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OF CALIFORNIA

9  
10 **CALIFORNIA OFFICE OF ADMINISTRATIVE LAW**

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12 In the Matter of the Review of the Petition for ) CASE NO. CTU2010-0329-02  
13 Determination re: )  
14 California Department of Insurance ) **PETITIONERS' REPLY TO**  
Communications to Insurers Dated February 10, ) **INSURANCE COMMISSIONER**  
15 2010, and March 4, 2010 ) **REGARDING REVIEW OF PETITION**  
16 \_\_\_\_\_ ) **FOR DETERMINATION**

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1 **I. INTRODUCTION**

2 The Insurance Commissioner has picked 51 corporations from throughout the world  
3 that are engaged in certain business in Iran. He concluded that any investment in any of those  
4 51 corporations is improper. He reached this conclusion while acknowledging that the  
5 investments in these 51 corporations “are in full compliance with state law,” including  
6 Insurance Code section 1241.1 that prohibits domestic insurers from acquiring any investment  
7 respecting a foreign jurisdiction designated as a state sponsor of terrorism (see the  
8 Commissioner’s February 10, 2010 press release, attached as Exhibit E to the Petition).

9 He instructed over 1,300 insurance companies doing business in California to report to  
10 him initially by March 12, 2010, what their plans were for making future investments in any of  
11 those 51 corporations. Finally, he ordered all 1,300 insurance companies to reduce the value of  
12 their investments by the value they attribute to the investments in those 51 corporations. In  
13 other words, he declared the value of any investment in those 51 corporations to be zero and  
14 ordered 1,300 insurance companies to remove those investments from their policyholder  
15 surplus (admitted assets minus liabilities), potentially affecting the ability of some insurance  
16 companies to continue to write insurance since surplus determines the financial capacity of a  
17 company to write insurance.

18 The Commissioner issued all of the directives described above, but contends before this  
19 Office that none of his conduct constitutes a rule of general application, that it was all done on  
20 a case-by-case basis, or simply the result of creating a report form. While he claims that his  
21 unprecedented conduct is not regulatory, he readily admits that he took the action that is the  
22 subject of this Petition.

23 Specifically, the Commissioner admits in his Response that he compiled a list of 51  
24 corporations doing business in Iran and that he ordered 1,300 insurance companies to report on  
25 their plans for future investments in those 51 corporations. In fact, in the Response, the  
26 Commissioner describes with apparent pride that 1,250 insurance companies responded and  
27 that over 1,000 stated that they had no plans to invest in any of those 51 corporations in the  
28 future. This can hardly be a surprise that so many companies responded as they did when the

1 Commissioner threatened to publish the names of the insurance companies that refused to  
2 promise that they would make no future investments in the 51 corporations that he  
3 characterizes as worthless, and even more problematic, that they support a terrorist nation.  
4 (See the Commissioner's February 10, 2010 letter, attached as Exhibit A to the Petition.)

5 In addition, the Commissioner admits in the Response that he ordered 1,300 insurance  
6 companies to treat investments in those 51 corporations as non-admitted assets, that is, treat  
7 them as though they have a value of zero. While the Response does not cite the level of  
8 compliance with this directive, it is no doubt quite high. The directive to treat investments in  
9 those corporations as non-admitted came with a tagline:

10 **“NON-COMPLIANT COMPANIES:** Companies that fail to submit a  
11 completed IRI-2010 Supplemental Filing by the due date requested will  
12 be considered in non-compliance and will be referred to the Department of  
Insurance's Legal Division for further action.”

13 In addition to the threats of adverse publicity and legal action, the Commissioner  
14 exercises extraordinary power over insurance companies. Whether it is in changes in policy  
15 forms, rate changes, market conduct exams, consumer complaints, or any of the 100 or so  
16 regulatory matters, the Commissioner, through the Department of Insurance, exercises the  
17 equivalent of life and death power over insurance companies. Hence, when the Commissioner  
18 issues directives and uses his “bully pulpit” to effect actions by insurance companies, his  
19 directives and pronouncements have the force of law.

20 The Commissioner, not once but twice, states in his Response that he used his “bully  
21 pulpit.” Using a bully pulpit, threatening adverse publicity and legal action if companies fail to  
22 comply with the Commissioner's directives, is, in essence, extra legal activity. While the  
23 directives alone constitute underground regulations, the combination demonstrates a significant  
24 reason why the Legislature enacted the Administrative Procedure Act, to create an open and  
25 fair process where the excesses of proposed administrative action can be addressed and the  
26 issues of necessity and legal authority can be highlighted and reviewed by this Office.

27 The Commissioner admits that he proceeded to issue and enforce his directives, making  
28 no attempt to comply with the APA. As a consequence, none of the APA safeguards are in

1 place. Accordingly, he is able through threats, intimidation, and the power of his office to  
2 compel insurance companies to comply with demands that exceed the Commissioner's  
3 jurisdiction and authority. He has issued and is enforcing underground regulations, that is the  
4 determination that the American Council of Life Insurers, the American Insurance Association,  
5 the Association of California Insurance Companies, the Association of California Life and  
6 Health Insurance Companies, and the Personal Insurance Federation of California have  
7 petitioned this office to make. This Reply is submitted on their behalf.

8 **II. THE COMMISSIONER'S DIRECTIVES RELATING TO INVESTMENTS IN 51**  
9 **CORPORATIONS LAWFULLY CONDUCTING BUSINESS IN IRAN ARE**  
10 **UNDERGROUND REGULATIONS**

11 While previous submissions in this case have addressed the Commissioner's directives  
12 as involving three regulations, in fact they are all part and parcel of one regulatory package.  
13 Compiling the list of 51 corporations that are engaged in certain business in Iran is significant  
14 not as an isolated activity, but as part of the Commissioner's directives to insurance companies  
15 to report on their plans regarding future investments in those 51 corporations and to treat  
16 investments in those corporations as non-admitted investments.

17 In other words, the issue is not whether the Commissioner can engage in an academic  
18 exercise compiling lists that pique his intellectual curiosity. The issue is whether he can  
19 compile a list and use that list to extract concessions from 1,300 insurance companies and order  
20 the write-down of insurance companies' surplus based on that list, all without complying with  
21 the APA.

22 The list is integral to the Commissioner's directives to the 1,300 insurance companies,  
23 and those directives are integral to the list. It is the totality that constitutes regulatory action  
24 requiring compliance with the APA.

25 **A. The Commissioner Admits That He Is Implementing and Interpreting Statutory Provisions**  
26 **That He Is Enforcing and Administering**

27 One of the features of a regulation is that it implements, interprets, or makes specific  
28 other provisions of law, typically statutory provisions, enforced or administered by the state  
agency adopting the standards. Government Code section 11342.600. The directives issued by

1 the Commissioner and that are the subject of this Petition were issued and enforced without  
2 reference to specific statutory provisions. The Commissioner, however, in his Response, sets  
3 out several provisions of the Insurance Code as the provisions of law that he is enforcing and  
4 administering.

5 None of the statutory provisions cited in the Response deal specifically with the issues  
6 raised in the Commissioner's directives that are the subject of this Petition. Hence, he is  
7 implementing and interpreting those statutory provisions. He admits as much in his Response.  
8 However, he asserts that he is interpreting the statutory provisions and applying his  
9 interpretations on a case-by-case-basis.

10 As will become apparent upon a review of the statutory provisions cited in the  
11 Response, the provisions relating to the solvency of insurance companies apply primarily to  
12 domestic companies, that is, those domiciled in California, not those domiciled in other states,  
13 but authorized to do business in California. Further, the Department of Insurance has  
14 interpreted California solvency laws as applying only to domestic companies. See, for  
15 example, section 2309.5 of the Commissioner's lawfully adopted regulations. It acknowledges  
16 that reports of an insurance company's financial position shall be "in conformity with statutory  
17 accounting practices prescribed or otherwise permitted by the Department of Insurance of the  
18 **state of domicile.**" (Emphasis added.) A review of the cited provisions will also demonstrate  
19 that the solvency provisions are to be applied separately to an individual insurance company  
20 based on its unique financial status, and that they call for a hearing before imposing  
21 administrative action.

22 Hence, a comparison of the statutes that the Commissioner states he is implementing  
23 and interpreting with his directives that are the subject of this Petition will demonstrate that he  
24 has not proceeded on a case-by-case basis, that he has not applied the statutory provisions to  
25 insurance companies on an individual basis, rather his directives apply to all 1,300 insurance  
26 companies without regard to their unique financial status, and that he has imposed  
27 administrative action through the directives without holding an administrative hearing.

28 In other words, the Commissioner has issued and is enforcing a standard of general

1 application. The standard of general application is his implementation and interpretation of the  
2 statutes he admits he is enforcing and administering.

3 B. The Financial Solvency Statutes That the Commissioner Is Enforcing Apply Principally to  
4 Domestic Insurance Companies Based On Their Individual Financial Status and Require A  
5 Hearing Before Taking Administrative Action

6 A brief description of insurance company financing law will help put the specific  
7 statutory provisions in context and reduce possible confusion. An insurance company has to  
8 satisfy two capital demands. The first is paid-in-capital. The laws of every state require  
9 insurance companies domiciled there to have a specified amount of paid-in-capital to begin  
10 business. Paid-in-capital is also referred to as general investments. Insurance Code sections  
11 1170-1182.

12 General investments are typically conservative investments such as federal and state  
13 bonds. *Id.* The specification of investments that satisfy the general investment or paid-in-  
14 capital requirement apply principally to domestic California companies. Insurance Code  
15 section 1170. Proof of paid-in-capital has to be established before the company can begin  
16 business.

17 The second kind of capital that an insurance company has is referred to as excess  
18 investments. Investments that exceed the required paid-in-capital constitute excess  
19 investments. California law specifies the kind of excess investments that can be held by a  
20 domestic insurance company. Insurance Code sections 1190-1202. These investments are less  
21 conservative than the paid-in-capital investments. Permitted excess investments vary,  
22 depending on the type of insurance the company sells and the value of its aggregated assets.

23 As part of the excess investment, California law permits domestic insurance companies  
24 to make discretionary investments and to invest in derivative transactions. Insurance Code  
25 sections 1210 and 1211. The latter investments typically carry more risk but offer the potential  
26 for greater return.

27 When insurance companies sell insurance, they take on risk, the risk of a claim being  
28 made and a payout being required. To assure that insurance companies have sufficient assets to

1 satisfy their claim obligations, the laws of every state require insurance companies domiciled in  
2 their states to maintain a certain amount of assets in relationship to the risk of claims. In  
3 California, this concept is referred to as risk-based capital, and the statute applicable to  
4 domestic insurers sets out a minimum ratio that different kinds of companies are to maintain in  
5 terms of investments versus risk. Insurance Code sections 739-739.12.

6 If an insurance company's assets or capital fall below the statutory set ratio, it is  
7 obligated to report that event to the Commissioner. *Id.* Hence, the rise or fall in the value of an  
8 insurance company's total investments may affect an insurance company's capacity to continue  
9 to write insurance, taking on more risk.

10 *1. The Commissioner's General Authority Regarding Solvency Does Not Support His Claim*  
11 *That He Issued the Directives That Are the Subject of This Petition on a Case-By-Case Basis*

12 The Commissioner states in his Response that he may take prompt action against all  
13 insurers that report inadequate levels of risk-based capital. As noted above, the statutory  
14 provisions relating to risk-based capital are set out in Insurance Code sections 739-739.12.  
15 Section 739.2 provides that, "Every domestic insurer shall, on or prior to each March 15 (the  
16 "filing date"), prepare and submit to the commissioner a report of its RBC Levels as of the end  
17 of the calendar year just ended, . . ." Based on the type of insurance company and the ratio  
18 between capital and risk, those factors can result in a "Company Action Level Event," a  
19 "Regulatory Action Level Event," an "Authorized Control Level Event," or a "Mandatory  
20 Control Level Event." An insurance company shall have a right to a departmental hearing, on  
21 the record, at which the insurer may challenge any determination or action by the  
22 commissioner. Insurance Code section 739.7. Moreover, it is clear from these provisions that  
23 the Commissioner's authority with respect to out of state domiciled, but admitted, insurance  
24 companies is very limited. See for example, section 739.10.

25 Nothing in any of the materials accompanying the directives issued by the  
26 Commissioner to the 1,300 insurance companies concerning their investments in any of the 51  
27 corporations doing business in Iran cites any risk-based capital event. While the Commissioner  
28 cites his general authority to respond to a report by the insurance company of a risk-based



1 capital event, those statutory provisions have no relevance to the directives that are the subject  
2 of this Petition. In fact, the Commissioner admits that no risk-based capital event occurred,  
3 nothing occurred that provides any basis for his action against any insurance company, and  
4 certainly not against 1,300 companies.

5 In his Response, the Commissioner states, “‘Non-admission’ of investments has not  
6 impaired any insurers’ surplus to trigger any action by the Department.” Response, page 9. In  
7 other words, treating the investments in the 51 corporations as non-admitted, that is, giving  
8 those investments a zero value, had no impact on any insurance company’s solvency, adversely  
9 impacting its ability to continue to write insurance. If no insurance company’s solvency was  
10 impacted after the write-down, certainly none would have reported a risk-based capital event  
11 prior to the write-down. After all, investments in those 51 corporations constitute only 0.15%  
12 of the total investments of the 1,300 insurance companies, hardly a percentage that raises  
13 solvency concerns (Exhibit E to the Petition).

14 Moreover, as noted, the provisions relating to risk-based capital apply to domestic  
15 insurance companies. The Commissioner’s directives pertaining to the investments in the 51  
16 corporations apply to all 1,300 insurance companies admitted to do business in California,  
17 including those domiciled in other states.

18 Also, a review of the administrative actions that the Commissioner is to take were a  
19 risk-based capital event to occur are totally unrelated to what the Commissioner did with  
20 respect to the investments in the 51 corporations. Nowhere in sections 739.-739. 12 is there a  
21 provision that the Commissioner may extract from insurance companies a concession that they  
22 will not make certain investments in the future, nor is there any authority to declare investments  
23 as non-admitted, an administrative action that would exacerbate the risk-based capital event if  
24 one were to exist.

25 The Commissioner also states in his Response that he “may similarly take prompt  
26 action against all insurers that had inadequate required deposits,” citing Insurance Code  
27 sections 939-956. This is a narrow, esoteric provision of insurance company financial law,  
28 applying primarily to companies writing workers compensation insurance. To ensure that a

1 company has sufficient assets to covers its worker compensation obligations, the law requires  
2 workers compensation insurance companies to deposit certain securities with the  
3 Commissioner. Those securities are not treated separately in terms of calculating risk-based  
4 capital events and are part of an insurance company's investments.

5 Again, the provisions of Insurance Code section 939-956 have no relevance to the  
6 directives that are the subject of this Petition. The directives issued by the Commissioner make  
7 no mention of securities deposited with the Commissioner or worker compensation insurance  
8 risk. Moreover, the statute provides that if the Commissioner determines that an individual  
9 insurance company's securities deposited with him are inadequate, he may order additional  
10 securities to be deposited. Nothing in those sections relate to anyone other than individual  
11 companies, nothing relates to the Commissioner's authority to compel insurance companies to  
12 agree to forego future investments, nothing relates to the Commissioner's authority to declare  
13 investments non-admitted.

14 The Commissioner, in his Response cites Insurance Code section 1069.2 as authority to  
15 issue cease and desist orders against all insurers that are in financially hazardous condition.  
16 Most likely, the Commissioner meant to cite Insurance Code section 1065.2 since there is no  
17 section 1069.2. Section 1065.2 is part of an article entitled "Stop Order Power of the  
18 Commissioner" and includes sections 1065.1 through 1065.7. Section 1065.1 begins:

19 "Whenever the commissioner has reasonable cause to believe, and  
20 determines, after a public hearing, that any person specified in Section  
21 1010 is conducting its business and affairs in such a manner as to threaten  
22 to render it insolvent, or that it is in a hazardous condition, or is  
23 conducting its business and affairs in a manner which is hazardous to its  
24 policyholders, creditors, or the public, or that it has committed or engaged  
25 in, was committing or engaging in, any act, practice, or transaction which  
26 under any provision of this code would constitute ground rendering the  
27 person subject to conservation or liquidation proceedings, he may make  
28 and serve upon the person such order or orders as shall be reasonably  
necessary to correct, eliminate or remedy such conduct, condition or  
ground."

As can be seen from section 1065.1, the stop-order power relates to a company that is  
conducting its business in a way that threatens to render it insolvent. As noted previously, the

1 Commissioner's directives pertaining to the 51 corporations are not based on the threatened  
2 insolvency of any insurance company. Certainly, none of the materials accompanying the  
3 directives refer to any insurance company's conduct that threatens to render it insolvent.  
4 Moreover, as noted above, the Commissioner admits that by completely writing off the value  
5 of the investments in the 51 corporations, no company's reserves were affected to create any  
6 limitations on its ability to continue to write insurance.

7  
8 If the Commissioner's position is that investing in the 51 corporations doing business in  
9 Iran is conduct that threatened the insolvency of insurance companies, to justify his case-by-  
10 case defense, he would have to have demonstrated that he made that specific determination  
11 "**after a public hearing**" with respect to each and every one of the 1,300 insurance companies.  
12 That simply did not happen. The Commissioner's own admission demonstrates that those  
13 investments had no impact on the solvency of any of the 1,300 insurance companies. He did  
14 not conduct one hearing and certainly not 1,300 hearings. Accordingly, Insurance Code  
15 section 1065.2 provides no support for the Commissioner's claim that he proceeded on a case-  
16 by-case basis.

17  
18 *2. The Commissioner's Specific Authority Regarding Solvency Does Not Support His Claim*  
19 *That He Issued The Directives That Are The Subject Of This Petition on a Case-By-Case Basis*

20 In addition to the provisions ostensibly relating to the Commissioner's general authority  
21 to deal with insolvent insurance companies, he cites specific sections. He cites his "duty to  
22 safeguard insurance portfolios by making determinations about investment soundness, quality,  
23 liquidity, and diversification," citing four specific statutory provisions. Each of those  
24 provisions will be analyzed below.

25 a. The Commissioner Did Not Proceed on a Case-By-Case Basis Under the Certificate of  
26 Authority Article

27 The Commissioner cites Insurance Code sections 706.5 and 717(b) as statutes he is  
28 applying on a case-by-case basis. Those two provisions are found in an article entitled,  
"Certificate of Authority." That article includes sections 699 through 728. It sets out

1 requirements that an insurance company must meet to be granted a certificate of authority to  
2 sell insurance in California.

3 For example, we discussed paid-in-capital earlier. Section 700.01 sets out the amount  
4 of paid-in-capital that is required, based on the kind of insurance the company proposes to  
5 write. Section 706.5 specifically authorizes the Commissioner to deny a certificate of authority  
6 if the insurer's investments "are not so made as to make available within a reasonable time  
7 sufficient monies to meet promptly any demand which might in the ordinary course of events  
8 be properly made against the insurer."

9 Section 717 deals with the qualifications of an applicant for a certificate of authority. It  
10 sets out ten factors that the Commissioner shall consider, (b) being one of those, the lawfulness  
11 and quality of investments. The balance of section 717 provides, "Upon consideration of all  
12 relevant qualifications, the commissioner shall issue a certificate of authority to such applicant,  
13 unless the commissioner shall have made a finding, or findings, that the applicant is materially  
14 deficient in respect to one or more of the items as outlined in (a) through (j) above."

15 Sections 706.5 and 717 have very limited application. They apply when a company is  
16 seeking a certificate to sell insurance in California. The Commissioner is to conduct a hearing  
17 in which he makes findings that the applicant is deficient. The directives that the  
18 Commissioner issued with respect to the 51 corporations went to over 1,300 insurance  
19 companies, all of whom have certificates of authority. Hence, neither of these sections have  
20 any relevance to the Commissioner's conduct with respect to the investments in the 51  
21 corporations.

22 It is of interest to note that section 720, which is part of the Certificate of Authority  
23 article, authorizes the Commissioner after notice and a hearing to adopt reasonable rules and  
24 regulations to carry out the purposes of the statutes governing the issuance, suspension and  
25 revocation of certificates of authority. It provides that such regulations shall be promulgated in  
26 accordance with the Administrative Procedure Act.

27 b. The Commissioner Did Not Proceed on a Case-By-Case Basis Under the Property  
28 Authorized for Excess Funds Investment Article

1           The Commissioner next cites section 1196. That section is part of an article entitled,  
2 “Property Authorized for Excess Funds Investments.” The specific subdivision he relies on is  
3 that, “Excess funds investments shall not be made in any stock or obligation unless: (a) The  
4 stock or obligation qualifies as a sound investment.” The implication of citing this section is  
5 that the Commissioner made the determination that the investments in the 51 corporation held  
6 by any number of the 1,300 insurance companies in varying amounts did not qualify as a sound  
7 investment. Assuming that is the decision that the Commissioner made, section 1202 sets out  
8 the administrative action that he may take.

9  
10           The commissioner may, in his discretion and **after hearing**, by a written order  
11 require the disposal of any investments made in violation of the provisions of  
12 this article, pending which disposal pursuant to such order no value shall be  
13 allowed for such investment in any statement, required by provision of this  
14 code, purporting to show the financial condition of the owner thereof, or in  
15 measuring the financial condition of the owner thereof for the purpose of  
16 determining whether such owner is solvent or insolvent. (Emphasis added.)

17           The directives issued by the Commissioner certainly result in “no value shall be allowed  
18 for such investment in any statement.” The Commissioner made that determination with  
19 respect to all 1,300 insurance companies and without a hearing for any of them as required by  
20 section 1202.

21           To sustain the Commissioner’s assertion that he proceeded on a case-by-case basis, he  
22 would be obligated under section 1202 to have conducted **a hearing for each and every**  
23 **insurance company** for whom he declared that investments in the 51 corporations had no  
24 value. The record is devoid of any evidence that even one hearing was conducted with respect  
25 to the investments by a single insurance company in any of the 51 corporations. Certainly, no  
26 information exists that he conducted a hearing for every insurance company holding an  
27 investment in any of the 51 corporations.

28           The Commissioner may argue that since he did not require the disposal of the assets, he  
had no obligation to proceed under section 1202. If so, that would be ironic. In his December  
2, 2009 press release (attached as Exhibit G to this Reply), the Commissioner said, “I call upon

1 the insurance industry to do what's right and divest themselves of these investments. If they do  
2 not do so voluntarily, I will use every tool at my disposal to force divestment.”

3 Moreover, no other remedy exists in the article in which section 1196 is found other  
4 than to proceed consistently with section 1202. The intent of his action is to compel disposal  
5 and it certainly resulted in the determination that those investments have no value. The fact  
6 that his directives resulted in that determination for all 1,300 insurance companies is a rule of  
7 general application. It is not a determination made on a case-by-case basis.

8 c. The Commissioner Did Not Proceed on a Case-By-Case Basis Under the Insurance Holding  
9 Company System Regulatory Act Article

10 Finally, the Commissioner cites section 1215.5(f)(6). That section is part of an article  
11 entitled, “Insurance Holding Company System Regulatory Act.” It pertains to investments and  
12 transactions with affiliates. Again, that article pertains to domestic insurers and it sets out  
13 specifically in section 1215.5 the factors to be considered in determining how to evaluate an  
14 investment in an affiliate. The specific section cited by the Commissioner pertains to an  
15 evaluation of the insurer's surplus in relationship to its liabilities and one of the factors among  
16 11 to be considered is “the quality, diversification, and liquidity of the insurer's investment  
17 portfolio.”

18 The article in which section 1215.5 is found pertains once again to domestic insurers. It  
19 relates to a very narrow circumstance of a holding company having invested in an affiliate. It  
20 does not apply, as the Commissioner's directives apply, to all 1,300 insurance companies doing  
21 business in the state of California. Moreover, the specific language relied on by the  
22 Commissioner relates to the quality, diversification and liquidity of the insurer's investment  
23 portfolio. By the specific terms, the Commissioner is obligated to look at the totality of the  
24 investments held by the affiliate in determining how to evaluate the investment held by the  
25 holding company. While this provision has very limited applicability, nothing in the materials  
26 accompanying the directives issued by the Commissioner suggests he made any evaluation of  
27 the quality, diversification and liquidity of any affiliate's investment portfolio before issuing  
28 the directives. This section provides no justification for the Commissioner's claim that he has

1 proceeded on a case-by-case basis.

2 Also, in the article pertaining to holding companies, other provisions specify the action  
3 that the Commissioner may take. None of those provisions authorize the Commissioner to  
4 compel a company to forgo future investments in any particular stock or to declare any  
5 particular stock as having no value. It is interesting again to note that section 1215.8 authorizes  
6 the Commissioner upon notice and an opportunity for all interested persons to be heard to issue  
7 rules and regulations as may be necessary to carry out the provisions of this article. It goes  
8 without saying that no notice and opportunity to be heard, as required by the Administrative  
9 Procedure Act, was made before the Commissioner issued the directives that are the subject of  
10 this petition.

11 *3. Other Arguments Offered by the Commissioner That He Proceeded on a Case-By-Case*  
12 *Basis or Was Merely Adopting a Form Provide No Support for His Claim That His Directives*  
13 *Are Not Underground Regulations*

14 The Commissioner, in his Response, argues that he made an individual determination  
15 with respect to each of the 51 corporations added to his list. He asserts, therefore, that he  
16 proceeded on a case-by-case basis and did not issue a rule of general application. To state the  
17 argument is to state its rebuttal.

18 The Commissioner regulates insurance companies. He does not regulate corporations  
19 doing business in Iran. As noted above, he proceeded against over 1,300 insurance companies  
20 in one fell swoop. He did not, as required by the solvency laws that he relies on, conduct any  
21 analysis of the financial condition of any of the 1,300 insurance companies. He treated them all  
22 the same. In fact, he proceeded to declare investments in the 51 corporations as having no  
23 value, even though every one of the 1,300 was solvent, having adequate reserves to continue  
24 operating without those investments.

25 The Commissioner asserts that asking 1,300 insurance companies what their future  
26 plans are with respect to investments in those 51 corporations was simply the creation of a  
27 form. The truth of the matter is that the form was written in a way to encourage an insurance  
28 company to concede that it would make no further investments in those 51 corporations.

1 Further, the Commissioner threatened to publish the names of all insurance companies that  
2 failed to make that concession. The effect of the Commissioner's conduct is to dictate specific  
3 investments that insurance companies cannot make. That goes much beyond the simple  
4 creation of a form. As such, it cannot fall within the exemption from the requirement that a  
5 standard of general application be adopted pursuant to the APA.

6 The Commissioner contends that insurance companies voluntarily agreed that they  
7 would not make future investments in any of the 51 corporations. As noted above, the form  
8 was worded so as to encourage insurance companies to make that selection. Further, the  
9 Commissioner threatened adverse publicity if they did not make that concession. Also, at the  
10 beginning of this reply, we emphasized the Commissioner's reliance on his "bully pulpit."  
11 Given the power of the Commissioner over insurance companies and the Commissioner's  
12 directive with respect to future investments in the 51 corporations, no basis is left for  
13 concluding that companies voluntarily conceded that they would not make future investments.

14 Certainly, the circumstances of the Commissioner's directives made it clear that he was  
15 proceeding as the regulatory authority over all 1,300 insurance companies. He was not  
16 engaged in an activity for which he had no interest in the outcome. Rather, he was heavily  
17 invested in discouraging future investments in the 51 corporations doing business in Iran, and  
18 he used the full force of his authority to compel the outcome he clearly wanted. Even apart  
19 from that effect, simply requiring insurance companies to reveal publicly their investments  
20 plans and strategies is regulatory in nature. Labeling the particular response as voluntary does  
21 not change the fact that the Commissioner compelled 1,300 insurance companies to report their  
22 plans with respect to investments in 51 corporations.

23 Similarly, the Commissioner claims that his directive that insurance companies treat all  
24 investments in the 51 corporations as non-admitted was no more than the creation of a form.  
25 Again, to state the argument is to state its rebuttal. The Commissioner created a supplemental  
26 form for 1,300 insurance companies to list any investments that they might have in any of those  
27 51 corporations. He then went beyond that and ordered every one of the 1,300 insurance  
28 companies to include their investments in any of those 51 corporations on that form so those



1 investments would be treated as non-admitted investment, that is, having no value. Again, the  
2 Commissioner's conduct goes much beyond the mere creation of a form. As such, it does not  
3 fall within the exceptions from the requirement that a rule of general application be adopted  
4 pursuant to the APA.

### 5 III. CONCLUSION

6 For the reasons set out above, this Office is urged to determine that the directives issued  
7 by the Commissioner, requiring 1,300 insurance companies to report on their plans for future  
8 investments in 51 corporations he listed as doing business in Iran and declaring the investments  
9 in those 51 corporations to be treated as non-admitted, is an underground regulation. The  
10 Commissioner's conduct in issuing these directives is in direct violation of the requirements of  
11 the APA. It is not credible to assert that directives issued to 1,300 insurance companies was  
12 done on a case-by-case basis. The sheer number of 1,300 insurance companies alone  
13 demonstrates that it is a rule of general application.

14 Contrary to the claims of the Commissioner, the directives are not mere forms and they  
15 are not a mere application of an interpretation of laws enforced and administered by the  
16 Commissioner. They are rules of general application implementing, interpreting and making  
17 specific the laws enforced and administered by him. Petitioners ask this Office to make that  
18 determination.

19 Dated: August 10, 2010

Respectfully submitted,

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22 By: 

GENE LIVINGSTON  
Attorney for Petitioners

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**EXHIBIT G**



CONSUMERS

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[News Overview](#) / [Press Releases](#) / [2010 Press Releases](#) / **Insurance Commissioner Poizner Protects California Policyholders from Risky Iran-Related Investments****News Overview****Press Releases**[2007 Press Releases](#)[2008 Press Releases](#)[2009 Press Releases](#)[→ 2010 Press Releases](#)**Studies, Reports & Publications****NEWS: 2010 PRESS RELEASE**For Release: February 10, 2010  
Media Calls Only: 916-492-3566**Insurance Commissioner Poizner Protects California Policyholders from Risky Iran-Related Investments**

List of 50 Companies Doing Business with Iranian Nuclear, Energy &amp; Defense Sectors Released

California Insurance Commissioner Steve Poizner today released a list of 50 companies doing business in the Iranian oil and natural gas, nuclear and defense sectors and announced that as of March 31, 2010, no investments that an insurer holds in any of those companies will be recognized on its financial statements in California.

"The deteriorating situation in Iran only underscores the need to take action to ensure that insurance company portfolios are not at risk from Iran-related holdings," said Commissioner Poizner. "After careful research and consultation, we have compiled a list of 50 companies that are doing business with the Iranian oil and natural gas, nuclear, and defense sectors. Those investments are subject to increased financial risk and insurers should avoid future investments in these 50 Iran-related companies."

Two insurance companies - one a major health insurer, the other a major personal lines carrier -- have stepped forward and agreed to divest Iran-related investments. These companies have asked the department not to reveal their identities. Negotiations continue with several other companies that have initiated discussions with the department on voluntary divestment.

"Investments in companies with certain ties to Iran encounter special reputational risks that can have an impact on share value, often in a manner that is asymmetric to the actual business activity in that country," said Roger Robinson, CEO of RWR Advisory Group, a Washington DC-based research and consulting firm that specializes in the assessment and management of global security risk. "Adverse public reaction brought on by corporate activity in Iran can cause an investment in such companies, including those identified by the Department, to take hits to corporate reputation and even share value when the size of the business transactions would otherwise be immaterial."

Commissioner Poizner set forth his actions in a letter sent to all 1,300 insurance companies that are licensed to do business in California. The letter, which is attached, contains three parts:

First, the letter shares with all insurers the indirect investment list. The 50 companies span 20 countries (all foreign) across four continents. The Department developed the list following extensive research and analysis; consultation with experts RWR Advisory Group and Conflict Securities Advisory Group (two research and consulting firms that specialize in the assessment and management of global security risk - i.e., risk associated with corporate ties to countries presenting security, terrorism or weapons proliferation concerns) and KLD Research and Analytics, Inc. (a firm specializing in corporations' Iran-related business activities); and review of lists developed by the California, Florida, and New York public pension funds. The list includes well-known companies such as Royal Dutch Shell Plc of the United Kingdom and Siemens AG of Germany, as well as lesser known companies such as Ulan-Ude Aviation Plant JSC of Russia, OMV of Austria and Dragon Oil PLC of Ireland. Of the 1,300 insurers licensed to do business in California, about 340 hold investments in companies on the list. Those investments total approximately \$6 billion.

Second, the letter announces that effective March 31, 2010, the Department will not give statement credit for investments in companies on the List. The Commissioner has determined that companies on the List are subject to financial risk as a result of doing business with the Iranian oil and natural gas, nuclear and defense sectors. Iran is economically and politically unstable. It faces wide-ranging international sanctions in response to its efforts to develop nuclear weapons and its sponsorship of international terrorism, with many countries contemplating adopting additional sanctions.

The elimination of statement credit for investments in companies on the list will mean that insurers will be required to reduce the capital and surplus reported on their financial statements by the amount of investments in these 50 companies. California law requires insurers to carry a minimum level of capital and surplus in order to continue to be licensed to sell insurance in this state.

Third, the Commissioner's letter requests that all insurers licensed to do business in California agree not to make future investments in any companies on the list or in any affiliates owned 50 percent or more by those companies until either (a) Iran is removed from the United States State Department's list of state sponsors of terrorism or (b) the company and its affiliates cease to do business with Iran's oil and natural gas, nuclear and defense sectors and is removed from the list.

Attached is the Department's form which all insurers must complete and return to the Department by March 12, 2010 indicating whether they will agree not to invest in the future in companies on the list.

The Department's analysis of the approximately \$6 billion invested by insurers in companies on the list shows that:

- The approximately \$6 billion in Iran-related investments accounts for only 0.15 percent of the total estimated \$4 trillion in investments by insurance companies licensed to do business in California.
- Insurers acquired \$1.8 billion in Iran-related investments in 2008 and \$2.4 billion during the first quarter of 2009.
- Companies on the list by geographic breakdown:
  - Asia: 22
  - Europe: 20
  - Russia: 6
  - Africa: 1
  - Australia: 1

The Department continues to investigate banks that may be doing business with the Iranian petroleum and natural gas, nuclear and defense sectors and may supplement its list in the future.

Earlier this month, Commissioner Poizner announced that 100 percent of the 1,327 insurance companies licensed in California responded to his request to provide data on their investments with companies doing business with Iran's oil and natural gas, nuclear, and defense sectors.

Commissioner Poizner first announced his Terror Financing Probe in June 2009 to review compliance with a recent California law that prohibits insurers from investing in designated state sponsors of terror. As part of a data call issued by the Commissioner, insurance companies were required to identify their direct investments in designated sectors of the Iranian economy and indirect investments in companies doing business in those sectors. In December, the Department announced that insurers reported no direct investments in Iran and therefore are in full compliance with state law prohibiting those investments. But the Department uncovered billions of dollars of indirect investments in companies doing business with the Iranian oil and natural gas, nuclear and defense sectors.

List of 50 companies can be found by selecting this [link](#).

Letter form sent to companies can be found by selecting this [link](#).

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Please visit the Department of Insurance Web site at [www.insurance.ca.gov](http://www.insurance.ca.gov). Non media inquiries should be directed to the Consumer Hotline at 800.927.HELP. Callers from out of state, please dial 213.897.8921. Telecommunications Devices for the Deaf (TDD), please dial 800.482.4833.

If you are a member of the public wishing information, please visit our [Consumer Services](#).

3 **DECLARATION OF SERVICE**

4 I am a citizen of the United States, over the age of 18 years, and not a party to or  
5 interested in this action. I am employed in the County of Sacramento, State of California and  
6 my business address is Greenberg Traurig, LLP, 1201 K Street, Suite 1100, Sacramento, CA  
7 95814. On this day I caused to be served the following document(s):

8 **PETITIONERS' REPLY TO INSURANCE COMMISSIONER REGARDING REVIEW  
9 OF PETITION FOR DETERMINATION**

10  by placing  the original  a true copy into sealed envelopes addressed and served as  
11 follows:

12 Susan Lapsley Office of Administrative Law

13 Kathleen Eddy

14 Elizabeth Heidig

*Via Hand-Delivery and E-mail*

15 OFFICE OF ADMINISTRATIVE LAW

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22 Adam M. Cole, Esq.

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Insurance

23 Bryant W. Henley, Esq.

24 James W. Holmes, Esq.

25 George Teekell, Esq.

*Via U.S. Mail and E-mail*

26 CALIFORNIA DEPARTMENT OF

27 INSURANCE, LEGAL DIVISION

28 45 Fremont Street, 23<sup>rd</sup> Floor

San Francisco, CA 94105

(415) 538-4500 Telephone

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Mr. Steve Poizner, Commissioner  
CALIFORNIA DEPARTMENT OF  
INSURANCE

California Insurance Commissioner

300 Capitol Mall, 17<sup>th</sup> Floor

*Via Hand-Delivery*

Sacramento, CA 95814

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I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on August 10, 2010 at Sacramento, California.

  
S. LYNNE GOMES

SAC 441,782,553v1 8-10-10