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**SFA****BILL ANALYSIS**

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House Bill 4432 (Substitute H-1 as reported without amendment)  
Sponsor: Representative Larry Julian  
House Committee: Insurance  
Senate Committee: Banking and Financial Institutions

Date Completed: 5-8-03

### **RATIONALE**

The Insurance Code requires fire insurance policies to include certain mandatory coverage. In addition, the Code requires that each fire insurance policy "contain, at a minimum, the coverage provided in the standard fire policy under former section 2832". That section was repealed in 1990 and contained what was known as the "standard fire policy". These provisions reportedly have their roots in regulations written as early as the 1880s and were derived from the New York Standard Fire Policy first codified in the 1940s. The standard fire policy contained a list of exclusions ("perils not included") for losses caused directly or indirectly by enemy attack by armed forces; invasion; insurrection; rebellion; revolution; civil war; usurped power; order of any civil authority, with some exceptions for fire fighting orders; and neglect of the insured to use all reasonable means to save and preserve the property at and after a loss.

The September 11, 2001, attacks on the World Trade Center and the Pentagon introduced terrorism as a peril similar in potential catastrophic consequences and costs to those listed in the standard fire policy's perils not included. In response to the attacks, the Federal Terrorism Risk Insurance Act of 2002 was enacted. This Act requires insurance companies to make terrorism coverage available to their commercial policy customers (but does not make terrorism coverage mandatory), and provides that the Federal government will share in the cost of claims for losses due to terrorism that exceed certain amounts. In light of these developments, representatives of the insurance industry have been urging states to allow insurers to exclude terrorism from mandatory coverage in commercial fire

insurance policies in the same way that the policies may exclude losses from such perils as enemy attack and invasion.

### **CONTENT**

The bill would amend the Insurance Code to specify that a commercial fire insurance policy issued or delivered in Michigan could exclude coverage for loss by fire or other perils insured against, if the fire or perils were caused directly or indirectly by terrorism.

Under the bill, "terrorism" would mean any of the following:

- A certified act of terrorism as defined in the Terrorism Risk Insurance Act (116 Stat. 2322). (That Act defines "act of terrorism" as an act certified by the Secretary of the Treasury, in concurrence with the U.S. Secretary of State and the U.S. Attorney General, to be an act of terrorism; to be a violent act or act that is dangerous to human life, property, or infrastructure; to have resulted in damage within the United States or, under certain conditions, outside of the country; and to have been committed by an individual or individuals acting on behalf of any foreign person or foreign interest, as part of an effort to coerce the U.S. civilian population or to influence the policy or affect the conduct of the U.S. government by coercion.)
- A violent act or an act that was dangerous to human life, property, or infrastructure that was committed by one or more individuals and that appeared to be part of an effort to coerce a civilian population or to influence the policy or affect the conduct of any government by coercion.

-- Terrorism as defined in a form that was voluntarily filed under and subject to Section 2236 of the Code and was properly in use (MCL 500.2236). (That section provides for basic insurance policy forms or annuity contract forms to be filed with the Office of Financial and Insurance Services (OFIS) and approved by the OFIS Commissioner before the forms are issued or delivered to a person in Michigan, and exempts certain types of insurance from the filing requirement.)

The provision allowing exclusion of terrorism coverage would apply notwithstanding Section 2833 of the Code (which mandates certain coverage in fire insurance policies).

Proposed MCL 500.2834

### **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**

The events of September 11, 2001, introduced terrorism as a peril that can produce catastrophic losses and immense costs. While insurance coverage of those losses should be available, businesses should not have to acquire and pay for that type of protection if they do not want it or believe that it is unnecessary for them. Typically, businesses negotiate with insurers for the kind of insurance coverage they want, based on their own perceived needs and interests. By making terrorism coverage optional in commercial fire insurance policies, the bill would allow businesses to decide for themselves whether to pay a higher premium for that coverage. In addition, insurance companies would be better able to calculate their potential exposure. Since they would know which commercial policy-holders had terrorism coverage, insurers would have less uncertainty about the size of reserves they must maintain and the prices they charge. Losses from terrorism would join such existing exclusions from mandatory coverage as losses from enemy attack, invasion, insurrection, civil war, and revolution.

Also, the Terrorism Risk Insurance Act provides a kind of reinsurance for terrorism coverage, in recognition of the potential

enormous costs and the lack of available private reinsurance. The Federal statute requires insurance companies to make the coverage for Federally certified terrorism available as an option, but does not mandate that coverage. Michigan should conform to the Federal provision and exclude losses from terrorism from its mandatory coverages in commercial fire insurance policies.

**Response:** The bill refers to losses caused directly *or indirectly* by terrorism. There is some concern about how broadly this could be interpreted and applied. In addition, the definition of "terrorism" in the bill is broader than that contained in the Federal law. The Terrorism Risk Insurance Act refers specifically to actions committed "on behalf of any foreign person or foreign interest", while the bill's definition appears to encompass what might be called domestic terrorism as well as terrorism on behalf of a foreign person or interest.

#### **Supporting Argument**

According to the Insurance Institute of Michigan, a recent national survey conducted by the Council of Insurance Agents and Brokers revealed that many commercial insureds are not buying terrorism coverage because they do not consider themselves targets of terrorism, the cost is too high, or both. Reportedly, nearly 60% of the brokers responding to the survey indicated that less than 10% of their small commercial property/casualty accounts, and under 20% of medium-sized accounts, purchased terrorism coverage; of the brokers handling large accounts, 48% said that fewer than 20% of the biggest customers bought terrorism coverage. According to the Insurance Institute, this survey also provided the first national sampling of the cost of terrorism coverage, finding that most of the small and medium-sized accounts were being assessed 10% of their premiums, and large accounts typically paid 20% or less. Assuming that commercial policy-holders in Michigan were represented in this survey, the results provide support for making terrorism coverage optional. Businesses should not have to pay for the coverage if a majority of them do not want it and they must pay 10% to 20% higher premiums for it.

Legislative Analyst: Patrick Affholter

### **FISCAL IMPACT**

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

Fiscal Analyst: Maria Tyszkiewicz

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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.