



BILL ANALYSIS

Senate Fiscal Agency

Lansing, Michigan 48909

(517) 373-5383

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Senate Bill 202 (Substitute S-1)

Sponsor: Senator Dick Posthumus

Committee: Commerce and Technology

Date Completed: 5-27-87

RATIONALE

The Insurance Code specifies the terms for refunding unearned premiums upon the cancellation of a policy for fire insurance, casualty insurance (except for workers' compensation), and disability insurance. Some people claim that the provisions for cancellation by the insured are punitive because they require refunds to be based on a "short rate" formula, which results in a smaller refund than pro rata refunds, while insurer-initiated cancellations are made on a pro rata basis. They argue that these provisions of the Code impede competitiveness by penalizing insureds who may wish to change policies and/or carriers before a policy's term expires.

CONTENT

The bill would amend the Insurance Code to require that a fire insurance contract and a casualty insurance policy (other than one for workers' compensation or no-fault auto insurance) contain a provision that, upon cancellation by the insured, the insurer would have to refund the excess premium on a pro rata (rather than a customary short-rate) basis; and the minimum earned premium on such a policy could not be less than 15% of the total premium payable or \$25, whichever was greater. A disability insurance policy also could include such a provision for premiums that had been financed with an insurer or a premium finance company.

For no-fault auto insurance, an insurer could file a rule with the Commissioner providing for a minimum retention of premium, upon cancellation of a policy under certain specified conditions; the rule would have to provide that a minimum retention would be applied only when the amount exceeded the amount that would have been retained had the policy been canceled on a pro rata basis.

Pro Rata Refunds

The Code requires an insurance policy for fire insurance or for casualty insurance (other than workers' compensation) to specify that refunds of premiums, upon cancellation of the policy by the insurer, are to be made on a pro rata basis. Also, the Code permits a policy for disability insurance to include a provision for a refund of "the unearned portion of any premium paid" in the event of cancellation by the insurer. All of these types of policies, however, specify that, upon cancellation by the insured, a refund is to be based on the excess of paid premium above the customary short rates for the expired time.

The bill would require fire insurance and casualty insurance policies (except for workers' compensation or no-fault auto insurance) to specify that cancellation at the request of the insured would entitle the insured to a refund of the "excess of paid premium above the pro rata rates for the expired time". Also, the bill would permit a cancellation provision

in a disability insurance policy to specify that an insured who had financed his or her premium would receive a pro rata refund upon cancellation.

In addition, the bill would require fire insurance and casualty insurance policies to include a statement that the minimum earned premium on any cancelled policy could not be less than \$25 or 15% of the total premium payable on the policy, whichever was greater. Similarly, the bill would allow the cancellation provision of a disability policy to specify that the minimum earned premium on a cancelled policy for which the premiums had been financed could not be less than \$25 or 15% of the total premium payable on the policy, whichever was greater.

Auto Insurance

The bill would allow an auto insurer to file a rule with the Commissioner to provide for a minimum retention of premium for private passenger auto insurance. The rule would have to specify the circumstances in which the retention would be applied and the amount to be retained. The retention could be applied only when the amount of the retention exceeded the amount that would have been retained had the policy been cancelled on a pro rata refund basis, and could not be applied to renewal policies. The retention could not apply if a policy were cancelled because the insured no longer was required to maintain security under the Code (MCL 500.3101) or because the insured had replaced the cancelled policy with auto insurance from another insurer, and had provided proof of the replacement coverage.

MCL 500.2832, 500.3020, and 500.3448

FISCAL IMPACT

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

ARGUMENTS**Supporting Argument**

The bill would remove a de facto penalty against cancellations of policies by insureds. The bill's provision of pro rata refunds when either the insured or the insurer cancelled a policy would encourage comparison insurance shopping (even during the term of a policy). By allowing a minimum earned premium of \$25 or 15% of the total payable premium, the bill also would protect against losses by insurers due to costs associated with policy issuance and cancellation.

Supporting Argument

Since certain automobile insurance coverages are mandatory, an insurer who cancelled its policy without

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valid reasons should be penalized. The bill's provision for insurers to set a minimum retention of premium would conform with an administrative rule being promulgated by the Insurance Bureau to allow auto insurers to recoup the cost of policy issuance and cancellation. Both the rule, and the bill's consistent provision, would encourage insureds to maintain the mandatory auto insurance coverage.

Opposing Argument

The provision of the bill that would allow pro rata refunds for disability insurance for which premiums had been financed, is not necessary because premiums on health and disability policies are not financed. Even if premiums on such policies were financed, the provision would be unfair because refunds on policies for which premiums were not financed still would be made on a short rate basis. This provision should be made consistent with the bill's refund provisions for fire and casualty policies — all cancellations should be made on a pro rata basis.

Legislative Analyst: P. Affholter

Fiscal Analyst: B. Klein

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.