PIFC

STATE FARM
FARMERS
LIBERTY MUTUAL INSURANCE
PROGRESSIVE
ALLSTATE
MERCURY
NATIONWIDE

August 7, 2013

Sent via email to jack.hom@insurance.ca.gov

Re: Comments on Proposed Regulation re "Hazardous Financial Conditions; Corrective Actions"

DOI File # REG-2013-00005

Dear Mr. Hom:

On behalf of the members of the Personal Insurance Federation of California ("PIFC"), we appreciate the opportunity to provide written comments to the California Department of Insurance ("Department") regarding the above-referenced proposed regulation ("Proposed Regulations").

PIFC member companies provide home, auto, flood and earthquake insurance for millions of Californians. Our member companies, State Farm, Farmers, Allstate, Liberty Mutual Insurance, Progressive, Allstate, Mercury and Nationwide, write the majority of home and auto insurance sold in this state.

For the reasons set forth below, PIFC respectfully requests that the Commissioner revise the Proposed Regulation in the following ways:

1. Modify the Purpose Section 2598.1[1] to clarify that these regulations are intended to set forth the standards that the commissioner may use for identifying insurers found to be in such negative financial condition as to threaten their solvency;

2. Modify the Standards Section 2598.2 to clarify what findings may be used to determine if an insurer is in a financial hazardous condition;

3. Delete the reference to "market conduct examination reports" in Section 2598.2(a); and

4. Substitute a right for the affected insurer to request a hearing before an administrative law judge in place of the right to request a meeting with the Commissioner as currently provided in Section 2598.3(c).

[1] All citations herein are to the Proposed Regulation unless otherwise noted.

Personal Insurance Federation of California
1201 K Street Suite 950 Sacramento California 95814
T (916) 442 6646 F (916) 446 9548 E **www.pifc.org**

THE REGULATION DOES NOT MEET THE REQUIREMENTS OF GOVERNMENT CODE SECTION 11349.1.

Clarity

The Proposed Regulation fails to meet the clarity standard as defined under the Administrative Procedure Act (APA) Section 11349(c). "Clarity means written or displayed so that the meaning of the regulations will be easily understood by those persons directly affected by them." An ambiguous regulation that does not comply with the rulemaking procedures of the APA is void. (*Capen v. Shewry (2007) 65 Cal.Rptr.3d 890*).

1. **Section 25981 Lacks Clarity as to the Regulation's Purpose**

Currently, the proposed regulation is not clear in its purposes to address negative financial conditions with respect to insurers. This could be resolved by amending the purpose section 2598.1 as follows:

> 25981. Purpose
>
> The purpose of these regulations is to set forth the standards that the commissioner may use for identifying insurers found to be in such negative financial condition as to threaten their solvency, thereby rendering the continuance of their business hazardous to their policyholders, creditors or the general public.

2. **Section 2598.2 Lacks Clarity with Respect to the Standards Used in Determining if an Insurer Is In a Financial Condition that Could Be Hazardous**

The proposed regulation also fails to meet the clarity standard with respect to the standards used in determining if an insurer is in a financial condition that could be hazardous to its policyholders, creditors or the general public. To address this clarity issue, PIFC recommends amending the Standards section 2598.2 as follows:

> 2598.2 Standards
>
> The following standards, either singly or a combination of two or more, may be considered by the commissioner to determine whether the continued operation of any insurer transacting an insurance business in this state might be deemed to threaten the solvency of the insurer and thereby be hazardous to its policyholders, creditors or the general public. The commissioner may consider:

(t) Any other finding related to the financial condition of an insurer, which, ~~determined by the commissioner~~ according to presently accepted actuarial standards of practice, might be deemed to threaten the solvency of the insurer and thereby be hazardous to the insurer's policyholders, creditors or general public.

Consistency

Consistency is defined in the Government Code Section 11349(d) as "being in harmony with, and not in conflict with or contradictory to, existing statutes, court decisions, or other provisions of law. An agency has no authority to promulgate a regulation that is inconsistent with controlling law (*Communities for a Better Environment v. California Resources Agency (2001) 103 Cal.App.4th 98*), nor with the governing statute. (*Pulaski v. California Occupational Safety and Health Standards Board (1999) 5 Cal.App.4th 98*).

1. **Section 2598.2(a)'s Reference to "Market Conduct Examination Reports" is Inconsistent with the Regulation's Focus on an Insurer's Financial Condition**

Section 2598.2 states those factors that may be considered by the Commissioner in determining whether the continued operation of any insurer transacting business in the state might be deemed to be "hazardous" to its policyholders, creditors or the general public. These factors properly include matters that regulators have long recognized as directly impacting an insurer's financial condition, including negative findings in financial examination reports, audit reports, actuarial opinions, and under the NAIC Insurance Regulatory Information System.

There is one exception to the Regulation's focus on an insurer's financial condition. This is Section 26952(a)'s reference to ***"market conduct examination reports"*** which, under California regulatory law, deal with an insurer's underwriting, rating and claims payment practices – not its financial condition.

PIFC respectfully submits that including adverse findings reported in a market conduct examination report as a potential trigger for the Commissioner to make a determination that the insurer is in a hazardous condition is misplaced because the Proposed Regulation, as its name "Hazardous ***Financial*** Conditions; Corrective Actions" (emphasis added) clearly addresses an insurer's ***financial*** condition and market conduct examination reports (as discussed below) have no bearing upon an insurer's financial condition. It is also contrary to the meaning of the term "hazardous" as used in Insurance Code §1065.1, which forms the principal basis for the Proposed Regulation, and generally under California's insurance laws.

In this regard, we note that the California courts have established that, in the context of insurers, "the term 'hazardous' . . . encompasses only dangers financial in nature" and that "no authority is cited . . . which supports any other interpretation." Blood Service Plan Ins, Co. v. Roddis, 259 Cal. App. 2d 807, 812 (1968) relying upon In re Bohlinger, 305 N.Y. 258, 262 (1953); see also Thacher v. City Terrace Cultural Center, 181 Cal. App. 2d 433, 442 n.2 ("the term 'hazardous' .

. . encompasses only dangers financial in nature. In our view, however, the record suggests that further operation of the I.W.O would prove 'hazardous' in a financial sense").

The financial nature of the Proposed Regulation is likewise evidenced by the repeated references to the word "financial" in both the Commissioner's Initial Statement of Reasons, dated June 21, 2013 ("ISR"), and the text of the Proposed Regulation itself. See e.g., ISR at p. 2 ("The proposed regulations are intended to provide guidance . . . in determining whether an insurer is operating in a hazardous ***financial*** condition") (emphasis added); ISR at p. 2 ("These proposed regulations . . . will ensure that California's laws are consistent with other states' laws in monitoring the ***financial*** condition of insurers . . .") (emphasis added); Section 2598.3(a)("For the purposes of making a determination of an insurer's ***financial*** condition under these regulations, the commissioner may . . . .") (emphasis added).

Consequently, Section 2598.2 "Standards" of the Commissioner's proposed "Hazardous Financial Conditions" regulation should include only those standards that bear some rational relationship to an insurer's ***financial*** condition.

Market conduct examination reports issued by the Commissioner -- as distinct from financial examination reports -- do not examine an insurer's financial condition. Instead, market conduct examination reports issued by the Commissioner address the following two subject areas of an insurer's operations: (i) claims handling practices and (ii) rating and underwriting practices. See http://www.insurance.ca.gov/0500-about-us/0500-organization/0100-consumer-services/market-conduct/index.cfm.

The stated objective of the Commissioner's claims handling market conduct examination process is to "protect California insurance consumers and claimants by enforcing the California Insurance Code, California Code of Regulations and related applicable laws through examinations of ***the claims handling practices*** of insurance entities doing business in the State of California." See http://www.insurance.ca.gov/0500-about-us/0500-organization/0100-consumer-services/market-conduct/field-claims.cfm (emphasis added).

The express objective of the Commissioner's rating and underwriting market conduct examination process is to "protect California insurance consumers by enforcing the provisions of the California Insurance Code and other applicable insurance laws through on-site examinations and special investigations of the ***rating and underwriting practices*** of licensed California . . . insurers." See http://www.insurance.ca.gov/0500-about-us/0500-organization/0100-consumer-services/market-conduct/field-rating.cfm (emphasis added).

As apparent from the aforementioned descriptions taken from the CDI's web site, neither the claims handling practices nor the rating and underwriting market conduct examinations that are conducted by the Commissioner investigate an insurer's financial condition. As such, none of these market conduct examination reports would provide the Commissioner with any relevant or probative information regarding an insurer's financial condition or otherwise provide any evidence that a particular insurer is likely to be in a hazardous financial condition.

Consequently, the Commissioner should delete what appears to be an incongruous reference to market conduct examination reports in Section 2598.2(a) to avoid what would be an unprecedented expansion of the term "hazardous condition" to include non-financial aspects of an insurer's operations. See Roddis, supra at 812; Thacher, supra at 442 n.2.

We would also note that the California Insurance Code ("CIC") already contains separate and distinct statutory remedies that authorize the Commissioner to take corrective action against an insurer in the event adverse findings are reported in a market conduct examination report. See Cal. Ins. Code § 790.05 (authorizing Commissioner to initiate administrative proceedings against any insurer that has engaged in unfair claims settlement practices and to impose a civil penalty upon any such insurer); Cal. Ins. Code § 1858.1 (authorizing Commissioner to initiate administrative proceedings against any insurer that has employed any rating and underwriting practices that violate the CIC and to impose a civil penalty upon any such insurer).

Thus, the CIC already provides the Commissioner with an effective remedy for addressing any deficiencies that might appear in an insurer's market conduct reports. There is no need to duplicate this statutory right by incorporating market conduct examination reports into a Proposed Regulation that is directed at clarifying when the Commissioner has the authority to make a determination that an insurer is in a hazardous financial condition.

We submit that including adverse findings contained in a market conduct examination report as a standard in a Proposed Regulation that is intended to address hazardous financial conditions would (i) include an item that bears no logical relationship to an insurer's financial health into a set of standards that are designed to allow the Commissioner to evaluate whether an insurer is in a hazardous financial condition, (ii) be inconsistent with the definition of "hazardous condition" recognized under California law, and (iii) conflict with (and undermine) the separate administrative processes that exist currently in CIC § 790.05 and CIC § 1858.1 that provide the Commissioner with a mechanism for addressing an insurer's market conduct related deficiencies.

Based upon the foregoing, PIFC respectfully requests that the Commissioner delete the reference to "market conduct examination reports" in Section 2598.2(a) in the final version of the Proposed Regulation.

2. The Regulation Should Substitute a Right for the Affected Insurer to Request a Hearing before an Administrative Law Judge in Place of the Right to Request a Meeting with the Commissioner

Section 2598.3(c) provides that an insurer subject to an order of the Commissioner finding its continued operation to be hazardous to its policyholders, creditors or the general public "shall have the opportunity to be heard." Under the Proposed Regulation as drafted this opportunity to be heard is limited to the right to "request a meeting with the commissioner pursuant to Section 12919 of the Insurance Code." Section 2598.3(c) does not appear to provide affected insurers with the right to an administrative hearing.

This failure to provide an administrative hearing appears to conflict with the express terms of CIC § 1065.1 and CIC § 1065.2. Pursuant to CIC § 1065.1, if the Commissioner has reasonable cause to believe that an insurer "is in a hazardous condition, or is conducting its business and affairs in a manner which is hazardous to its policyholders, creditors or the public," the Commissioner is required make that determination "after a public hearing." See Cal. Ins. Code § 1065.1.

Likewise, CIC § 1065.2 allows the Commissioner to "without notice, and before a hearing" issue a cease and desist order against an insurer that is in a hazardous condition or is conducting its business and affairs in a manner which is hazardous to its policyholders, creditors or the public, if the Commissioner believes that he must act immediately to avoid "irreparable loss and injury." Nevertheless, if the Commissioner avails himself of his power under CIC § 1065.2 to act "before a hearing," the Commissioner is required to "issue and also serve upon the person [i.e., insurer] a notice of hearing to be held at a time and place fixed therein which shall not be less than 20 or more than 30 days after the service thereof." See Cal. Ins. Code § 1065.2(b).

Thus, an insurer deemed by the Commissioner to be in a hazardous condition has a statutory right to an administrative hearing under both CIC § 1065.1 and CIC § 1065.2.[2] Accordingly, allowing the Commissioner to make a determination of hazardous condition based on a meeting with the Commissioner and without holding a public hearing (in accordance with the provisions of proposed Section 2598.3(c)) would arguably defeat the insurer's statutory right to a hearing under CIC § 1065.1 and CIC § 1065.2.

For this reason, PIFC respectfully requests that the Commissioner substitute a right for the affected insurer to request a public hearing before an administrative law judge in place of the right to request a meeting with the Commissioner that is currently provided in Section 2598.3(c).

In closing, PIFC appreciates the efforts of the Commissioner and Department to implement the NAIC model regulation while at the same time maintaining clarity and the consistency of the Proposed Regulation with California law. PIFC wishes to thank you in advance for consideration of these comments and invites you to contact us with any questions.

Respectfully,

Kara Cross
PIFC General Counsel

[2] We observe that the CIC provides the affected insurer with the option of pursuing an administrative hearing or bypassing the administrative process and seeking judicial relief. See Cal. Ins. Code § 1065.2(c)("At any time prior to the commencement of a hearing as provided in section 1065.1 or subdivision (b) of this section, the person may waive a hearing and have judicial review of the order . . .").