losses should, of course, lower the premiums for insureds. Further, the bill permits insurers to refuse insurance to anyone who threatens or physically assaults an insurance agent or employee. This will provide a reasonable measure of protection for agents, who have been victims of harassment and threats in the past.

Response: The bill does not go far enough to protect the rights of insureds. Currently, consumers are subject to companies' linking insurance premiums to an applicant or insured's credit rating. This practice illogically draws a connection between a person's spending habits and his or her insurance risk. In addition, the bill fails to address a more appalling issue in the insurance industry, detailed in recent *Detroit Free Press* articles (12-27-01 and 1-31-02): a pattern of companies' indefinitely delaying payment to claimants who have suffered loss of property due to fire. This practice often forces the insured to settle for a smaller payout because something is better than nothing. In some cases, companies wrongly accuse the claimant of arson and refuse to make any payment. Unlike insurers in most other states, those in Michigan face no serious punishment in court when they refuse to pay a valid claim or wait a long time to make payment. The Code should allow a claimant to sue an insurance company for money he or she is due, and, if the insured prevails, money to recover legal fees and damages.

Opposing Argument

Under the bill, homeowners whose dwellings do not meet the new minimum coverage amounts may become ineligible for coverage in the regular insurance market, and be forced to seek coverage in the Michigan basic pool.

Since the pool's rates might be slightly higher than the regular market policy rates, this amendment may force those who can least afford it to pay more for insurance.

Response: The bill requires the pool to offer an additional, higher level of homeowners' coverage in the form of an HO-3, all-perils policy. This may help compensate those who are forced into the pool by offering them an option for more comprehensive coverage.

Opposing Argument

It appears that the bill removes the ability of the Commissioner to promulgate rules setting minimum standards of insurability for a dwelling. Under the bill, a dwelling is ineligible for coverage if it has a physical condition that clearly presents an extreme likelihood of a significant loss under a home insurance policy, language that currently is found in the underwriting rules section of the Code. The revision allows insurers to use the significant loss language to refuse to renew an existing policy, instead of using it only as a condition for refusing to issue a new insurance policy. This change may result in more homeowners' losing their regular market coverage and being forced into the Michigan basic pool. At least, "physical conditions that clearly present an extreme likelihood of significant loss" should be defined as it has been in the past, with sample underwriting rules.

Response: The Commissioner still may use his or her general rule-making authority to clarify this provision, if necessary.

Legislative Analyst: Claire Layman

FISCAL IMPACT

The bill will have no impact on State or local government.

Fiscal Analyst: Maria 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.