Personal Insurance Federation of California
California's Personal Lines Trade Association
REPRESENTING THE LEADING AUTOMOBILE AND HOMEOWNERS INSURERS
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MEMORANDUM

Date: August 10, 2004

To: The Honorable Judy Chu, Chair
Members, Assembly Appropriations Committee

From: Dan C. Dunmoyer, President
G. Diane Colborn, Vice President of Legislative and Regulatory Affairs
Michael A. Gunning, Senior Legislative Advocate
Michael A. Paiva, Senior Legislative Advocate

RE: SB 574 (Alpert): Special Excess Workers' Compensation Policies and CIGA
Assembly Appropriations Committee Hearing: Aug. 11, 2004
PIFC Position: Oppose Unless Amended As Amended June 30, 2004

The Personal Insurance Federation of California (PIFC), representing insurers who write over 50% of the personal lines insurance policies sold in California **opposes SB 574** authored by Senator Alpert.

This bill rewards a broker who violated the Labor Code and who ignored the specific warnings of the Department of Industrial Relations. In addition, this bill weakens the beleaguered California Insurance Guarantee Fund (CIGA).

PIFC would remove its opposition if the bill were amended to require the school districts to assign their rights to the Insurance Commissioner to thoroughly investigate and pursue any and all potential wrongdoers whose negligent or willful actions created this problem. Upon the assignment of the rights, the funds shall be immediately available to the school districts. A copy of PIFC's proposed amendment is attached.

Background: In the mid-1990s workers' compensation rates dropped and many employers, including the 68 school districts listed in this bill, decided to transition from being self-insured and elected to purchase private workers' compensation policies. The purchase of these workers' compensation policies relieved the school districts of their obligation for future workers' compensation claims but did nothing to relieve the school districts of their obligation to insure against the "long-tail" claims that employees had filed under the self-insured program and that had not yet been paid in full when the employer converted to private insurance.

In order to cover their "long-tail" claims, the school districts purchased loss portfolio transfer (LPT) insurance from Fremont Insurance Company. According to the sponsor, the districts paid $16 million for this coverage.

On June 4, 2003 Fremont Insurance was declared insolvent by the Department of Insurance. The school districts then sought coverage from CIGA. CIGA has maintained that the school district claims are not "covered" claims because they were purchased in violation of the Labor Code. PIFC opposes this bill for the following reasons:

Then existing Labor Code Section 3702.8 prohibited the purchase of LPT insurance by public agencies: Proponents of the bill maintain that the purchase of LPT insurance was not prohibited. PIFC disagrees.

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At the time that the broker sold these policies to the districts, Labor Code Section 3702.8 permitted private employers, who had ceased to be self-insurers, to discharge their continuing obligations as a self-insurer by purchasing LPT insurance. There was no mention in Section 3702.8 regarding whether public sector employers (such as the school districts) could discharge any part of its continuing workers' compensation obligations by purchasing LPT insurance. In fact, it took Legislative action in 1999 to clarify that public sector employers could purchase these policies. The Assembly Floor Analysis of AB 1309 (Scott), Statutes of 2000, summarizes the intent of the bill by noting that the bill "allows self-insured public employers to discharge workers' compensation obligations by purchasing a special excess workers' compensation policy."

The Department of Industrial Relations warned public agencies and brokers to stay clear of LPT insurance policies: In a letter dated April 20, 1998, Mark B. Ashcraft, Manager Self-Insured Plans for the Department of Industrial Relations warned brokers and all public sector self insurers, including the schools, that they should not purchase LPT insurance. The following excerpt is taken verbatim from the Ashcraft letter. Emphasis is not added.

> "There is **NO** mention in Section 3702.8 that a PUBLIC self insurer may discharge **any** part of its continuing workers' compensation obligations by use of a special excess workers' compensation policy. Since the statute does not specifically authorize "any employer," or "all employers," or "public employers," or "a employer," but rather, specifically limits the authorization to only…"Private employers, who have ceased to be self insured employers"…, a public sector employer is NOT authorized by this statute to discharge any part of its continuing compensation obligations by selling those liabilities off to a carrier."

The Ashcroft letter concludes with the following admonition to public sector employers contemplating the purchase of LPT insurance:

> "Any such agreement you are entering into has no legal force or effect. This would put you in a very awkward position if your carrier fails to live up to the terms of the agreement by whatever name it is called. When the language of Labor Code Section 3702.8 was enacted, the legislature certainly knew that the public sector existed and that a large number of you were self insured for workers' compensation liabilities. But the application of Section 3702.8 was clearly limited to the private sector."

NOTE: All insurance brokers and carriers licensed in California were sent a copy of the "Ashcraft letter." The "Ashcraft letter" is attached.

There are other insurance mechanisms, including Errors and Omissions coverage, that school districts should first explore for a financial remedy before turning to the already precariously balanced CIGA fund: Given the fact that the policies in question were sold to the districts in clear violation of then existing Labor Code Section 3702.8, and given the fact that the broker should have received a copy of the "Ashcraft letter" in which the DIR opined that the purchase of LPT insurance policies by public sector employers was prohibited, PIFC asserts that the broker's Errors and Omissions insurance should be pursued before any other scheme is considered.

Bad Precedent: Honoring the school district claims would send the wrong message to employers who played by the rules and would encourage others to appeal to the Legislature when they need an infusion of CIGA cash to solve their problems.

CIGA is the financial backstop consumers rely on to make sure that all of their claims are paid in the event that their insurance company goes bankrupt. As it relates to workers' compensation insurance, CIGA is the backstop for both the employer and the injured worker and "guarantees" the payment of the injured workers' claim. If CIGA cannot meet its financial obligations, the state's injured workers are left to collect their workers' compensation insurance from their employer. If the employer cannot pay for these damages (and most small business could not), the employer will go bankrupt and the injured worker will get nothing.

Weakens an already damaged fund: Three years ago, CIGA had an $800 million surplus. Since then, 27 companies have been declared insolvent and CIGA is now $3.9 billion in debt. As noted in the Assembly Insurance Committee analysis of this bill, CIGA board members recently received a report noting that, as a result of recent insolvencies; CIGA is "facing an all line cash drain approaching $84 million per month." According to the memo, CIGA sought and obtained from the Legislature (AB 227, Vargas, Chapter 635, Statutes of 2003) the ability to issue bonds so that it could continue paying workers compensation benefits. The memo notes that without these extra funds it projects that it will be unable to pay workers compensation benefits by the third quarter 2004. CIGA is currently in the process of selling up to $800 million of the authorized bonds in order to meet its cash flow needs.

For the reasons stated above **PIFC opposes SB 574 and urges your no vote on this measure**. If you have any questions regarding this position please contact Mike Paiva at (916) 442-6646.

cc: Senator Alpert, Author
Mark Sektnan, Assembly Insurance Committee
Kevin Hanley, Assembly Republican Caucus
Brian Perkins, Senate Insurance Committee
Tim Conaghan, Senate Republican Caucus
Cynthia Bryant, Office of the Governor
Scott Reid, Office of the Insurance Advisor