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SFA BILL ANALYSIS

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Senate Bill 883 (Substitute S-1 as enrolled)
Sponsor: Senator Alan Sanborn
Committee: Financial Services

Date Completed: 4-1-02

RATIONALE

When a consumer borrows money from a financial institution to purchase a large personal property item such as a boat or car, the financial institution typically requires, in the loan contract, that the purchaser maintain insurance on the item. The insurance is meant to benefit both the lender and the borrower: If the collateral property is damaged, the creditor collects the amount due on the loan, and the borrower is released from the loan contract. If the borrower fails to purchase physical damage insurance on the collateral, the terms of the loan contract allow the creditor to purchase creditor-placed insurance and charge the cost to the borrower.

According to the Office of Financial and Insurance Services (OFIS), a problem arises when lenders purchase creditor-placed insurance plans that contain additional and unnecessary types of coverages. The cost of the inflated premiums is then charged to the borrowers. For example, some creditor-placed insurance plans include coverage for mechanic liens, repossession fees, and storage fees; these plans directly benefit the lender but do not benefit the borrower. Problems also arise when borrowers do not receive proper and timely notification about a lending institution's intent to purchase creditor-placed insurance. Without timely notification, a borrower does not have an opportunity to purchase physical damage coverage in the regular insurance market at a lower premium.

Because Michigan does not have a law that clearly defines how creditor-placed insurance must be sold, OFIS has no legal authority to set or enforce fair market standards for the practice. Some people believe that it would benefit consumers if there were established standards for creditor-placed insurance and if the Commissioner of OFIS had the authority to take action against creditors and insurers when the standards were breached.

CONTENT

The bill would create Chapter 16 (Creditor-Placed Insurance) within the Insurance Code to do all of the following:

- **Provide for creditor-placed insurance, which would allow creditors to purchase insurance on collateralized personal property and charge the cost of the coverage to the debtor.**
- **Require the debtor and creditor to enter into a credit agreement, which would state the debtor's responsibility to maintain insurance on the collateral, and authorize the creditor to place the insurance if the debtor failed to provide evidence of the insurance.**
- **Require that the creditor provide time and notice for the debtor to purchase insurance before creditor-placed insurance was purchased.**
- **Require that all policy forms and schedules for creditor-placed insurance be filed with the Commissioner of the Office of Financial and Insurance Services, who would have to approve or disapprove them.**
- **Authorize the Commissioner to conduct investigations or examinations of insurers and producers, and to bring an action in circuit court for an injunction or for restitution on behalf of wronged parties.**
- **Permit an insurer or producer to request a hearing to protest an order issued by the Commissioner.**

-- **Allow the Commissioner to levy monetary penalties against an insurer who had violated an order of the Commissioner.**

The bill would teak effect 90 days after its enactment.

Definitions

The bill would define "creditor-placed insurance" as insurance "that is purchased unilaterally by the creditor, who is the named insured, subsequent to the date of the credit transaction, providing coverage against loss, expense, or damage to the collateralized personal property as a result of fire, theft, collision, or other risks of loss that would either impair a creditor's interest or adversely affect the value of collateral covered by limited dual interest insurance". ("Collateral" would mean personal property that was pledged as security for the satisfaction of a debt.) Creditor-placed insurance would be purchased according to the terms of the credit agreement as a result of the debtor's failure to provide required physical damage insurance, with the cost of the coverage being charged to the debtor. It would be either single interest insurance or limited dual interest insurance.

"Single-interest insurance" would be defined as insurance purchased by the creditor to insure its interest in the collateral securing a debtor's credit transaction where all of the following conditions would have to be met for payment of loss under the policy: the debtor had defaulted in payment; the creditor had legally repossessed the collateral, unless collateral had been stolen from the debtor; and the creditor had suffered an impairment of interest. "Limited dual interest insurance" would mean insurance purchased by the creditor to insure its interest in the collateral securing the debtor's credit transaction. This type of insurance would waive the three conditions for loss payment under single interest insurance and would extend coverage on the collateral while in the possession of the debtor.

"Creditor" would mean the lender of money or vendor or lessor of goods, services, property, rights, or privileges for which is payment was arranged through a credit transaction, or any successor to the right, title, or interest of a lender, vendor, or lessor. "Debtor" would mean the borrower of money or a purchaser or lessee of goods, services, property, rights, or privileges, for which payment was arranged through a credit transaction. "Credit transaction" would mean a transaction by the terms of which the repayment of money loaned or credit commitment made, or payment of goods, services, or properties sold or leased, was to be made at a future date.

Policies

Under the bill, creditor-placed insurance would have to be set forth in an individual policy or certificate of insurance. A copy of the individual policy, certificate of insurance coverage, or other evidence of insurance coverage would have to be mailed via first class or delivered in person to the last known address of the debtor.

Commissioner Approval

The bill would require that all policy forms and certificates of insurance to be delivered or issued for delivery, as well as the schedules of premium rates pertaining to them, be filed with the Commissioner. Within 30 days after the forms, certificates, and schedules were filed, the Commissioner would have to disapprove a form or schedule if it did not conform to the standard in the bill for reasonable premiums.

If the Commissioner disapproved a form or schedule of premium rates, he or she promptly would have to notify the insurer in writing of the disapproval, and the insurer would be prohibited from issuing or using the form or schedule. The Commissioner would have to specify the reasons for disapproval in the notice, and state that a hearing would be granted upon request, pursuant to the Administrative Procedures Act (APA).

A schedule of premium rates would have to provide for premiums that were not unreasonable in relation to the benefits provided by the form to which the schedule applied. A premium rate or schedule of premium rates would be reasonable if the rate or schedule of rates produced, or were reasonably expected to produce, a loss ratio of 60% or greater. The Commissioner, however, could approve other loss ratios he or she found reasonable. ("Loss ratio" would mean the ratio of incurred losses to earned premium.)

Unless the Commissioner disapproved the form or schedule of premium rates as described above, or gave written approval of the form or schedule within 30 days after the filing, the form or schedule would be considered approved 31 days after the filing. The Commissioner could withdraw approval of an approved form or schedule of premium rates when he or she would be required to disapprove the form or schedule of premium rates if it were filed at the time of the withdrawal. The withdrawal would have to be in writing, and specify the reasons for withdrawal and the effective date of the withdrawal. An insurer adversely affected by a withdrawal could, within 30 days after receiving this notification, request a hearing pursuant to the APA, to determine whether the withdrawal should be annulled, modified, or confirmed. Unless the Commissioner granted an extension in writing in the withdrawal or subsequently granted an extension, the withdrawal, in the absence of a request for hearing, would become effective prospectively and not retroactively, 91 days after delivery of the notice of withdrawal and, if the request for hearing were filed, 91 days after delivery of written notice of the Commissioner's determination.

Premiums

The bill provides that premiums for creditor-placed insurance coverage could be calculated based on an amount not exceeding the net debt, even though the coverage could limit the insurer's liability to the net debt, actual cash value, cost of repair, or other premium calculation methods that more closely reflected the exposure of each item insured and approximated the premium calculation method of the coverage required by the credit agreement.

An insurer would be prohibited from writing creditor-placed insurance for which the premium rate differed from that determined by the schedule of the insurer on file with the Commissioner. The premium or amount charged to the debtor for creditor-placed insurance could not exceed the premiums charged by the insurer, computed at the time the charge to the debtor would be determined. Billing insurance charges to the debtor on closed-end credit transactions that created a balloon payment at the end of the credit transaction or extended the credit transaction's maturity date would be prohibited, unless specifically disclosed at the time of the origination of the credit agreement and specifically agreed to by the debtor at the time the charge was added to the outstanding credit balance.

Refund

Under the bill, an insurer would have to refund any unearned premium or other identifiable charges within 60 days after the termination of creditor-placed insurance. (The refund would have to be in accordance with Sections 2833(1)(h) and 3020(1)(c) of the Code, which state that the minimum earned premium must not be less than the pro rata premium for the expired time or $25, whichever is greater.) Within 60 days after the termination, the insurer also would have to give the debtor a statement of refund disclosing the effective date, the termination date, the amount of premium being refunded, and the amount of premium charged for the coverage provided.

If coverage under Chapter 16 were not provided, the entire amount of premiums, minimum premiums, fees, or charges of any kind would have to be refunded.

Loss Indemnification

If a loss were incurred under a creditor-placed insurance policy, the insurer would have to pay, at a minimum, the lesser of the following, determined as of the date of loss:

-- The cost to repair the collateral less any applicable deductible.
-- The actual cash value of the collateral, less any applicable deductible.
-- The net debt, less any applicable deductible. ("Net debt" would mean the amount necessary to liquidate the remaining debt in a single lump-sum payment, excluding all unearned interest and other unearned charges.)
-- The amount by which the creditor's interest was impaired, if single interest insurance were provided.

The bill provides that the net debt or actual cash value amounts could be reduced by the value of salvage if the insurer did not take possession of the insured property. ("Actual cash value" would mean the cost of replacing damaged or destroyed property with comparable new property, minus depreciation and obsolescence.) A creditor or insurer

would be prohibited from abandoning salvage to a towing or storage facility instead of paying storage fees without the consent of the facility and the claimant. The insurer would be responsible for the payment of towing and storage charges for a covered loss occurrence from the time the claim was reported to the insurer in accordance with the terms of the policy to the time the claim was paid. When the claim was paid, the insurer would have to give the claimant written notice that the claimant could incur storage charges after the date the claim was paid.

Whenever a claim was made on a creditor-placed insurance policy, the insurer would have to furnish the claimant with a written statement of the loss, explaining the settlement amount and the method of settlement. Further, in the event of a loss, no subrogation would run against the debtor from the insurer. (Subrogation refers to the substitution of one person in the place of another in regard to a lawful claim, demand, or right.)

Credit Agreement

Under the bill, for a creditor to place insurance on collateral pledged by the debtor and pass the cost of the insurance on to the debtor, all of the following would have to be met: The creditor would have to have a security interest in the collateral; the credit agreement would have to require the debtor to maintain insurance on the collateral to protect the creditor's interest; the credit agreement would have to authorize the creditor to place the insurance if the debtor failed to provide evidence of the insurance; and these requirements would have to be clearly disclosed to the debtor at the inception of the credit transaction. ("Credit agreement" would mean the written document that set forth the terms of the credit transaction and would include the security agreement.)

The debtor would have the right to provide required insurance through existing policies of insurance owned or controlled by the debtor or to procure and furnish the required coverage through an insurer authorized to transact insurance within the State. A creditor, however, could establish maximum acceptable deductibles, insurer solidity standards, and other reasonable conditions with respect to the required insurance.

Premiums Due from Creditors

Under the bill, the entire amount of the

premium due from a creditor would have to be remitted to the insurer or its producer in accordance with the insurer's requirements. No commissions could be paid to, or retained by, a person or entity except a licensed and appointed producer. (A "producer" would be a person who received a commission for insurance placed or written or who, on behalf of an insurer or creditor, solicited, negotiated, effected, procured, delivered, renewed, contained, or bound policies of insurance to which the bill applied. A producer would not include either a regular salaried officer, employee, or other representative of an insurer who devoted all of his or her working time to activities other than those described above for a producer, and who received no commission; or a regular salaried officer or employee of a creditor who received no compensation that was directly dependent on the amount of insurance effected or procured.)

A creditor could not retain unearned premiums upon cancellation of the insurance without crediting to the debtor's account the amount of unearned insurance charges.

Rebates

Rebates to the creditor of a portion of the premium charged to the debtor would be prohibited, as would be other inducements provided to the creditor by an insurer or producer. All of the following activities would be prohibited rebates or inducements:

- Allowing insurers or producers to purchase certificates of deposit from the creditor, or to maintain accounts with the creditor at less than the market interest rates and charges that the creditor applied to other customers for deposit accounts of similar amounts and duration.
- Paying a commission to a person, including a creditor, who was not appropriately licensed as a producer in the State.
- Purchasing or offering to purchase certificates of deposit from, or maintaining or offering to maintain deposit accounts or investment accounts with a creditor as part of a creditor-placed insurance solicitation.
- Any other activity identified by the Commissioner and prohibited by rule, regulation, or order.

Prohibited rebates or inducements would *not* include any of the following:

-- Paying commissions and other compensation to a duly licensed and appointed producer, whether or not affiliated with the creditor.
-- Paying to the creditor policyholder group experience rated refunds or policy dividends.
-- Paying to the creditor amounts intended to reimburse the creditor for its expenses incurred incidental to the creditor-placed insurance program, provided that these payments would be approved in a manner consistent with the procedures for Commissioner approval of policy forms and certificates (described above), and were calculated in a manner that did not exceed an amount reasonably estimated to equal the expenses incurred by the creditor.

Producer Commissions

An insurer who paid commissions to producers for creditor-placed insurance that were greater than 20% of the net written premium would have to demonstrate to the Commissioner that the commissions were not unreasonably high in relation to the value of the services rendered.

Insurers or producers would not be prohibited or restricted from maintaining a demand, premium deposit, or other account or accounts with a creditor for which the insurer or producer provided insurance, if the accounts paid the market interest rate and charges that the creditor applied to other customers for deposit accounts of similar amounts and duration.

Adequate Disclosure

Under the bill, a creditor would be prohibited from imposing charges, including premium costs and related interest and finance charges, on a debtor for creditor-placed insurance coverage, unless adequate disclosure of the requirement to maintain insurance had been made to the debtor. Adequate disclose would be accomplished if all of the following occurred: The credit agreement set forth the requirement that the debtor had to maintain insurance on the collateral (as described above); the creditor made reasonable efforts to notify the debtor of the requirement to maintain insurance, and allowed a reasonable time for compliance with the requirement; a final notice as required under the bill was sent to the debtor; and, if creditor-placed insurance coverage were issued, a copy of the policy or certificate was sent to the debtor.

After adequate disclosure of the request to maintain insurance had been made to the debtor, a creditor could proceed to impose charges for creditor-placed insurance if the debtor failed to provide evidence of insurance. A creditor could not impose charges earlier than 10 days after sending the final notice.

Reasonable efforts to notify the debtor would be accomplished if the creditor did all of the following:

-- Mailed a notice by first-class mail to the debtor's last known address as contained in the creditor's records, stating that the creditor intended to charge the debtor for creditor-placed insurance coverage on the collateral if the debtor failed to provide evidence of the property insurance to the creditor.
-- Allowed the debtor at least 20 days to respond to the notice and provide evidence of acceptable insurance coverage before sending a final notice.
-- Sent a final notice in compliance with the bill by first-class mail to the debtor's last known address at least 10 days before the creditor would charge the cost of insurance to the debtor. Proof of the mailing of the final notice would have to be retained for at least three years following the expiration or termination of the coverage, or as otherwise required by law.

The creditor would have to design and write the initial notice to remind the debtor of the requirements to maintain insurance on the collateral. The final notice would have to be as complete as the following example, printed in at least 12-point type, and modified where necessary to fit the nature of the credit transaction:

Final Notice

> Your credit agreement with us requires you to have property insurance on the collateral until you pay off your loan. You have not given us proof you have insurance on the property. You can ask your insurance company or agent to give us proof of insurance or you can

send us proof you have property insurance within 10 calendar days after the date this letter was postmarked. If you do not, we will buy the insurance and charge the cost to you.

You must pay for the property insurance we buy. It may cost more than insurance you can buy on our own. The cost of the insurance we buy may be added to your loan balance and we may charge you interest on it. If we do, you will pay interest at the same rate you pay on your loan.

The insurance we buy will pay claims to us (the creditor) for physical damage to your property. It will not pay you for any claims you make (and it may not pay you for any claims you make [delete if limited dual interest coverage]). The insurance we buy will not give you any liability insurance coverage and will not meet the requirements of a state's financial responsibility law.

We may receive compensation for placing this insurance, which is included in the cost of coverage charged to you. The property coverage we buy will start on the date shown in the policy or certificate, which may go back to the date of the loan or the date your prior coverage stopped. We will cancel the insurance we bought for you and give you a refund or credit of unearned charges if you give us proof you have bought property insurance somewhere else or if you have paid off the loan.

All creditor-placed insurance would have to be set forth in an individual policy or certificate of insurance. Not earlier than the sending of the final notice or 25 days after a charge was made to the debtor for creditor-placed insurance coverage, the creditor would have to send, via first-class mail, a copy of the policy, certificate, or other evidence of creditor-placed insurance coverage to the debtor's last known address.

Commissioner Investigation; Hearing

Under the bill, the Commissioner would have the authority to conduct investigations or examinations of insurers and producers to ensure compliance with and enforcement of the provisions of Chapter 16.

When the Commissioner found that an insurer or producer had violated a provision of the proposed chapter or a regulation promulgated under it, the Commissioner could issue an order directing that the insurer or producer cease and desist from committing the violation, impose a civil penalty for the violation, provide an equitable remedy for past violations, or order any combination of these.

Upon the issuance of an order, the insurer or producer could request a hearing. At the hearing, the burden would be on the insurer or producer to show cause why the issued order should be annulled, modified, or confirmed. Pending the hearing and the decision by the Commissioner, the Commissioner would be required to suspend the effective date of the order. Within 60 days of the hearing, the Commissioner would have to enter an order of final determination that would specify all relevant findings of fact, conclusions of law, and orders. With the agreement of each affected insurer or producer, and in lieu of a hearing, the Commissioner could enter into a consent agreement disposing of the matters that would be the subject of the hearing and order.

Court Action

The Commissioner could bring an action in the Ingham County Circuit Court for an injunction or other appropriate relief to enjoin threatened or existing violations of Chapter 16 or of the Commissioner's orders or regulations, or for restitution on behalf of those aggrieved by a violation of the proposed chapter or of the Commissioner's orders or regulations.

A person aggrieved by a final order, decision, finding, ruling, action, or inaction could seek judicial review as provided in Section 244 of the Code. (Section 244 provides insurers being investigated by the Commissioner with the right to judicial review, petition for stay of order, and an appeal of a court order issuing a stay.)

To the extent that the order of final

determination of the Commissioner was affirmed, the court would have to issue its own order commanding obedience to the terms of the Commissioner's order or final determination. If either party applied to the court for leave to produce additional evidence, and showed to the satisfaction of the court that the additional evidence was material and there were reasonable grounds for the failure to produce the evidence in the proceeding before the Commissioner, the court could order the additional evidence to be taken before the Commissioner and to be produced in a hearing. The Commissioner could modify the findings of fact or make new findings by reason of the additional evidence taken, and would have to file the modified or new findings with a recommendation, if any, for the modification or setting aside of the original order or final determination, with the return of the additional evidence.

A cease and desist order issued by the Commissioner would become final upon expiration of the time allowed for filing a petition for review, if no petition had been filed. The Commissioner, however, could modify or set aside the order to the extent provided in the bill, or upon the final decision of the court, if the court directed that the order of the Commissioner be affirmed or the petition for review dismissed.

A Commissioner order or an enforcement order of a court would not relieve or absolve any person affected by the order from liability under any other State laws.

Penalties

An insurer who violated an order of the Commissioner under this proposed chapter would have to be allowed a hearing before the Commissioner under the APA. If the Commissioner found a violation had occurred, he or she could order either or both of the following penalties: payment of a monetary penalty of up to $1,000 for each violation, but not to exceed an aggregate penalty of $100,000, unless the violation was committed in a conscious and flagrant disregard of Chapter 16, in which case the Commissioner could order the payment of a monetary penalty of up to $25,000 for each violation, but not to exceed an aggregate penalty of $250,000; or suspension or revocation of the insurer's license.

Ineligible Insurance

All creditor-placed insurance written in connection with credit transactions for personal, family, or household purposes would be subject to the provisions of Chapter 16, except for the following:

-- Transactions involving extensions of credit primarily for business or commercial purposes.
-- Insurance on collateralized real property.
-- Insurance offered by the creditor and elected by the debtor at the debtor's option.
-- Insurance for which no specific charge was made to the debtor or the debtor's account.
-- Blanket insurance, whether paid for by the debtor or the creditor. (The bill would define "blanket insurance" as insurance that provided coverage on collateral as defined in a policy issued to a creditor, without specifically listing the collateral covered.)

Creditor-placed insurance coverage would not include coverage for the cost of repossession; skip, confiscation, and conversion coverage; coverage for payment of mechanics' or other liens that did not arise from a covered loss occurrence; coverage that required a debtor's insurance deductible to be less than $250; and coverage that was broader than the insurance coverages that met the minimum insurance requirements of the credit agreement. Separate insurance policies or endorsements could be issued for these coverages; however, no charge could be passed along to the debtor for them.

Effective Date

The bill provides that creditor-placed insurance would become effective on the latest of the following dates: the date of the credit transaction; the date prior coverage, including prior creditor-placed insurance coverage, lapsed; one year before the date on which the related insurance charge was made to the debtor's account; or a later date provided for in the agreement between the creditor and insurer.

An insurance charge could not be made to a debtor for a term longer than the scheduled term of the creditor-placed insurance when it became effective, nor could it be made to the debtor for creditor-placed insurance before the

effective date of the insurance. If a charge were made to a debtor for creditor-placed insurance coverage that exceeded one year, the debtor would have to be notified at least annually that the insurance would be canceled, and a refund or credit of unearned charges would have to be provided if evidence of acceptable insurance secured by the debtor were provided.

Termination Date

Under the bill, creditor-placed insurance would terminate on the earliest of the following dates: a date other acceptable insurance became effective, subject to the debtor's providing acceptable evidence of other insurance to the creditor; the date the collateralized personal property was repossessed, unless the property was returned to the debtor within 10 days of the repossession; the date the collateralized personal property was determined by the insurer to be a total loss; the date the debt was completely extinguished; or an earlier date specified in the individual policy or certificate of insurance.

Other Provision

The bill specifies that a creditor's compliance with or failure to comply with Chapter 16 could not be construed to require the creditor to purchase insurance coverage on the collateral, and the creditor would not be liable to the debtor or a third party as a result of its failure to purchase the insurance.

Proposed MCL 500.1601-500.1631

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Currently, some insurance companies charge debtors for coverage beyond physical damage insurance, and some do not. Those that do not, believe that they are acting ethically, but that this choice puts them at a disadvantage in the marketplace: many creditors will choose to purchase a plan that allows them to charge the debtor, not themselves, for maximum coverage. Under the bill, when creditors purchased coverages above and beyond physical damage insurance, they could not pass the cost of those coverages on to the debtors. The bill would give all insurers clear guidelines about which coverage debtors would be required to pay for, thus allowing all insurers to conduct their business on a level playing field.

In addition, the bill would protect debtors from creditors' purchasing insurance on the debtors' property without their knowledge. A lender would have to provide clear information about the conditions of creditor-placed insurance at three points: at the time the loan contract was signed, at the time the insurance was eligible to be placed, and at the time the coverage was placed. Disclosure of the debtor's responsibility in maintaining coverage on the collateral at the inception of the loan contract could remedy the problem of debtors' failure to read or understand all the terms of the contract. In instances in which a debtor had maintained insurance on the collateral but received a warning that creditor-placed insurance was about to be purchased, the bill would provide the debtor with enough time to contact the lender and clear up the error.

Finally, the bill would give the Commissioner access to remedies and penalties in order to ensure that insurance companies and creditors complied with the requirements of the law. Currently, the Commissioner may take action against insurers that conduct unfair trade practices, but often the problems found in the creditor-placed insurance programs exist in the "fair" practices of the creditors. The bill would remedy this, as well as provide guidelines for lenders and protection for debtors.

Legislative Analyst: Claire Layman

FISCAL IMPACT

The bill would increase the responsibilities of the Commissioner of the Office of Financial and Insurance Services (OFIS) within the Department of Consumer and Industry Services. The added responsibilities would include approval or disapproval of forms, rate schedules, and related materials with regard to the proposed creditor-placed insurance. The Commissioner also would have the authority to conduct investigations of insurers offering creditor-placed insurance. A hearing process would be provided for review of contested disapprovals or penalties. These procedures would be similar to those for other

types of insurance filings. In FY 2001-02, the OFIS is funded entirely from restricted fee and assessment revenue. The requirements of the new program would increase the workload on existing personnel; however, Department staff indicate that the exact impact is not known.

The bill would have no fiscal impact on local government.

Fiscal Analyst: Elizabeth Pratt

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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.