SFA BILL ANALYSIS

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

Senate Bill 490 (as enrolled)
Sponsor: Senator Dick Posthumus
Senate Committee: Finance
House Committee: Insurance

PUBLIC ACT 305 of 1990

Date Completed: 2-15-91

RATIONALE

As with many kinds of contracts, insurance policies often contain language that may be difficult for the uninitiated to understand. When conflicts arise, therefore, consumers often must either accept the conditions of the contracts as interpreted by insurers and deal with any consequences of that acceptance, or resort to costly lawsuits. Not only is this fundamentally unfair to consumers, some claim, but, in the long run, it is bad business.

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 one of 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) apparently has approved model legislation declaring a Flesch score of 40 acceptable for insurance contracts. Some consumer advocates believe a higher score is preferable.

One "unreadable" contract used by Michigan insurers, the standard fire policy, actually is mandated by law. The State requires companies to use a policy prescribed word-for-word by the Insurance Code. The 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 Companies need to supplement the standard policy more and more as it becomes increasingly outdated, resulting in the proliferation of extra attachments sent to policyholders, only adding to their confusion.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 should be removed from the Insurance Code, some say, and replaced with general requirements that would protect consumers but allow individual companies some flexibility in their language and in their methods of meeting statutory standards.

In a separate matter, the Michigan Insurance Code currently provides that standard fire insurance policies become effective at noon on the date specified in the policy. Further, although the Code requires policies to specify the date a policy will expire, no provision is made for specifying the time at which it will expire. Some claim that these provisions are problematic for both the insurance industry and the consumer. The "effective time" provision, for example, apparently is inconsistent with the "effective time" provisions in about 47 other states that use 12:01 a.m. as the time at which a policy becomes effective. Insurance companies that do business nationwide, therefore, must amend

their policy forms to contain a noon effective time if they wish to do business in Michigan--a practice, some say, that is costly and burdensome to the insurers. Further, since all other property and casualty policies in Michigan have the 12:01 a.m. effective time, consumers who have several policies that include the same risk may have overlapping coverage or gaps in coverage. The same situation may occur because there is no specified expiration time for fire insurance policies.

CONTENT

The bill would amend the Insurance Code to:

- **Require all basic insurance forms and contracts aimed at serving personal, family, and household purposes to meet a readability standard beginning January 1, 1992.**
- **Replace current required language for the standard fire insurance policy with a set of standards that each fire insurance policy would have to meet.**
- **Require standard fire insurance policies to become effective at 12:01 a.m. standard time, and expire at 12:01 a.m. standard time, on the dates specified in the policy.**
- **Repeal Section 2832 of the Code, which specifies the language to be contained in standard fire insurance policies, January 1, 1992.**

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 January 1, 1992, the bill would prohibit the Commissioner from approving a form providing for or relating to personal, family, or household purposes 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 were proposed. The formula for evaluating a form's readability would be: Readability Score = 206.835 - X + Y, where X = words/sentences x 1.105 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. 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. The method and formula also would not be applied to language specifically agreed upon through collective bargaining or required by a collective bargaining agreement, or to language prescribed by State or Federal statutes, or by affiliated rules and regulations.

The bill also would require insurance forms and contracts to contain topical captions and exclusions and, if the policy, other than an indorsement, contained more than three pages of text or more than 3,000 words, a table of contents. 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.

Fire Insurance Policies

The bill would repeal the section of the Code prescribing the "Michigan Standard Policy", and would delete references to the standard fire insurance policy format. Instead, the bill would specify provisions concerning the extent of coverage, procedures for changing provisions in the policy or canceling the policy, and the rights of the insured and insurer. These provisions would have to be included in all fire insurance contracts.

MCL 500.2103 et al.

FISCAL IMPACT

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

ARGUMENTS

Supporting Argument
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 had 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 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, would allow the use of necessary technical terms in insurance policies if they were 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 would 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 January 1, 1992, so companies would have time to prepare forms that complied. In fact, many companies probably already have forms that would comply, particularly those that do business in states with readability regulations.

Supporting Argument
The bill would do away with statutorily prescribed fire insurance policy language that is archaic,. and instead would place general standards in the Insurance Code for fire insurance policies to meet. Rather than imposing any new standards on insurance companies, the bill simply would rid the Insurance Code of outdated (and unreadable) language that insurers are now required to use in contracts word-for-word. Companies would have the flexibility to draft their own fire insurance contracts with the understanding that certain standards, substantially similar to those in place now, had to be met.

Supporting Argument
By specifying a 12:01 a.m. effective time and expiration time for standard insurance policies, the bill would bring the State's insurance policy provisions into conformance with those of 47 other states, would save insurers the cost of changing their forms to meet the State's format specifications, and would help ensure that consumers did not purchase overlapping policies or unknowingly have gaps in their coverage.

Opposing Argument
The Flesch test that would be required by the bill to ensure 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, for 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 all 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, rather than a subjective test, is included in this bill for several reasons. For one thing, insurers 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 already are scrutinized by the Insurance Bureau on other grounds and would continue to be.

Opposing Argument

Some insurance company representatives have urged the adoption of the minimum readability score of 40, which is found in the NAIC model and has been adopted in most other states. Uniform state laws enable multistate insurers to operate more efficiently and less expensively, since they then do not have to restructure their contracts for each state.

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