House
Legislative
Analysis
Section

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BANKS & INSURANCE SALES

House Bill 5281 as enrolled
Public Act 409 of 1994
Sponsor: Rep. Mary C. Brown

House Committee: Insurance
Senate Committee: Corporations and Economic Development

House Bills 4021 and 4022 as enrolled
Public Acts 405 and 382 of 1994
House Bills 4726-4729 as enrolled
Public Acts 406, 386, 407, and 408 of 1994

Sponsor: Rep. William R. Keith
House Committee: Business and Finance
Senate Committee: None

Second Analysis (1-11-95)

THE APPARENT PROBLEM:

Should banks be able to sell insurance? That is, should banks and other financial institutions be able to own and operate insurance agencies and sell a full line of products and coverages? (Financial institutions routinely sell credit insurance in connection with home mortgages and auto loans.) This is a longstanding controversial issue. Representatives of banks, credit unions, and savings institutions have argued that the issue is one of introducing additional choice and competition into insurance sales. They note how the traditional dividing lines between financial service businesses have become blurred, so that insurance companies, investment brokerages, and others have begun selling banking-type products and services. Insurance agents, consumer groups, and representatives of small business interests have complained that allowing financial institutions to sell insurance would actually have an anti-competitive effect because banking customers and seekers of credit would be susceptible to coercion, whether open or subtle, if the purchase of homeowner's, auto, and business insurance becomes tied to credit transactions and other bank-related transactions. They point to consumer experience with credit insurance, a product much criticized for its marketing and cost, the sale of which is dominated by lending institutions.

The issue has been made more pressing by a recent Michigan Supreme Court decision. In Ludington Service Corporation v Acting Commissioner of Insurance, the court essentially overturned a declaratory ruling by the insurance commissioner that had said the business plan prepared by a wholly owned subsidiary of Ludington Savings Bank in order to buy and operate an existing insurance agency would violate the Insurance Code. The supreme court decision affirmed a 1992 court of appeals decision on the case.

According to the syllabus of the January 25, 1994 decision, the supreme court held that the commissioner "lacked the necessary competent, material, and substantial evidence to support his findings" of code violations. The court also said, "the commissioner additionally erred as a matter of law" in applying in this case a section of the code (500.1242(3)) that permits the commissioner to use certain reasons to deny an agent's license because that section "is limited to the granting or renewing of a license, as opposed to the acquisition of a licensed insurance agency." Reportedly, the parties

to the case have requested a rehearing of the case by the court. Those who oppose allowing banks and other financial institutions to own and operate insurance agencies obviously are concerned about the impact of the decision and in particular see as a major loophole the court's finding that Section 1242(3) does not apply in cases where a financial institution is acquiring an existing agency.

The Insurance Code does not specifically prohibit financial institutions from operating as insurance agents, but certain provisions in the code have served as barriers to licensing financial institutions as agents. Insurance agents are licensed by the state. Section 1242(3) says the insurance commissioner can refuse to grant or renew a license to act as an agent "if he determines by a preponderance of the evidence, that it is probable that the business or primary occupation of the applicant will give rise to coercion, indirect rebating of commissions or other practices in the sale of insurance which are prohibited by law." (This is the section the supreme court says was wrongly applied by the commissioner in the Ludington case.)

Section 1207(5) of the code says "a person may not sell or attempt to sell insurance by means of intimidation or threats, whether express or implied," and specifies that "a person may not induce the purchase of insurance through a particular agent or from a particular insurer by means of a promise to sell goods, to lend money, to provide services, or by a threat to refuse" to do so. Section 1207(3) provides that, with certain specified exceptions, "an agent shall not reward or remunerate any person for procuring or inducing business in this state, furnishing leads or prospects, or acting in any other manner as an agent."

Another key section, Section 2077, prohibits a person or entity lending money or extending credit from requiring a borrower to negotiate an insurance policy or contract through a particular agent or with a particular insurer and from requiring, directly or indirectly, a borrower to "pay a consideration of any kind to substitute the insurance policy of one insurer for that of another." Further, Section 2077(2) provides that in cases where an instrument requires the furnishing of insurance on real property, a creditor is prohibited from using that information "to his own advantage or to the detriment of the purchaser, mortgagor, borrower, insurance company or agency."

Generally speaking, opponents of allowing banks and similar institutions to sell insurance claim that these prohibited commercial practices are virtually inherent when the ownership and operation of banking operations and insurance agency operations are combined. However, the recent decision suggests that the state supreme court believes a financial institution can craft a business plan so as to own and operate an insurance agency without violating the Insurance Code.

In response to the court decision, the House passed on May 12 of this year House Bill 5281, which in general, prohibited financial institutions from engaging in any aspect of the insurance or surety business as a principal, underwriter, agent, broker, solicitor, or insurance counselor. Exceptions were made for the sale of credit insurance and for existing insurance operations. That approach was supported by representatives of insurance agents, consumer organizations, and small business but opposed by financial institutions and some large retailers. Since then, an agreement has been worked out by representatives of the various parties to the dispute and new versions of the legislation have been drafted for consideration by the House and Senate.

THE CONTENT OF THE BILLS:

House Bills 4021, 4022, and 4276 would specifically permit financial institutions 1) to engage in any aspect of the insurance and surety business as an agent, broker, solicitor, or insurance counselor, and 2) to own an insurance agency in whole or in part, both as provided under the Insurance Code. Each of the three bills applies to a different kind of financial institution. House Bill 4021 would amend the Banking Code (MCL 487.451). House Bill 4022 would amend the Savings and Loan Act (MCL 491.500). House Bill 4726 would amend the credit union act (MCL 490.4). Three other bills would make related amendments to laws governing various financial transactions. House Bill 4727 would amend an act regulating credit card transactions (MCL 493.110). House Bill 4728 would amend the Regulatory Loan Act of 1963 (MCL 493.13a). House Bill 4729 would amend the secondary mortgage loan act (MCL 493.72). House Bill 5281 would amend the Insurance Code (MCL 500.1243) to regulate the involvement of financial institutions in insurance sales. Its provisions would apply to, among others, lenders that had been affiliated with licensed agencies or had employed licensed agents

before the bill's effective date. All of the bills dealing with financial institutions were tie-barred to House Bill 5281, which in turn was tie-barred to them.

A description of the provisions of House Bill 5281 follows.

Lenders as Agents. The insurance commissioner would have to issue an insurance agency license to an affiliate of a lender or an agent license to an employee of the affiliate if the commissioner determined that the affiliate or the employee had met the prerequisites for licensure and that the affiliate and lender would conduct the sale of insurance in accordance with the new act. If a lender acquired ownership in or became affiliated with an agency with an existing license, an application for a new license would not be required. The commissioner could issue an insurance agency or agent license directly to a lender (or an employee of a lender who was not an employee of an affiliated agency) if he or she determined that the lender or employee had met the prerequisites for licensure and would conduct the sale of insurance in substantial compliance with the law.

A lender, an agent affiliated with a lender, or an agent employed by a lender could be licensed to sell any insurance product. A lender could own an insurance agency in whole or in part and would have to provide notice to the insurance commissioner and the Financial Institutions Bureau of any acquisition, in whole or in part, of an insurance agency. There would be no limit on the percentage of insurance business sold to customers of a lender through an insurance agency affiliated with a lender if sold in compliance with the bill's provisions.

Applications for insurance agency or agent licenses would have to be promptly reviewed, and an application would be considered approved if the commissioner had not denied an application for good cause within 60 days after the filing of the application. An application filed before November 1, 1994, would be considered approved if was not denied within 10 days after the effective date of the bill (April 1, 1995). Licenses would have to be issued within 10 days of approval.

Borrower Protections and Required Disclosures. A lender could not require a borrower to purchase any policy or contract of insurance through a particular agency or agent or with a particular insurer or fix or vary the terms or conditions of a loan as an inducement to purchase insurance. Nor could a lender, except as otherwise provided by law, require a person to purchase any insurance product from the lender or an affiliate as a condition of making a loan. This would not prohibit a lender from requiring a borrower to purchase a required insurance policy that conformed to the requirements, if any, of the loan. An officer or employee of a lender could not directly or indirectly delay or impede the completion of a loan transaction for the purpose of influencing a consumer's selection or purchase of insurance products from an agent, solicitor, agency, or insurer not affiliated with the lender.

A loan representative could not act as an agent or solicitor for the sale or provision of required insurance relating to an application, approval, commitment, or closing of a loan if the loan representative participated in the application, approval, commitment, or closing of that loan agreement. A lender and its employees could not knowingly initiate a discussion concerning the availability of insurance products from the lender or an affiliated agency to or with a person in response to an inquiry about credit made by the person or loan applicant, prior to the loan applicant being notified of the disposition of a loan application. This would not prohibit a lender or its employees from discussing with the person making the inquiry or the loan applicant that insurance must be maintained as a condition of obtaining a loan.

If asked about the availability of insurance by a loan applicant or other person inquiring about a loan, the lender could indicate that insurance products were available from the lender or an affiliated agency and provide instruction about how to obtain further information concerning the agency or agent and available insurance products.

If insurance was required as a condition of obtaining a loan, and if the insurance was available through the lender or an affiliate of the lender, the lender would have to disclose: a) that the lender would not require the borrower to purchase any policy or contract of insurance through a particular agent or agency or with a particular insurer; b) that the lender, except as otherwise provided by law, would not require the borrower to purchase any insurance product from the lender or an affiliate as a condition of the loan; and c) that the purchase of

any insurance product from the lender or its affiliated agency was optional and would not in any way affect current or future credit decisions. This disclosure would be made to a loan applicant at the time he or she inquired about the availability of required insurance or at such time as the lender advised the applicant that the insurance was available through the lender or an affiliate, whichever was earlier. The disclosure would have to be confirmed in writing, dated, and signed by the applicant no later than the closing of the loan.

If insurance was required as a condition of the loan, the credit and insurance transactions would have to be completed independently and through separate documents. A loan for premiums on required insurance could not be included in the primary credit without the written consent of the customer.

The offering of a loan by a lender and the sale of insurance products by an affiliated agency would have to be made in different areas that were clearly and conspicuously signed and separated so as to preclude confusion on the part of customers. However, in the limited situation where physical or employee considerations prevented lending and the sale of insurance products from being conducted in different areas, the lender would have to take appropriate measures to minimize customer confusion. This subsection would not prohibit, on an irregular basis, applications for a loan, extensions of loans, and insurance sales at locations not so separated, in unique circumstances to accommodate the needs of or for the convenience of a particular customer.

Signs and other informational material concerning the availability of insurance products from the lender or an affiliated agency could not be displayed in areas when loan applications were being taken and when loans were being closed.

Relationship Between Lender and Agent. The board of directors of an insurance agency affiliated with a lender would have to act separately from the board of directors of a lender. A director of a lender could also serve as a director of an affiliated agency, but a majority of directors of the affiliated agency could not be directors of the lender. (These provisions would not apply to a lender that was also the licensed agency.)

An officer or employee of a lender could be an officer or employee of an affiliated agency. Except as otherwise provided by the bill, for purposes of soliciting or selling insurance products, the officer or employee would not be able to use or disclose information that the lender could not disclose to the affiliated agency.

An insurance agent could not reward or remunerate an affiliated lender for procuring or inducing insurance business for the agency or agent or for furnishing leads and prospects or acting in any other manner as an agent. This would not preclude an affiliated agency from compensating its employees, who could also be employees of the lender, or reimbursing its affiliated lender at fair market value for any goods, services, or facilities that the lender was allowed to provide to the agency or for expenses incurred by the lender in advising its customers and the general public of the agency's services. Further, an insurance agency could pay dividends and make other distributions of assets to the agency's shareholders, including an affiliated lender, as a return on the capital invested and risks assumed by the shareholders or in conjunction with a merger, liquidation, or other corporate transactions.

Exchange of Information Between Lender and Agency. A lender could not directly or indirectly provide to an affiliated agency or agent the following customer documents or information: loan applications; financial statements regarding assets, liabilities, net worth, income, and expenses; budgets or proposed budgets; business plans; contracts; credit reports; inventory records; collateral offered as security for loans; appraisals; personal guarantees and related information; and insurance policies, certificates, or binders. (However, a lender could provide to an affiliated agency or agent employed by the lender the name, address, telephone number, and account relationship concerning a loan applicant after the applicant had been notified of the disposition of the application.)

The bill would not prohibit a lender from providing information about the customers of the lender to an affiliated agency or agent if that information was otherwise available from a public record. And, the bill would not prohibit a lender from releasing customer information in its possession to any person if the customer authorized the release of that information. The release would have to be in writing, dated, and signed by the customer. A lender could not knowingly ask a loan applicant to release such information prior to the loan applicant

being notified of the disposition of the application unless the applicant had asked about the availability of insurance products. A lender could not require the release as a condition of applying for the loan.

Further, a lender could not directly or indirectly provide to an affiliated agency or agent employed by the lender the following information if obtained from an insurance policy or pre-authorized payment agreement in the possession of the lender: the expiration date of the insurance policy; the name of the insurance company that issued the policy; the amount of the premium; scheduled coverages and policy limits; deductibles; information from the declarations sheet; or cash or surrender values. A lender could disclose to an affiliated agency or employed agent information obtained from a policy of required insurance that the borrower had failed to keep in force if the information was necessary to obtain required insurance. If a customer had failed to keep required insurance in force, the bill would not prohibit a lender from obtaining insurance in accordance with the terms of the extension of credit or from obtaining insurance limited to repayment of the outstanding balance due in the event of loss or damage to property used as collateral on the loan.

The bill would not require the lender to remove the name, address, or other information about a customer from the customer list if the information was on the list by reason of other account relationships with the lender and the lender was otherwise authorized to disclose the list to an affiliate agency or lender-employed agent.

Permitted Marketing. A lender and its employees, agents, and representatives could advise the general public and its customers, through mailings or otherwise, that insurance products were available from the affiliated agent and could advise the general public and its customers how to obtain more information about those insurance products, so long as the information was not occasioned by submission of any loan application, or any inquiry about the availability, terms, and conditions of any loan; the timing of the communications was not based on the maturity or expiration date of a policy of required insurance or an insurance policy in the lender's possession; and no information concerning customers prohibited for use in soliciting or selling insurance (as detailed later) was used to determine which customers should receive the information.

A lender could provide the names, addresses, telephone numbers, and information related to account relationships with customers to an affiliated agency or lender-employed agent so long as the lender did not disclose account balances, maturity dates of certificates of deposit, or account relationships to an agency or agent in a manner that account balances or maturity dates of certificates of deposit could be determined. This section would not prohibit disclosure of minimum required balances, terms, or conditions of an account.

Penalties and Enforcement. If after an opportunity for a hearing under the Administrative Procedures Act, the insurance commissioner found that a person had violated the provisions of the bill, he or she would reduce the findings and decision to writing and serve upon the person charged with the violation a copy of the decision and an order requiring the person to cease and desist from the violation. In addition, the commissioner could order any of the following:

-- For all violations committed in a six-month period, the payment of a civil fine of not more than $1,000 for each violation up to an aggregate civil penalty of $30,000, unless the person knew or reasonably should have known the person was in violation. In that case, the civil fine would be up to $5,000 per violation and $150,000 in the aggregate.

-- Restitution to the insured or any other person, including a customer claimant, to cover actual damages directly attributable to the acts that are found to have been in violation by a person who knew or reasonably should have known of the violation.

-- The suspension or revocation of the person's license under the Insurance Code.

If a person knowingly violated a cease and desist order and had been given notice and an opportunity for a hearing, the commissioner could order a civil fine of up to $25,000 for each violation, or a suspension or revocation of the person's license, or both. However, an order could not require the payment of civil fines exceeding $250,000.

The commissioner could apply to the Ingham County Circuit Court for an order of the court enjoining a violation. An action could not be brought more than five years after the occurrence of the violation.

Exemptions. The bill would not apply to mortgage life insurance or insurance offered under the Credit Insurance Act. The bill specifies that payment by an insurance company of consideration to an agency or agent for an individual policy of insurance on the life of the borrower issued in connection with a loan on a dwelling or mobile home made or serviced by an affiliated lender would not be considered a monetary or financial benefit to the lender as a result of the insurance.

The bill would not prohibit a lender, or a manufacturer or an affiliate of a manufacturer acting as a lender from soliciting or selling insurance products to a closed dealership, designated family member, new motor vehicle dealer, or proposed new motor vehicle dealer. (Those terms are defined in Public Act 118 of 1981, which regulates the relationship between motor vehicle manufacturers and dealers.) This provision could not be construed to include customers of motor vehicle dealers.

FISCAL IMPLICATIONS:

The Senate Fiscal Agency reports that the House Bill 5281 "would not have an impact on the regulatory workloads of state or local regulatory agencies, nor would it have a fiscal impact on the state." Also, says the SFA, no mandated costs would be imposed on local governmental units. (11-29-94)

ARGUMENTS:

For:

These bills are part of an agreement reached by the parties to a longstanding dispute over whether banks and other financial institutions should be able to own and/or act as insurance agencies. Under this agreement, financial institutions could own and act as agents subject to certain safeguards that would be placed in the Insurance Code. As described by the parties to the agreement, the legislation would require the separation of lending and insurance transactions; would prohibit offering or discussing insurance while a loan application was pending; would require separate lending and insurance areas; and would require full written disclosure to customers. Plus, there would be substantial penalties for violations. Proponents of the agreement say it should provide for fair and open competition, protect consumers, and bring positive returns to Michigan business and citizens. Among the parties to the compromise are representatives of insurance agents and of some small business groups, both of which have previously expressed strong opposition to the sale of insurance products by banks.

Response:

It should be noted that the arguments against allowing banks to sell insurance were based, in large part, on the unfair economic advantage that is inherent when lenders are in a position to sell prospective borrowers products and services not directly related to the loans sought. This situation has typically been portrayed as necessarily coercive. If the protections contained in the compromise legislation are to be meaningful, there will need to be vigorous enforcement. A further argument against lenders selling insurance has been that it will lead to a greater concentration of economic power. (For a full discussion of the arguments in favor of preventing banks from owning insurance agencies or acting as agents, see the analysis of House Bill 5281 dated 3-2-94)