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INSURANCE WITHHOLDING

House Bill 5224 (Substitute H-1)
Sponsor: Rep. Vera Rison

House Bill 5344 (Substitute H-1)
Sponsor: Rep. Samuel Buzz Thomas

Committee: Insurance
First Analysis (2-24-98)

THE APPARENT PROBLEM:

Public Act 495 of 1980 (sometimes referred to as the Fire Insurance Withholding Act) amended the Insurance Code to allow cities, townships, and villages to escrow 15 percent of a fire insurance settlement for fire and explosion losses within their jurisdiction until there is evidence that the property is being or will be repaired, replaced, or removed. Then the funds can be released to the insured. The municipality can use the money to do the work itself if the insured party does not act within a specified amount of time. The act only applies to settlements that exceed 49 percent of the insurance carried on the property and does not apply to personal property or contents damage coverages. The act contains a number of procedural requirements that a municipality must meet before insurance proceeds can be escrowed, and the withholding of funds does not apply if the insured property owner files evidence of a contract to repair the property within 15 days after agreeing to a final settlement with the insurer or agrees to have payments made directly to a contractor. The act was passed to help communities deal with abandoned and blighted properties. It provides an incentive for property owners to deal with damaged and burned-out buildings and, when they don't, communities gain some additional funds to demolish and remove blighted buildings themselves. The list of communities that have elected to participate in this program is extensive; large and small municipalities all over the state make use of the program.

Legislation has been introduced to improve the operation of the fire insurance withholding program by making more funds available from insurance proceeds, speeding up the timetable for municipalities to act on their own using escrowed insurance funds, and, in the case of large cities, expanding the category of claims that trigger the withholding of funds. Currently, for example, in cases where a property owner has not acted to repair, replace, or remove a damaged structure, a city cannot use escrowed funds until 445 days have passed. Critics say this is far too long to wait. Such delay in clearing or repairing buildings contributes to further blight in neighborhoods and is an invitation to arson, vandalism, and other mischief.

THE CONTENT OF THE BILLS:

The bills would amend the Insurance Code to address the subject of municipalities withholding fire insurance proceeds. House Bill 5224 would amend current provisions of the Fire Insurance Withholding Act (MCL 500.2845) and would apply to cities, villages, and townships with a population of 50,000 or less located in counties with a population of less than 425,000. House Bill 5344 would create a new, similar but not identical, set of provisions (MCL 500.2227) for all cities, villages, and townships in counties with a population of 425,000 or more and cities, villages, and townships with a population of 50,000 or more in smaller counties. The bills would take effect January 1, 1999 and would apply to losses on or after that date. Losses occurring prior to that date would be governed by the current Fire Insurance Withholding Act.

Changes to current law include the following.

** Currently, the fire withholding provisions apply to insurance claims for losses due to fire or explosion. That would continue to be the case in House Bill 5224, but House Bill 5344 would include claims for loss due to fire, explosion, vandalism, malicious mischief, wind, hail, riot, or civil commotion.

** Currently, insurance companies are required to withhold 15 percent of the actual cash value of the insured real property or 15 percent of the final settlement, whichever is less. The bills would raise that figure to 25 percent, but would impose a limit for residential property of $6,000. (That amount would be adjusted annually beginning June 1, 1999, in accordance with the consumer price index. The insurance commissioner would notify insurance companies of the new adjusted amount each year.)

** At present, a municipality can use retained insurance proceeds to secure, repair, or demolish a damaged structure itself if reasonable proof of removal, repair or replacement is not presented within 445 days after the policy proceeds are received by the municipality. The bills would reduce that time period to 120 days.

** As now, the escrowed funds would be immediately forwarded to the insured when the municipality is shown reasonable proof that the structure has been repaired or replaced to the extent possible without using the withheld funds; that the remains have been satisfactorily cleared, in compliance with local codes; or that a contractor has been hired to do the necessary work. In this last case, the escrowed funds would be sent to the contractor. There are standards of proof for release of the funds, including the inspection of the property by the appropriate municipal official. House Bill 5344 would require that the contractor be a licensed contractor.

** Under the bills, when notified of a settlement, an authorized representative of the municipality would request the insurance company to pay the withheld amount into an escrow account maintained by the local treasurer. In the case of an insurance settlement, a copy of the request would be sent to the insured (the property owner) and any mortgagees. In the case of a judgment, a copy would also be sent to the court. Upon receipt of the municipality's request by the company or upon the motion of the municipality to the court, the withheld amount would be forwarded to the local treasurer. The bills would specify that a final settlement that exceeds 49 percent of the insurance on the real property would be prima facie evidence that the damaged structure violates existing health and safety standards and requires escrow of the withheld amount as surety for the repair, replacement, or removal of the damaged structure and constitutes cause for the escrowing. The municipality would have to notify the insured person that he or she had 10 days to object to the municipality's retention of the withheld amount. The notice would identify the authorized representative that objections should be addressed to. The insured would be notified that he or she could 1) seek resolution with the representative of the municipality or 2) seek relief in circuit court. In the first case, a municipality would have to make a final determination within 30 days. If the insured was not satisfied, he or she could go to circuit court.

The current act requires the municipality to demonstrate that the withholding is necessary to protect the public health and safety. If no such demonstration is made, the withheld policy proceeds are paid to the insured. To escrow and retain withheld proceeds, a municipality must produce an affidavit from its chief fire official, or some other designated official, stating that the damaged insured structure violates specified health and safety standards and that the withheld proceeds are needed as surety for the repair, replacement, or removal of the damaged structure. Upon receipt of the affidavit, the insurance company must send the withheld funds to the municipality (or the court does so, when a court judgment is involved). Further, the municipality within 30 days after escrowing the funds must apply to the circuit court for declaratory relief in order to establish its right to the funds. If it fails to do so, the proceeds are returned to the insured.

** The bills would specify that if an insurance company withholds payment under a policy in good faith because of suspected arson, fraud, or other question concerning coverage, the fire insurance withholding provisions would not apply until the issue or question was resolved and final settlement made.

** The act currently says that there is no liability on the part of, and a cause of action shall not arise against, an insurance company or an agent or employee of the company for withholding or transferring money in the course of complying with the act. The bills would specify that if there was a dispute with a lienholder concerning the distribution of an amount withheld from payment, the insurance company could file an action in circuit court to identify all parties that could have a financial interest in the withheld money and to determine how the withheld money should be distributed.

FISCAL IMPLICATIONS:

There is no information at present.

ARGUMENTS:

For:

The bills aim at strengthening the fire insurance withholding program within the Insurance Code. One bill applies to large counties and larger communities within smaller counties, to recognize the special problems of urban areas with abandoned property and blighted structures. In brief, the bills would speed up the process by which communities can use escrowed insurance proceeds to remove damaged buildings; would make a larger percentage of insurance proceeds available for such purposes (up to a maximum amount); and would streamline procedures for retaining insurance funds. The bill that applies to larger communities would allow for the escrowing of insurance proceeds in cases beyond fire and explosion perils, expanding the program to apply to vandalism, malicious mischief, wind, hail, riot, and civil commotion.

Against:

Withholding one-quarter of a real property claim could be a considerable hardship to a commercial enterprise that is trying to rebuild after a fire. It could have an effect on company cash flow at a particularly difficult time.

POSITIONS:

Among those who have indicated their support for the bill are: the Michigan Municipal League, the Detroit Regional Chamber of Commerce, the Alliance for a Safer, Greater Detroit, the Michigan Arson Prevention Committee, State Farm Insurance, AAA Michigan, and Allstate Insurance. (2-18-98)

Analyst: C. Couch

■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.