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9 CALIFORNIA OFFICE OF ADMINISTRATIVE LAW

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13)
14 CALIFORNIA DEPARTMENT OF)
15 INSURANCE)
16 COMMUNICATIONS TO INSURERS)
17 DATED FEBRUARY 10, 2010, AND)
18 MARCH 4, 2010.)
19)
20)

**PETITION FOR DETERMINATION
PURSUANT TO CALIFORNIA
GOVERNMENT CODE § 11340.5**

21 **1) INTRODUCTION.** The Petitioner has been retained by and is acting on behalf of the
22 American Council of Life Insurers (ACLI), the American Insurance Association (AIA), the
23 Association of California Insurance Companies (ACIC), the Association of California Life and
24 Health Insurance Companies (ACLHIC), and the Personal Insurance Federation of California
25 (PIFC). This petition is submitted to the Office of Administrative Law (OAL) requesting a
26 determination pursuant to California Government Code § 11340.5¹ of whether the
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28 ¹ Section 11340.5 provides in pertinent part “(a) No state agency shall issue, utilize, enforce, or attempt to enforce any guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule, which is a

1 above-captioned communications contain underground regulations as defined by title 10, Cal
2 Code Regs § 250(a)². These communications designate certain companies as “doing business
3 with the Iranian oil and natural gas, nuclear, and defense sectors”, they require each California-
4 licensed insurer to submit a statement to the California Department of Insurance (Department)
5 stating its future intentions regarding investment in the designated companies, and they require
6 all insurers to report investments in those companies as non-admitted assets on their quarterly
7 and annual statements. These requirements in the communications are illegal underground
8 regulations.

9 An underground regulation is invalid and unenforceable³. By issuing these underground
10 regulations, the Department is attempting to implement regulations which are void, and therefore
11 unenforceable. If the Department wishes to implement the rules that it is attempting to impose
12 through these underground regulations it must do so within the scope of its statutory authority
13 pursuant to section 11342.1 of the Government Code⁴ and it must comply with the other
14 procedural and substantive requirements of the California Administrative Procedure Act (APA),
15 found in California Government Code sections 11340 *et seq.*

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18 regulation as defined in Section 11342.600, unless the guideline, criterion, bulletin, manual, instruction, order,
19 standard of general application, or other rule has been adopted as a regulation and filed with the Secretary of State
20 pursuant to this chapter. ¶ (b) If the office [OAL] is notified of, or on its own, learns of the issuance, enforcement of,
21 or use of, an agency guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other
22 rule that has not been adopted as a regulation and filed with the Secretary of State pursuant to this chapter, the office
23 may issue a determination as to whether the guideline, criterion, bulletin, manual, instruction, order, standard of
24 general application, or other rule, is a regulation as defined in Section 11342.600.”

22 ² Title 10, Cal Code Regs 250(a) “‘Underground regulation’ means any guideline, criterion, bulletin, manual,
23 instruction, order, standard of general application, or other rule, including a rule governing a state agency procedure,
24 that is a regulation as defined in Section 11342.600 of the Government Code, but has not been adopted as a
25 regulation and filed with the Secretary of State pursuant to the AP A and is not subject to an express statutory
26 exemption from adoption pursuant to the APA.”

25 ³ A “regulation or order of repeal may be declared to be invalid for a substantial failure to comply with [the
26 rulemaking chapter of the APA]” Cal Gov Code § 11350.

26 “[W]e conclude that DLSE’s policy for determining whether to apply IWC wage orders to maritime employees
27 constitutes a regulation and is void for failure to comply with the APA.” *Tidewater Marine Western, Inc. v.*
28 *Bradshaw*, 14 Cal. 4th 557, 576 (Cal. 1996)

28 ⁴ The pertinent part of Cal Gov Code § 11342.1 provides that “Each regulation adopted, to be effective, shall be
within the scope of authority conferred and in accordance with standards prescribed by other provisions of law.”

1 This petition does not ask OAL to determine whether or not the Department actually has
2 authority to issue the challenged underground regulations. Such a determination is beyond the
3 scope of a petition pursuant to Gov. Code § 11340.5. An evaluation of the scope of the
4 Department's authority should occur in the course of formal APA rulemaking. The Department
5 has never identified specific statutes which might authorize these actions, as it would be required
6 to do in formal APA rulemaking. By issuing these rules as underground regulations, without
7 going through formal APA rulemaking, the Department has avoided any scrutiny regarding its
8 legal power, or lack thereof, to impose these requirements. Only by requiring the Department to
9 obey the APA may its authority, or its lack of authority, be revealed.

10 The Department's authority is certainly not unlimited. An earlier attempt by the
11 Department to regulate in the area of foreign affairs was invalidated by the United States
12 Supreme Court, which found that federal law preempted state law in the matter under review
13 (*American Insurance Association v. Garamendi*, 539 U.S. 396; 123 S. Ct. 2374; 156 L. Ed. 2d
14 376 (2003)). Since we know that the Department's authority is not unlimited, it is important to
15 subject these rules to formal APA rulemaking so that this issue may be examined. The
16 Department should not be permitted to avoid this review by issuing these rules as underground
17 regulations. An OAL determination on this issue is therefore the first step in evaluating the
18 underlying legality of the rules themselves.

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20 **2) THE PURPORTED UNDERGROUND REGULATIONS.** On February 10, 2010, the
21 Department distributed three documents related to insurer investments in business entities that
22 the Department believes conduct business in Iran. These three documents comprise:

- 23 A) A form letter directed to insurers with the subject "Identification of Companies
24 Doing Business in Specified Iranian Economic Sectors; Treatment of Investments
25 in Such Companies on Insurers' Financial Statements; Request for Moratorium on
26 Future Iran-Related Investments". A copy of that letter is attached to this petition
27 as Exhibit A.
- 28 B) A list entitled "List Of Companies Doing Business With The Iranian
Petroleum/Natural Gas, Nuclear, And Defense Sectors (As Of February 9, 2010)".
A copy of that list is attached to this petition as Exhibit B.

- 1 C) A document entitled “Response Form – Insurer Agreement Not To Invest In
2 Companies Doing Business With The Iranian Oil And Natural Gas, Nuclear, And
3 Defense Sectors”. A copy of that document is attached to this petition as
4 Exhibit C.

5 On March 4, 2010 the Department distributed an email message all California licensed
6 insurers from “CA Department of Insurance FSB” addressed to “Statutory Financial Statement
7 Contact Person”. A copy of this email message is attached to this petition as Exhibit D.

8 Collectively these four documents contain at least three different underground regulations
9 in violation of section 11340.5 of the Government Code. These underground regulations are:

- 10 A) The provision of Exhibit A declaring that “effective March 31, 2010, the
11 Department will treat all investments by insurers holding a certificate of authority
12 to transact insurance in California in companies on the List and affiliates owned
13 50% or more by companies on the List as non-admitted on the insurer’s financial
14 statements. For all financial statements filed with the Department for periods
15 ending on or after March 31, 2010, each insurer must report all of its investment
16 holdings on the List as not admitted assets.” This will be referred to in this
17 petition as the “Non-admitted Asset Rule.”
- 18 B) The Department’s determination in Exhibit A that the companies listed in
19 Exhibit B are “subject to financial risk as a result of doing business with the
20 Iranian oil and natural gas, nuclear, and defense sectors.” This will be referred to
21 in this petition as the “Listed Company Rule.”
- 22 C) The mandate imposed upon insurers, pursuant to Exhibit A, C and D, to submit a
23 response form to the Department not later than April 2, 2010. This will be
24 referred to in this petition as the “Mandatory Response Rule.”

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26 **3) AGENCY ACTIONS DEMONSTRATING THAT THE DEPARTMENT HAS ISSUED,
27 USED, ENFORCED, OR ATTEMPTED TO ENFORCE THE PURPORTED
28 UNDERGROUND REGULATIONS.** Exhibits A-D are, by their own terms, directives
addressed to insurers and issued by the Department. They are manifestly documents
demonstrating, at the least, that the Department has issued the purported underground
regulations. The letter of February 10 is signed by the General Counsel of the Department. The
March 4 email was sent from the Department’s Financial Surveillance Branch. Individual
insurers have reported to the Petitioner that they have received these documents from the

1 Department of Insurance, delivered by the U.S. Postal Service.

2 Also, the Department has publicly announced that it is taking the actions indicated in the
3 documents. On February 10, 2010 the Department issued a press release on this subject. The
4 lead paragraph of this press release says the following:

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

9 The Department's February 10 press release also makes reference to "the Department's
10 form which all insurers must complete and return to the Department by March 12, 2010." These
11 references in the Department's February 10 press release clearly demonstrate that the
12 Department has issued the challenged underground regulations. A copy of the Department's
13 February 10 press release on this topic is attached to this petition as Exhibit E. This copy of the
14 press release was downloaded from the Department's web site at
15 <http://www.insurance.ca.gov/0400-news/0100-press-releases/2010/release021-10.cfm>.

16 On March 26, 2010 the Department issued another press release discussing the
17 "progress" in the Department's "initiative" regarding Iran. The fact that the Department is
18 reporting progress on this initiative clearly demonstrates that the Department has issued, used
19 enforced or attempted to enforce the purported underground regulations. The Department's
20 March 26 press release is available on its web site at <http://www.insurance.ca.gov/0400->
21 [news/0100-press-releases/2010/release045-10.cfm](http://www.insurance.ca.gov/0400-news/0100-press-releases/2010/release045-10.cfm). A copy of the March 26, 2010 press release
22 downloaded from this web site is attached to this petition as Exhibit F.

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24 **4) THE LEGAL BASIS FOR BELIEVING THAT THE ALLEGED UNDERGROUND**
25 **REGULATIONS ARE REGULATIONS AS DEFINED IN SECTION 11342.600 OF THE**
26 **GOVERNMENT CODE AND THAT NO EXPRESS STATUTORY EXEMPTION TO**
27 **THE REQUIREMENTS OF THE APA IS APPLICABLE.**

28 **4a) The challenged underground regulations satisfy the legal definition of**

1 **“regulation” and are not exempt from APA requirements.** The APA defines a regulation as
2 “every rule, regulation, order, or standard of general application or the amendment, supplement,
3 or revision of any rule, regulation, order, or standard adopted by any state agency to implement,
4 interpret, or make specific the law enforced or administered by it, or to govern its procedure”
5 (Cal Gov Code § 11342.600). The California Supreme Court has refined this definition as
6 follows:

7 A regulation subject to the APA thus has two principal identifying characteristics. (See
8 *Union of American Physicians & Dentists v. Kizer* (1990) 223 Cal. App. 3d 490, 497
9 [272 Cal. Rptr. 886] [describing two-part test of the Office of Administrative Law].)
10 First, the agency must intend its rule to apply generally, rather than in a specific case. The
11 rule need not, however, apply universally; a rule applies generally so long as it declares
12 how a certain class of cases will be decided (*Roth v. Department of Veterans Affairs*
13 (1980) 110 Cal. App. 3d 622, 630 [167 Cal. Rptr. 552].) Second, the rule must
14 “implement, interpret, or make specific the law enforced or administered by [the agency],
15 or . . . govern [the agency's] procedure” (Gov. Code, § 11342, subd. (g).) *Tidewater*
16 *Marine Western, Inc. v. Bradshaw*, 14 Cal. 4th 557, 571 (Cal. 1996)

17 In order to conclude that the purported underground regulations satisfy the legal standard,
18 therefore, it must be demonstrated that each of them is intended to apply generally and that each
19 implements, interprets or makes specific a more general law. Each of the challenged
20 underground regulations meets these standards.

21 A third requirement of Gov. Code § 11340.5 is that the challenged regulation must not be
22 exempt from APA rulemaking requirements. Pursuant to Gov. Code § 11346, any law
23 exempting a regulation from APA rulemaking requirements “must do so expressly.” The
24 challenged underground regulations, therefore, are required to be adopted pursuant to APA
25 rulemaking requirements unless they are subject to an express statutory exemption from those
26 requirements. They are not.

27 **4b) The Non-admitted Asset Rule.** The Non-admitted Asset Rule is stated in Exhibit A
28 as follows:

[E]ffective March 31, 2010, the Department will treat all investments by insurers holding
a certificate of authority to transact insurance in California in companies on the List and

1 affiliates owned 50% or more by companies on the List as non-admitted on the insurer's
2 financial statements. For all financial statements filed with the Department for periods
3 ending on or after March 31, 2010, each insurer must report all of its investment holdings
4 on the list as not admitted assets.

5 This rule explicitly applies to "all investments by insurers holding a certificate of
6 authority". Since an insurer is prohibited by law from transacting insurance in the state of
7 California if it doesn't hold a California certificate of authority⁵, the Non-admitted Asset Rule, if
8 valid, applies to every insurer permitted by law to operate in the state of California.

9 Furthermore, the Non-admitted Asset Rule would apply to all investments equally. It
10 does not distinguish, for example, between equity investments and debt investments, even
11 though these two different types of investments are subject to very different types and degrees of
12 financial risk. This is clearly a "rule, regulation, order, or standard of general application" within
13 the meaning of section 11342.600 of the APA.

14 The reporting requirement in the Non-admitted Asset Rule is similarly imposed upon
15 "each insurer". The rule provides no case-by-case review for individual insurers, nor does it
16 provide any mechanism for individual insurers to appeal the designation of its assets as non-
17 admitted assets. Both with respect to the requirement that listed assets are considered to be
18 non-admitted by the Department and the requirement that they be reported that way by insurers,
19 the Non-admitted Asset Rule is a rule of general application.

20 The Department has not identified any statutory authority for the Non-admitted Asset
21 Rule. Therefore, any discussion of whether it implements, interprets, or makes specific the law
22 enforced or administered by it must first speculate upon what law the Department might assert if
23 it were to identify its purported legal authority. If the underground regulations were subjected to
24 the APA rulemaking procedure, the Department might say that it is implementing a federal law
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⁵ California Insurance Code section 700.

1 that regulates commerce with Iran, or it might assert that it is implementing Ins. Code § 900. But
2 because this is an underground regulation for which the Department has cited no authority, a
3 rigorous analysis of whether the rule implements “the law enforced or administered by the”
4 Department cannot be made based upon available information.
5

6 Fortunately, such an analysis is not truly necessary. If the Department does have some
7 statutory authority for the challenged underground regulations, the specificity of the purported
8 underground regulations makes it clear that they “implement, interpret, or make specific” that
9 hypothetical authority and, thus, satisfy the APA definition of “regulation”. Alternatively, if
10 there is no statutory authority that the challenged underground regulation implements, interprets,
11 or makes specific, then the rule violates section 11342.1 of the APA. Only by subjecting these
12 underground regulations to the rulemaking requirements of the APA may the authority question
13 be resolved. But whatever authority the Department believes it has, it is beyond any question
14 that the purported underground regulations attempt to implement it and make it specific.
15

16 There is no apparent express exemption permitting adoption of Non-admitted Asset Rule
17 without complying with the rulemaking requirements of the APA. Section 900 of the Insurance
18 Code requires insurers to file annual and quarterly financial statements “in the number, form, and
19 by the methods prescribed by the commissioner.” While this statute gives the Department an
20 element of discretion regarding the manner of insurer filing of financial statements, it does not
21 give any apparent authority to regulate the content of financial statements, as the Non-admitted
22 Asset Rule purports to do. More importantly, it certainly does not amount to an express
23 exemption from the rulemaking requirements of the APA. Even if this section authorizes the
24 Department to regulate the content of financial statements, such regulation must be done
25 pursuant to the rulemaking requirements of the APA. An express exemption must state
26 explicitly that regulations may be adopted without complying with the requirements of the APA.
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1 Insurance Code section 900 does not provide such an express exemption.

2 There are no other express exemptions from the APA that permit the Non-admitted Asset
3 Rule to be adopted without APA compliance. The general exemptions of Government Code
4 § 11340.9 are not applicable. The Department has not identified any statutory authority pursuant
5 to which it has promulgated the Non-admitted Asset Rule. Without the identification of
6 authority and reference statutes it is difficult to demonstrate the non-existence of an express
7 exemption definitively. The Petitioner is a California lawyer familiar with both the APA and the
8 Insurance Code who knows of no express statutory exemption and who asserts that no such
9 express exemption exists. A claim that this rule is subject to an express exemption amounts to
10 an affirmative defense to the general rule that a regulation must be adopted pursuant to APA
11 rulemaking. Therefore, the burden is on the Department to demonstrate that this rule is exempt
12 from APA rulemaking requirements if that is the case. Rather than presuming that this purported
13 underground regulation is expressly exempt from APA rulemaking, OAL should accept this
14 petition and offer the Department the opportunity to defend the regulation on that basis, should it
15 choose to do so.

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18 **4c) The Listed Company Rule.** In Exhibit A the Department says that it “has developed
19 a list of companies doing business with the Iranian oil and natural gas, nuclear, and defense
20 sectors (“List”).” Although the Department asserts that the List was developed “[f]ollowing
21 extensive research, analysis and consultation” and identifies four sources of information upon
22 which the List was “based”, the Department identifies no criteria upon which a company was
23 evaluated for inclusion or exclusion from the List. The List is the result of a “black box”
24 analytical process whereby unknown inputs are evaluated pursuant to unknown criteria and the
25 results merely announced. There is no way that any company could evaluate its operations to
26 determine whether it will or will not result in being included on the List.
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1 The Listed Company Rule is therefore difficult to evaluate. Due to the black box nature
2 of the Department’s development of the rule, the universe of business entities subject to this
3 analysis cannot be determined. For purposes of APA evaluation, however, it is clear that this is a
4 rule of general application in at least two ways. To begin with, it is clearly applicable uniformly
5 to all of the 50 companies on the list. Each of these companies has been identified by the
6 Department as “doing business with the Iranian oil and natural gas, nuclear, and defense
7 sectors.” The rule is applied generally to all companies on the List.

9 Furthermore, the Listed Company Rule does not distinguish between which of the
10 identified “sectors” a listed company is associated. In terms of public perception, and thus in
11 terms of reputational risk to the listed companies, it may make a large difference whether the
12 company is identified with the Iranian oil sector or the Iranian defense sector. For example, it
13 may be of little importance to one of the listed oil companies to be identified with the Iranian oil
14 industry, but of a great deal of importance to that oil company if it is identified with the Iranian
15 defense sector. The Listed Company Rule, however, does not accommodate these different
16 interests. Since it applies to all listed companies equally, without distinguishing which of the
17 listed “sectors” the companies are “doing business with”, it is a rule of general application.

19 In addition, the rule is generally applicable to all California insurers. By virtue of a
20 company being included on the List, all insurers are required by the Department to treat
21 investments (of whatever form) in that company differently from any investments in companies
22 not on the List. In this manner also the Listed Company Rule is applied generally in California.
23 It is a standard of general application.

24 The Listed Company Rule, like the Non-admitted Asset Rule, cannot be evaluated as an
25 implementation of any specific statute since no statutory authority has been identified by the
26 Department authorizing the rule. Again, the Department may assert that it is implementing Ins.
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1 Code section 900, federal law governing commerce with Iran, or some other statute, but that
2 cannot be determined from available information. But as with the Non-admitted Asset Rule, the
3 Department is either making statutory law specific, thus bringing this rule within the APA
4 definition of “regulation”, or it is implementing a rule for which it lacks authority in violation of
5 section 11342.1 of the APA. If there is statutory authority for the Listed Company Rule, it is a
6 rule of general application which implements and makes specific that statutory authority the
7 Department may have in this area. It is a regulation as defined by the APA.
8

9 As with the Non-admitted Asset Rule, there is no apparent express exemption permitting
10 adoption of Listed Company Rule without complying with the rulemaking requirements of the
11 APA. The general exemptions of Government Code § 11340.9 are not applicable. The
12 Department has not identified any statutory authority pursuant to which it has promulgated the
13 Listed Company Rule. Without the identification of specific authority and reference statutes it is
14 difficult to demonstrate the non-existence of an express exemption definitively. The Petitioner is
15 a California lawyer familiar with both the APA and the Insurance Code who knows of no express
16 statutory exemption and who asserts that no such express exemption exists. The burden is on the
17 Department to demonstrate that this rule is exempt from APA rulemaking requirements, if that is
18 the case. Rather than presuming that this purported underground regulation is expressly exempt
19 from APA rulemaking, OAL should accept this petition and offer the Department the opportunity
20 to defend the regulation on that basis, should it choose to do so.
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23 **4d) The Mandatory Response Rule.** Exhibit C is a form which an executive officer of
24 each California insurer is required to complete and return to the Department. In Exhibit A the
25 Department “requests that your company agree not to invest in the future” in companies on the
26 List. The mandatory response form requires each company to specify its intention regarding this
27 request. Completion and return of this form is mandatory. The form was presented to California
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1 insurers subject to the instruction, found in Exhibit A, that “[y]our company must respond by
2 March 12, 2010.” Pursuant to the email message conveyed in Exhibit D, the deadline for
3 response was delayed until April 2, 2010, but the mandatory nature of the response was not
4 changed.

5
6 Insurers who do not return the form to the Department would, pursuant to Exhibit A, be
7 subject to potential sanctions. Exhibit A tells each insurer that “[i]f your company does not
8 respond to or declines the Department’s request for a moratorium on future investments . . . the
9 Department may publish your company’s name on the Department’s website.” Thus the
10 Department has established a potential means to enforce the Mandatory Response Rule in the
11 form of publicly identifying a non-compliant insurer – one that does not respond or that responds
12 in a manner that the Department does not favor – on its website. Publication of an insurer’s
13 name under these circumstances would carry the implication that the insurer has undesirable
14 connections with Iran and, thus, the Department’s threatened sanction is that it will damage the
15 reputations of non-compliant insurers by implicitly identifying them as collaborators with the
16 government of Iran. .

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19 The Mandatory Response Rule applies to all California insurers. It imposes a mandatory
20 requirement upon all of them (“[y]our company *must* respond”), and it establishes potential
21 punishment for those insurers who do not respond or who respond in a manner that the
22 Department disfavors. It is a rule of general application which, in order to be valid, must be
23 adopted pursuant to the rulemaking requirements of the APA.

24
25 As with the other two challenged underground regulations, the Mandatory Response Rule
26 clearly implements and makes specific the statutory authority, if any, of the Department. The
27 requirement imposed by the Department to file a specific response to a specific issue is far more
28 specific than any requirement of any California statute. If there is statutory authority for this

1 rule, the rule itself clearly implements and makes that authority specific. Since the Mandatory
2 Response Rule is a rule of general application which implements and makes specific whatever
3 authority the Department may have, it is a regulation pursuant to section 11342.600 of the
4 Government Code.

5
6 As with the other two underground regulations contained in the Department's
7 communications, there is no apparent express exemption permitting adoption of Mandatory
8 Response Rule without complying with the rulemaking requirements of the APA. The general
9 exemptions of Government Code § 11340.9 are not applicable. The Department has not
10 identified any statutory authority and reference pursuant to which it has promulgated the
11 Mandatory Response Rule. Without the identification of authority and reference statutes it is
12 difficult to demonstrate definitively the non-existence of an express exemption. The Petitioner is
13 a California lawyer familiar with both the APA and the Insurance Code who knows of no express
14 statutory exemption and who asserts that no such express exemption exists. The burden is on the
15 Department to demonstrate that this rule is exempt from APA rulemaking requirements, if that is
16 the case. Rather than presuming that this regulation is expressly exempt from APA rulemaking,
17 OAL should accept this petition and offer the Department the opportunity to defend the
18 regulation on that basis, should it choose to do so.

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22 **5) INFORMATION DEMONSTRATING THAT THE PETITION RAISES AN ISSUE OF**
23 **CONSIDERABLE PUBLIC IMPORTANCE REQUIRING PROMPT RESOLUTION.**

24 There are at least three issues of considerable public importance requiring prompt resolution
25 raised by this petition.

26
27 **Issue #1: Legal Uncertainty Regarding Insurer Reporting and Reserving.** The
28 challenged underground regulations conflict with provisions of the Insurance Code and the

1 California Code of Regulations, thus creating ambiguity regarding how insurers are to comply
2 with the California law. Every insurer licensed to transact insurance in California is required,
3 pursuant to California Insurance Code 900, to file annual and quarterly financial statements,
4 which must be “completed in conformity with the Accounting Practices and Procedures Manual
5 adopted by the National Association of Insurance Commissioners” (Ins Code § 923). The
6 challenged underground regulations purport to regulate the content of these financial statements
7 in a way that is not consistent with the requirements of the Insurance Code § 923.

9 This is a matter of great importance. A company that files a false financial statement
10 may lose its certificate of authority (Ins Code § 900.8). The correctness of financial statements
11 must be certified by officers of the insurer (Ins Code § 903). The challenged underground
12 regulations create legal uncertainty regarding the required contents of insurer financial
13 statements and thus make it impossible for insurers to determine how to comply with the law.

15 If the purported underground regulations are valid an insurer reports investments in listed
16 companies as admitted assets will violate these regulations. Conversely, if the challenged
17 underground regulations are invalid, an insurer that prepares its financial statements in
18 compliance with those underground regulations will violate the Insurance Code. Unless and
19 until the validity of the challenged underground regulations is established through formal APA
20 rulemaking, it is impossible for any insurer, no matter which choice it makes, to be certain that it
21 is preparing its financial statements in compliance with the law.

23 The uncertainty created by these underground regulations is even greater for insurers
24 licensed in California but domiciled in another state. Rather than forcing each insurer to prepare
25 different financial statements to satisfy different reporting requirements in each state, state laws
26 generally provide reciprocity in reporting standards. States require insurers to prepare their
27 financial reports pursuant to the law of the state of domicile, and every state agrees to accept the
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1 financial reporting as required by the state of domicile. California imposes this requirement
2 pursuant to regulations adopted by the Department in title 10, Cal Code Regs § 2309.5⁶. Due to
3 the legal uncertainty created by the challenged underground regulations, insurers domiciled
4 outside of California cannot know whether to prepare their annual financial statements in
5 accordance with the requirements of the challenged underground regulations or the requirements
6 of 10 CCR 2309.5 – the Department’s lawfully-adopted regulation.
7

8 This uncertainty does not merely affect the contents of an insurer’s financial statements.
9 It has a significant impact in the market as well. Insurers are required to maintain adequate
10 financial reserves to support the insurance business that it writes (Ins. Code § 923.5). Only
11 admitted assets can be used as reserves. Thus the validity of the challenged underground
12 regulations has a direct impact on the amount of business that an insurer may transact. In simple
13 terms, an insurer that has investments in companies on the List may lawfully write more
14 insurance if the challenged underground regulations are void than it may write if they are valid.
15

16 Only by requiring the Department to comply with the rulemaking requirements of the
17 APA will the validity of the challenged rules be determined and only then will insurers be able to
18 prepare their financial statements with the level of certainty needed to comply with the accuracy
19 and verification requirements of the Insurance Code. Filing incorrect financial statements can
20 potentially put an insurer’s certificate of authority in jeopardy and can subject officers of
21 insurance companies to legal exposure for falsely verifying financial statements. Resolution of
22 these uncertainties is a matter of considerable public importance requiring prompt resolution.
23

24 **Issue #2: Due Process for Listed Companies.** The black box analysis employed by the
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27 ⁶ Title 10, Cal Code Regs § 2309.5 “The annual audited financial report shall report the financial position of the
28 insurer as of the end of the most recent calendar year and the results of its operations, cash flows and changes in
capital and surplus for the year then ended in conformity with statutory accounting practices prescribed, or otherwise
permitted, by the Department of Insurance of the state of domicile.”

1 Department in developing the List exposes the listed companies to potential reputational and
2 economic harm without due process and without recourse. The Department has, through black
3 box procedures which have never been subjected to public disclosure or evaluation, declared that
4 the named companies are affiliated with Iran. Whether or not that is true, due process
5 considerations dictate that companies subjected to such an evaluation should be advised of the
6 standards by which they are being evaluated and should have a procedure for responding to that
7 evaluation. The purported underground regulations do not allow this. This is a matter of
8 considerable public importance requiring prompt resolution. Only by subjecting these
9 underground regulations to the scrutiny provided by APA rulemaking can this be corrected.

11 **Issue #3: The Scope of the Department's Legal Authority.** The failure to employ the
12 rulemaking process means that the scope of authority that the Department may have in this area
13 of regulation has never been subjected to public scrutiny. There is a substantial legal question
14 whether it is within the scope of the Department's statutory authority to pass judgment upon
15 classes of insurer assets in the manner done in the challenged underground regulations or to
16 require insurers to specify their future intentions regarding those investments.

18 In this case the Department has decreed generally that every listed company is deemed to
19 be financially threatened with no apparent regard for the actual financial condition of any
20 individual company. Whether or not the Department has the legal authority to make such global
21 determinations upon all investments in specified companies is a significant legal question with
22 far-reaching implications. By enacting the challenged rules as illegal underground regulations
23 the Department has avoided all scrutiny with respect to its authority. It is entirely possible that
24 the Department is employing rules which exceed its authority in violation of section 11342.1 of
25 the APA. Only by subjecting these rules to formal rulemaking pursuant to the APA may the
26 Department's authority be properly evaluated.

1 /
2 **6) CONCLUSION.** The enactments by the Department reflected in Exhibits A-D constitute a
3 significant exercise of regulatory power both over the companies which the Department has
4 listed as being affiliated with Iran and over every insurer licensed to transact the business of
5 insurance in California. This power has been exercised through rules of general application
6 which have never been subjected to the scrutiny and public comment that is a central purpose of
7 APA rulemaking. The Petitioner respectfully requests that OAL accept this petition so that the
8 challenged regulations may be evaluated pursuant to the APA.
9

10 /
11 **6) Certifications:**

12 I certify that I have submitted copies of this petition and all attachments to the state agency
13 which has issued, used, enforced, or attempted to enforce the purported underground regulation.

14 The copies were submitted as follows:

15 Via hand delivery of a printed copy to: Darrel Woo, Staff Counsel
16 300 Capital Mall, 17th Floor
17 Sacramento, CA 95814
(916) 492-3556

18 Via email in PDF format to: Adam Cole, General Counsel
19 ColeA@insurance.ca.gov
20 (415) 538-4375

21 Peter Conlin, Counsel to the Commissioner
22 ConlinP@insurance.ca.gov
(916) 492-3199

23 I certify that all of the above information is true and correct to the best of my knowledge.
24

25 DATED: March 29, 2010

MICHELMAN & ROBINSON, LLP



27 By: _____

28 WILLIAM L. GAUSEWITZ

EXHIBIT A

DEPARTMENT OF INSURANCE

Legal Division, Office of the Commissioner

45 Fremont Street, 23rd Floor

San Francisco, CA 94105



February 10, 2010

VIA ELECTRONIC AND U.S. MAIL

[@@@Name and Address of Insurer Contact@@@]

SUBJECT: Identification of Companies Doing Business in Specified Iranian Economic Sectors; Treatment of Investments in Such Companies on Insurers' Financial Statements; Request for Moratorium on Future Iran-Related Investments

Dear [@@@Insert Company Contact Name@@@]:

The Department of Insurance ("Department") received your company's response to Commissioner Poizner's July 2, 2009 data call ("Data Call") seeking information about investments in companies doing business with the Iranian oil and natural gas, nuclear, and defense sectors. Thank you for your response. The Department also independently reviewed your company's investments based on its financial statements on file with the Department.

I. List of Companies Doing Business in Specified Iranian Economic Sectors

Following extensive research, analysis and consultation, the Department has developed a list of companies doing business with the Iranian oil and natural gas, nuclear, and defense sectors ("List"). The List is attached. The Department developed the List based on:

- Insurers' responses to the Data Call;
- Consultation with independent research firms KLD Research and Analytics, Inc. and Conflict Securities Advisory Group, Inc.;
- Consultation with reputational/financial risk experts at RWR Advisory Group; and
- Review of the lists of the California, Florida, and New York public pension funds.

The Department may in the future revise the List by adding companies found to be doing business with the Iranian oil and natural gas, nuclear, and defense sectors; removing companies that cease doing business with those sectors; or making changes based on other risk-related considerations. In addition, the List currently does not include banks. Based on subsequent research, analysis and consultation, the Department may supplement the List to include banks doing business with the Iranian oil and natural gas, nuclear, and defense sectors.

II. Treatment of Specified Iran-Related Investments on Insurers' Financial Statements

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 terrorism. Companies doing

February 10, 2010
Page 2

business with the Iranian oil and natural gas, nuclear, and defense sectors are subject to asymmetric reputational harm, and, accordingly, financial or market risk, stemming from the nature of their business activities in Iran.

Based on financial soundness considerations, the Department considers investments in companies on the List to be at risk.

Accordingly, effective March 31, 2010, the Department will treat all investments by insurers holding a certificate of authority to transact insurance in California in companies on the List and affiliates owned 50% or more by companies on the List as non-admitted on the insurer's financial statements. For all financial statements filed with the Department for periods ending on or after March 31, 2010, each insurer must report all of its investment holdings on the List as not admitted assets.

III. Request for Moratorium on Specified Future Iran-Related Investments

In recognition of the financial risk presented by investments in companies on the List, the Commissioner requests that your company agree not to invest in the future in any of those companies or in any affiliates owned 50% 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 to this letter is a form for your company's response to this request. **Your company must respond by March 12, 2010.** Please mail the response to the Department at the following address:

California Department of Insurance
Field Examination Division - 9th floor
300 S. Spring Street
Los Angeles, CA 90013
Attention: Al Bottalico, Division Chief

If your company does not respond to or declines the Department's request for a moratorium on future investments in companies on the List and affiliates owned 50% or more by those companies, the Department may publish your company's name on the Department's website.

Thank you for your attention to this matter.

Very truly yours,

Adam M. Cole
General Counsel

Attachments

EXHIBIT B

CALIFORNIA DEPARTMENT OF INSURANCE
LIST OF COMPANIES DOING BUSINESS WITH THE IRANIAN PETROLEUM/NATURAL GAS, NUCLEAR,
AND DEFENSE SECTORS
(AS OF FEBRUARY 9, 2010)

| | |
|---|---|
| <ol style="list-style-type: none"> 1. ABB Ltd. [Switzerland] 2. ACS, Actividades de Construccion Y Servicios, S.A. [Spain] 3. Alstom [France] 4. Ashok Leyland, Ltd. [India] 5. Aker Solutions [Norway] 6. China National Petroleum Corp. [China] 7. China Petroleum & Chemical Corp. [China] 8. CNOOC Ltd. [China] 9. CNPC (Hong Kong) Limited [Hong Kong] 10. Daelim Industrial Co., Ltd. [South Korea] 11. Dragon Oil PLC [Ireland] 12. Edison Spa [Italy] 13. Eni S.p.A. [Italy] 14. Everest Kanto Cylinder Ltd. [India] 15. Finmeccanica SPA [Italy] 16. GAIL (India) Limited [India] 17. Gas Natural SDG [Spain] 18. Gazprom Neft [Russia] 19. Gazprom OAO [Russia] 20. GS E&C (Engineering & Construction) [South Korea] 21. GS Holdings Corp. [South Korea] 22. Hyundai E&C (Engineering and Construction) Co., Ltd. [South Korea] 23. Hyundai Heavy Industries [South Korea] 24. Ina-Industrija Nafta DD [Croatia] 25. Indian Oil Corporation, Ltd. [India] | <ol style="list-style-type: none"> 26. Linde AG [Germany] 27. Lukoil OAO [Russia] 28. Oil & Natural Gas Corp. (ONGC) [India] 29. OMV [Austria] 30. PetroChina Company Limited [China] 31. Petrofac Limited [United Kingdom] 32. Petroliam Nasional Bhd (Petronas) [Malaysia] 33. Petronas Gas Bhd [Malaysia] 34. PT Citra Tubindo Tbk [Indonesia] 35. PTT Exploration & Production PCL (PTTEP) [Thailand] 36. PTT Public Company Limited [Thailand] 37. Rahnill Bhd [Malaysia] 38. Repsol YPF [Spain] 39. Royal Dutch Shell Plc [United Kingdom] 40. Sasol Limited [South Africa] 41. Siemens AG [Germany] 42. StatoilHydro ASA [Norway] 43. Tatneft [Russia] 44. Technip S.A. [France] 45. Trevi-Finanziaria Industriale S.p.A. (Trevi Group) [Italy] 46. Total S.A. [France] 47. Welspun-Gujarat Stahl Rohren Limited [India] 48. Worley Parsons Ltd. [Australia] 49. Ulan-Ude Aviation Plant JSC [Russia] 50. ZiO-Podol'sk OAO [Russia] |
|---|---|

EXHIBIT C

DEPARTMENT OF INSURANCE**Legal Division, Office of the Commissioner**

45 Fremont Street, 23rd Floor

San Francisco, CA 94105

**RESPONSE FORM****INSURER AGREEMENT NOT TO INVEST IN COMPANIES DOING BUSINESS WITH THE IRANIAN OIL AND NATURAL GAS, NUCLEAR, AND DEFENSE SECTORS****(MUST BE COMPLETED AND RETURNED TO THE DEPARTMENT OF INSURANCE ON OR BEFORE MARCH 12, 2010)**

In your capacity as an executive officer and on behalf of your Company, please mark an "X" in the appropriate category below.

CATEGORY A:

[]

My company has reviewed the list of companies determined by the California Department of Insurance ("Department") to be at risk for doing business with the Iranian oil and natural gas, nuclear, and defense sectors (list circulated February 10, 2010) ("List"). My company agrees not to invest in the future in any companies on the List or in any affiliates owned 50% or more by companies on the List 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.

CATEGORY B:

[]

My company does not agree to refrain from investing in the future in companies on the List or in affiliates owned 50% or more by companies on the List.

(Signature of Executive Officer)

(Printed Name of Officer)

Dated: _____ at _____
(Location City and State)

On behalf of:

(Company Name)

(NAIC No.)

(NAIC Group No.)

EXHIBIT D

From: CA Department of Insurance FSB [<mailto:CA.Ins.Dept.FSB@insurance.ca.gov>]
Sent: Thursday, March 04, 2010 5:52 PM
Subject: February 10, 2010 Letter to CEO - Iran Investment - Extension to Response Due Date (4)

To: Statutory Financial Statement Contact Person

The message below relates to February 10, 2010 letter on Iran related investments. Please forward this message to your Chief Executive Officer. If you are the financial statement contact person for multiple insurers licensed in California, please be sure to forward the below message to each Chief Executive Officer of the respective companies for which you are designated as the financial statement contact person.

In a letter dated February 10, 2010, over the signature of Adam M. Cole, General Counsel, the California Department of Insurance provided a list of companies doing business with the Iranian oil, natural gas, nuclear, and defense sectors (the "List"). That letter included a Request for a Moratorium on Specified Future Iran-Related Investments and established a deadline of March 12, 2010 for companies to respond to the department regarding the request for an investment moratorium.

This correspondence is to inform your company that the deadline for responding to the request for an investment moratorium has been postponed until April 2, 2010.

This change does not affect or delay the department's intention to treat, effective March 31, 2010, all investments by insurers holding a certificate of authority to transact insurance in California in companies on the List and affiliates owned 50% or more by companies on the List as non-admitted on the insurer's financial statements. The department intends to provide additional direction regarding disqualification and financial statement reporting at a later date.

EXHIBIT E

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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 & 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. 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](#).

EXHIBIT F

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Media Calls Only: 916-492-3566**Insurance Commissioner Steve Poizner Announces That 460 Insurers Have Already Agreed To Forgo Future Investments In Iran-Related Companies**

Insurance Commissioner Steve Poizner announced today that 460 insurers have agreed in writing to a moratorium on future investments in 50 companies identified by the California Department of Insurance (CDI) to be doing business with the Iranian energy, nuclear and defense sectors.

"This level of participation in the moratorium signals tremendous progress in our initiative to ensure that California policyholder dollars are not put at risk through investments in companies doing business with the Iranian nuclear, defense and energy sectors," said Commissioner Poizner. "We already know that 1,000 out of the 1,300 insurance companies licensed in California have no investments in any of the 50 Iran-related companies. Now, more than one third of the insurance companies have pledged not to make new investments in those risky companies helping to prop up the Iranian regime. It's up to the other two thirds of the industry to do the right thing and agree to forgo future investments in Iran-related companies."

Insurers that have agreed to the moratorium include such well-known companies as Mercury Insurance, a prominent auto insurer; Zenith Insurance, a significant workers' compensation insurer; and Anthem Blue Cross, the largest insurer in the individual health insurance market in California.

On Feb. 10, [Commissioner Poizner released a list](#) of 50 companies doing business in the Iranian oil and natural gas, nuclear and defense sectors.

Two significant milestones in the CDI Iran Initiative will be reached next week. First, as of March 31, no investment held by an insurer in any company on the list will be recognized on that insurer's financial statements in California. Second, the Commissioner requested that all insurers licensed to do business in California agree to a moratorium on future investments in any of the 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) a specified 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. Commissioner Poizner initially asked insurers to respond to the moratorium request by March 12. At the request of the insurance industry, he extended that deadline to April 2.

CDI will release additional information regarding the insurance industry response to the request for an investment moratorium in the coming weeks along with other data on insurance industry investments in Iran.

[Earlier this year](#), 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 2009](#), 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.

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