House Legislative Analysis Section

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READABILITY OF INSURANCE CONTRACTS

House Bill 4996 (Substitute H-1)
First Analysis (11-30-89)

Sponsor: Rep. Nick Ciaramitaro
Committee: Consumers

THE APPARENT PROBLEM:

Like other kinds of contracts, insurance policies often contain language that the average consumer cannot understand. When people cannot understand or misunderstand their insurance policies, they do not know what they are obligated to do or what they have asked others to do for (or to) them. When conflicts arise, consumers must either accept the conditions of the contracts as interpreted by insurance companies and suffer the consequences or resort to costly lawsuits. Not only is this fundamentally unfair to consumers but, in the long run, it is bad business. Many companies recognize this and, as a result, insurance policies are steadily being improved. Nonetheless, problems remain.

Some 30 states, reportedly, have dealt with the problem of arcane and unreadable language in insurance policies and annuity contracts by adopting readability standards, by statute or rule. Some states have laws requiring all consumer contracts to be readable. Generally, state regulations have followed two models, one involving an objective test of readability, the other a subjective test (or else have combined them). The most popular standard derives from a test of writing (devised by Rudolph Flesch) that takes into consideration the number of words in a sentence and the number of syllables in each word. The lower the number of words per sentence and syllables per word, the higher the readability score. A piece of writing must average about 8.5 words per sentence and 1.64 syllables per word to be considered "plain English," which according to Flesch, means scoring from 60 to 70 on a scale of 100 points. Scores from 50 to 60 mean that the writing is "fairly difficult" to understand, and those from 30 to 50 mean it is "difficult" The National Association of Insurance Commissioners (NAIC) has approved model legislation declaring a Flesch score of 40 acceptable for insurance contracts. Some consumer advocates believe a higher score (50 or hither) is preferable.

One "unreadable" contract used by Michigan insurers, the standard fire policy, is actually mandated by law. The state requires companies to use a policy prescribed word-for-word by the Insurance Code. The so-called Michigan standard policy was adapted from a 1943 NAIC model, according to the Insurance Bureau, and no longer serves its original purposes. Companies need to supplement the standard policy more and more as it becomes increasingly outdated, resulting in the proliferation of extra attachments sent to policyholders, only adding to their confusion. The mandated language of the standard fire policy needs to be removed from the Insurance Code and replaced with general requirements that will protect consumers but allow individual companies some flexibility in their language and in their methods of meeting statutory standards.

THE CONTENT OF THE BILL:

The bill would amend the Insurance Code to:

(1) Require all basic insurance forms and contracts aimed at serving personal, family, and household purposes to meet a readability standard; and

(2) Replace current required language for the "standard fire insurance policy" with a set of standards that each fire insurance policy must meet.

Readability Standards. The Insurance Code requires the forms of insurance policies and annuity contracts, including application forms, rider and indorsement forms (amendments to a contract), renewal forms, and group certificates, to be approved by the insurance commissioner before being put to use. Beginning July 1, 1990, the bill would prohibit the commissioner from approving a form aimed at serving a personal, family, or household purpose unless its language had a readability score of 45 or more on a test prescribed by the bill. This would apply to a new policy or contract form and to a form not previously approved if a change or addition to the form was proposed. The formula for evaluating a form's readability would be:

$$\text{Readability Score} = 206.835 - X + Y,$$
where X = words/sentences x 1.015 and
Y = syllables/words x 84.6

If a form contained no more than 10,000 words, it would have to be analyzed in its entirety. Longer forms would be analyzed by taking at least two 200-word samples per page. The samples would have to be separated by at least 20 printed lines. The bill stipulates that a contraction, hyphenated word, or numbers or letters when separated by spaces would count as one word. A unit of words ending with a period, semicolon, or colon, but excluding headings and captions, would count as one sentence.

The method and formula would not be applied to a word or phrase defined in the document if the definition had a readability score of 45 or more. The method and formula would also not be applied to language specifically agreed upon through collective bargaining or required by a collective bargaining agreement nor to language prescribed by state or federal statutes, or by affiliated rules and regulations.

The bill would also require insurance forms and contracts to contain topical captions and, if the policy contained more than three pages of text or more than 3,000 words, a table of contents. Exclusions from coverage would have to be included immediately after the agreement establishing the coverage. Each rider or indorsement form that changed coverage would have to contain a properly descriptive title and be accompanied by an explanation of the change. It would also have to reproduce either the entire paragraph or the provision as changed. A form would be considered in compliance with the bill if it matched the readability requirements of a computer system that had been approved by the commissioner.

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Fire Insurance Policies The bill would repeal current references under the code to a standard fire insurance policy format, and would instead provide general standards for fire insurance contracts that would be substantially similar to current requirements

MCL 500 2103 et al

FISCAL IMPLICATIONS:

According to the Department of Licensing and Regulation, which houses the Insurance Bureau, the bill has no fiscal implications to the state (11-29-89)

BACKGROUND INFORMATION:

A readability bill applying to consumer contracts other than insurance contracts, House Bill 4995, has also been introduced this session In addition, Senate Bill 389 has been introduced to provide for a minimum charge upon cancellation of an insurance policy

ARGUMENTS:

For:

Consumers ought to be able to read and comprehend their insurance policies (as well as other everyday household contracts), and yet many insurance policies are virtually unreadable due to their use of arcane language, technical jargon, and unnecessary legalisms The bill would require that new insurance policy forms and annuity contract forms meet a readability standard and be clearly organized so that consumers will have a better understanding of what insurance companies are required to do for them and of their own responsibilities Legal writing specialists say this can be done, that ridding contracts of unnecessary legalisms and jargon is a matter of attitude and habit and *can be accomplished without affecting 'terms of art,"* those expressions that have special, sometimes untranslatable meanings The bill, moreover, allows the use of necessary technical terms in insurance policies if they are clearly defined Many insurance companies have produced readable policies and have found them to be an effective marketing tool Voluntary efforts, however, are not enough and readability standards need to be put into law so that readable insurance contracts become commonplace

The bill does not apply to contracts currently in existence, only to new policy and contract forms submitted to the insurance commissioner (although old contract forms would have to be reviewed when proposed changes to them were submitted to the commissioner) Further, the insurance commissioner would not apply the readability standard to new forms until July 1, 1990, so companies will have time to prepare forms that comply (Many companies probably already have forms that comply, particularly those that do business in states that have readability regulations)

For:

The bill would do away with statutorily prescribed fire insurance policy language that is archaic and instead place general standards in the Insurance Code for fire insurance policies to meet The new provisions are not aimed at imposing any new standards on insurance companies, only ridding the Insurance Code of outdated (and unreadable) language that insurance companies are now required to use in contracts word-for-word Companies will have the flexibility to draft their own fire insurance contracts with the understanding that certain standards, substantially similar to those in place now, will be met

Against:

Currently, a binder for temporary insurance is usually made out in an amount that is lesser than that of the full life insurance policy until the health of the person applying for the insurance can be confirmed by a physical examination The bill's requirement that "binders for temporary insurance be considered to include all of the terms and conditions of the policy that is being applied for" could result in heavy financial costs to insurance companies since many of those who apply for life insurance intentionally misrepresent the status of their health (Insurance companies also have to contend with many in the industry who are part-time life insurance salespersons and who work in collusion with their friends to provide them with policies for which they do not actually qualify) The bill should be amended to include the provision that temporary life insurance binders could be specifically limited to a stated amount

Against:

The bill would delete the current provision requiring insurers to retain at least fifteen percent of the premium on a cancelled casualty insurance policy and would instead require insurers to provide a pro rata refund, or $25 whichever is greater The bill should be amended to include this provision in fire insurance policies in order to be consistent with the rest of the bill and with similar legislation that has been proposed (Senate Bill 389)

Against:

The Flesch test used in House Bill 4996 to insure the readability of insurance forms is not a test of readability or comprehension, it is merely a crude attempt to quantify what cannot be quantified For instance, a technical term such as 'tort," because it contains one syllable, would be considered more readable than "raspberry " which to that matter, would be assumed under the bill to be as understandable as "syzygy,' which contains the same number of syllables The test is simply a mathematical exercise that has been found to work sometimes in evaluating textbooks An insurance policy containing short sentences of monosyllabic words would pass the test no matter how ambiguously it had been drafted

Response: The Flesch standard has been used successfully by insurance bureaus and companies in other states in evaluating the readability of contracts While nobody claims that the Flesch test eliminates ambiguity it does allow the drafter of a contract to assume that removing long words and complex sentences will help a consumer understand the document The Flesch test is used in this bill, rather than a subjective test, for several reasons For one thing, insurance companies prefer it, in part because it provides an easily determined objective standard Further the substance of many insurance policies is closely regulated by the state in other ways which reduces the opportunity for ambiguity (whether intentional or otherwise) Policy and contract forms are already scrutinized by the insurance bureau on other grounds

Against:

Some insurance company representatives have urged the adoption of a minimum readability score of 40, which is that found in the NAIC model and adopted in most other states Obviously, life is easier and less costly for insurance companies that operate in many states if state laws are consistent, otherwise they have to restructure their contracts for each state

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