



**House
Legislative
Analysis
Section**

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MORTGAGE LIFE INSURANCE

House Bill 5238 (Substitute H-1) First Analysis (2-7-96)

Sponsor: Rep. Willis Bullard, Jr.
Committee: Insurance

THE APPARENT PROBLEM:

Section 4418 of the Insurance Code permits the issuance of group life insurance in connection with loans on dwellings or mobile homes in cases where the lending or servicing financial institution is the policyholder. This is known as mortgage life insurance. It is decreasing term insurance, meaning that the death benefit decreases as the principal of the loan decreases. The code limits the amount of such a policy to about \$120,000. (The limit was raised to \$80,000 from \$50,000 in 1982, and the new limit was indexed to inflation.) Industry officials seek a lifting of the limit to allow the full amount of a mortgage loan to be covered by a mortgage life policy. They say that the current limit results in hard feelings and disputes when, for example, a surviving spouse discovers that a mortgage life policy does not cover the full amount of a large mortgage. Some consumers need to be able to cover the entire amount of a large mortgage to protect surviving family members, says the industry. This ought to be a matter of consumer choice, they say.

Additionally, the code contains limitations on payments by insurance companies to financial institutions (e.g., commissions) offering mortgage life insurance policies of the insurers. Some people believe that such payments should be generally permitted if there are safeguards protecting the consumer from coercion, including disclosure of the financial relationship between the insurer and financial institution and notification to customers that they need not purchase insurance to obtain the loan. (Provisions of this kind were included in Public Act 409 of 1994, which permitted and regulated the ownership of insurance entities by financial institutions. However, that act does not apply to group mortgage life policies.) Also, industry representatives say there has been ambiguity over the legality of financial institutions or their affiliates receiving dividends from stock they own in reinsurance companies. The industry has said that a large number of Michigan financial institutions that sponsor group mortgage life insurance programs own stock in a reinsurance company that assumes some of the risk in connection with the programs. Industry officials say that the financial institutions take a business risk in making this investment and profits from the reinsurer are not guaranteed. This being the case, they

say, dividends from stock in an insurer should not be seen as an indirect method of making illegal payments to financial institutions. The industry seeks clarification of this.

THE CONTENT OF THE BILL:

The bill would amend Section 4418 of the Insurance Code, which deals with group mortgage life insurance, in several ways.

(1) It would remove the current limit (of about \$120,000) on the amount of such policies and specify that the limit of the policy would be the amount of the loan. (The limit was set in 1982 at \$80,000, with the amount to be adjusted annually for inflation.)

(2) The bill would remove existing limits on the payment by an insurance company to a financial institution of monetary or financial benefits as result of the insurance on the life of a borrower in connection with a loan on a dwelling or mobile home. The bill would specify that an insurer can provide or pay monetary or financial benefits in such a case. It would, however, specify that such benefits could only be provided or paid if the insurer has taken reasonable steps to ensure each of the following:

-- the loan and insurance transactions are separated through a written disclosure given by the lending or servicing financial institution to the borrower, at the time it first initiates discussion of the insurance with the borrower, stating that the insurance need not be purchased as a condition of the loan.

-- the written disclosure states that the borrower is not required to decide whether or not to apply for the insurance until after the approval of the loan has been communicated to the borrower.

-- The lending or servicing financial institution gives a written disclosure to the borrower that it or an affiliate has a financial interest in the insurance transaction by not later than the time borrower is asked to decide whether or not to apply for the insurance coverage.

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-- The loan and insurance transactions are completed through separate documents.

(3) The bill also would specify that dividends paid to a financial institution or its affiliate on stock owned in a reinsurer that accepts cessions from an insurer that provides group mortgage life insurance are lawful. This would apply to dividends paid before, on, and after the effective date of the bill.

(Barron's Dictionary of Insurance Terms describes reinsurance as a "form of insurance that insurance companies buy for their own protection, a 'sharing of insurance.'" An insurance company "reduces its possible maximum loss on either an individual risk or on a large number of risks by giving [ceding] a portion of its liability to another insurance company [the reinsurer].")

MCL 500.4418

FISCAL IMPLICATIONS:

The House Fiscal Agency described an earlier, but similar, version of this bill as having no fiscal implications. (Fiscal Note dated 10-23-95)

ARGUMENTS:

For:

It makes sense to allow customers to be able to choose to purchase mortgage life insurance policies that cover the full amount of the mortgage, as this bill would. The current limit is about \$120,000 and that amount is not sufficient to cover all mortgages today. Industry officials say that surviving spouses often do not understand that their mortgage insurance will not cover the full amount of the mortgage and this results in disputes with insurers and hard feelings when the insured dies. Also, survivors may need to be able to insure the full amount to be able to pay off the mortgage or keep the home. Additionally, the bill clarifies that a financial institution can receive dividends from stock it owns in a reinsurance company. The bill also permits an insurance company to pay monetary or financial benefits to a financial institution that offers its product only if certain consumer safeguards are maintained. These include keeping loan and insurance transactions separated; requiring the disclosure to the consumer that insurance need not be purchased as a condition of the loan; requiring disclosure that a decision on insurance is not required before a financial institution makes a decision on the loan; and disclosure of the financial institution's own financial interest in the insurance transaction. These requirements are consistent with provisions in Public Act 409 of 1994,

regulating the ownership of insurance entities by financial institutions. (That act did not apply to group mortgage life insurance policies.)

POSITIONS:

The Michigan League of Savings Institutions supports the bill. (2-6-96)

The Minnesota Mutual Life Insurance Company has indicated support for the bill. (2-6-96)

The Insurance Bureau is not opposed to the bill. (2-6-96)

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.