SFA BILL ANALYSIS

Senate Fiscal Agency • Lansing, Michigan 48909 • (517) 373-5383

Senate Bill 389 (Substitute S-6 as reported)
Sponsor: Senator William Faust
Committee: Commerce and Technology

Date Completed: 4-30-90

RATIONALE

Under the Insurance Code, when a policy for casualty, disability, or property insurance is canceled by the insured or the insurer, the insurance company's minimum earned premium (the amount the company can keep for issuing the policy) cannot be less than 15% of the total premium payable on the policy or $25, whichever is greater. This means, for example, that if a business insured its office building and contents, and the premium was $10,000 for one year, if the insurance were canceled after two weeks, for whatever reason, the insurance company would keep $1,500 (15% of the premium). Some people feel this places an unfair burden on policyholders, particularly those who pay large premiums (for medical malpractice, for instance). Reportedly, some insurance companies routinely retain minimum earned premiums on a pro rata basis to ease the burden on policyholders; however, the Code does not specifically allow such a practice. It has been suggested that the Code be amended to require that minimum earned premiums be retained on a pro rata basis for cancellation of casualty, disability, or property insurance policies.

Currently, an insurer can file for a rule with the Insurance Commissioner to provide for the minimum retention of insurance premiums for motorcycles, watercraft, off-road vehicles, or snowmobiles. Since persons usually insure such items for only a portion of the year, these policies present special problems with regard to refunds for canceled policies. It has been suggested that insurers be allowed to file for a rule that would allow them to issue short rate premiums for such insurance. Generally, if a short rate premium is canceled, more of the premium can be retained by the insurer during the first two months of the policy than can be retained on a pro rata basis; this allows insurers to cover the costs of issuing policies for short time periods.

CONTENT

The bill would amend the Insurance Code to specify that the minimum earned premium that an insurer could retain on a casualty, disability, or property insurance policy canceled by the insured or the insurer could not be less than the pro rata premium for the expired time or $25, whichever was greater.

The bill also would allow an insurer to provide a short rate premium for insurance on motorcycles, watercraft, off-road vehicles, or snowmobiles, provided the insurer filed for a rule with the Commissioner to establish a short rate premium. The rule would have to describe the circumstances under which a short rate could be applied and set forth the amount or percentage to be retained.

Further, the bill would require that a disability or health insurance policy sent to a person contain a notice that the policyholder could cancel the policy after 10 days (30 days for a disability policy issued to a person eligible for Medicare), and that, in the event of such cancellation, the insurer would have to refund to the policyholder the excess of any paid premium above the pro rata premium for the expired time.

The bill would take effect June 1, 1990.

MCL 500.2832 et al.

FISCAL IMPACT

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

ARGUMENTS

Supporting Argument

Currently, the Code's provisions regarding minimum earned premiums on canceled policies are inflexible and unfair. On one hand, a policyholder, particularly one who pays a sizable amount for insurance, can be subjected to a severe penalty if, for some reason, his or her policy is canceled within a short time from the date of issuance; according to the Code, the insurer keeps 15% of the premium regardless of whether 15% of the time the policy was supposed to cover has elapsed. On the other hand, even if an insurance company wants to issue a refund on a canceled policy, on a pro rata basis, the Code contains no language that allows the company to do so. The bill, by requiring that minimum earned premiums be based on a pro rata calculation, would ensure that policyholders got what they paid for, whether they or the insurance company canceled a policy. The bill would thus encourage consumers to shop around for insurance, without having to worry about losing money in the event they wished to cancel their policy.

Supporting Argument

Allowing an insurer to establish a short rate premium for motorcycles, watercraft, off-road vehicles, or snowmobiles would help insurance companies defray the cost of issuing such policies. Reportedly, some people insure some items with the intention of using them for a couple of weeks and then cancel the policy. A short rate premium would allow an insurer, in the event a policyholder canceled a policy, to retain an amount of the premium that would be greater than the pro rata rate. After a couple of months, the amount an insurer could retain would taper down to approximately the pro rata rate.

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