

# HOUSE BILL REPORT

## ESSB 5717

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### As Reported by House Committee On:

Insurance, Financial Services & Consumer Protection

**Title:** An act relating to the establishment of a program of market conduct oversight within the office of the insurance commissioner.

**Brief Description:** Establishing a program of market conduct oversight within the office of the insurance commissioner.

**Sponsors:** Senate Committee on Financial Institutions & Insurance (originally sponsored by Senators Berkey, Hobbs, Prentice, Hatfield and Franklin; by request of Insurance Commissioner).

### Brief History:

#### Committee Activity:

Insurance, Financial Services & Consumer Protection: 3/15/07 [DP].

#### Brief Summary of Engrossed Substitute Bill

- Creates a program of market conduct oversight within the Office of the Insurance Commissioner (OIC).
- Requires and establishes procedures for the OIC to conduct market analysis.
- Establishes market actions for the OIC to use when market analysis determines that further inquiry into a particular insurer or practice is needed.
- Authorizes the OIC to do market conduct examinations in accordance with the market conduct uniform examination procedures established by the National Association of Insurance Commissioners (NAIC) and the NAIC market regulation handbook.
- Requires examined entities to pay for certain examination costs.
- Establishes requirements for market conduct personnel.

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*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

- Establishes confidentiality requirements and exempts certain papers and documents from public disclosure.

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## HOUSE COMMITTEE ON INSURANCE, FINANCIAL SERVICES & CONSUMER PROTECTION

**Majority Report:** Do pass. Signed by 8 members: Representatives Kirby, Chair; Kelley, Vice Chair; Roach, Ranking Minority Member; Strow, Assistant Ranking Minority Member; Hurst, Rodne, Santos and Simpson.

**Staff:** Sarah Beznoska (786-7109).

### **Background:**

#### Examinations by the Insurance Commissioner

Under the Insurance Code, the Office of the Insurance Commissioner (OIC) is authorized to examine the affairs, transactions, accounts, records, documents, and assets of insurers at least every five years. The OIC is also authorized to examine other regulated entities. After determining that an examination should be conducted, the OIC appoints one or more examiners to perform the examination. In conducting an examination, the OIC must be given access to accounts, records, documents, and files relating to the subject of the examination.

#### Examination Reports

Within 60 days after completing an examination, the OIC makes a full certified written report containing facts, conclusions, and recommendations. A copy of the report is provided to the entity examined not less than 10 days and not more than 30 days prior to the filing of the report for public inspection. If the examined entity requests in writing within this time period, the OIC must hold a hearing to consider objections to the report as proposed, and must not file the report until after the hearing and after any necessary modifications in the report have been made. Within 30 days of this time period, the OIC must consider the report, together with any written submissions or rebuttals and any relevant portions of the examiner's workpapers and enter an order that may be appealed.

#### Examination Report Confidentiality

After adopting an examination report, the OIC must continue to hold the content of the examination report as private and confidential information for a period of five days except that the order may be disclosed to the entity examined. Thereafter, the OIC may open the report for public inspection so long as no court of competent jurisdiction has stayed its publication. The OIC may withhold from public inspection any examination or investigation report for so long as he or she deems it advisable.

#### Examination Costs

Examinations that take place within the state of any insurer domiciled or having its home offices in the state, other than a title insurer, made by the OIC or the OIC's examiners and employees must, except as to witness fees, mileage, and expense, be at the expense of the state.

Every other examination of any entity domiciled or having its home offices in this state that requires travel and services outside this state, must be made by the OIC or by designated examiners at the expense of the entity examined. A domestic insurer is not liable for the compensation of examiners employed by the OIC for services outside the state.

The entity examined must reimburse the state upon presentation of an itemized statement, for the actual travel expenses of the OIC's examiners, their reasonable living expense allowance, and their per diem compensation, including salary and the employer's cost of employee benefits. Reimbursement must be at a reasonable rate approved by the OIC.

#### National Association of Insurance Commissioners (NAIC) Market Analysis

The NAIC has established a variety of working groups related to market analysis and coordinating market analysis between states. The NAIC has also established Market Conduct Annual Statement procedures to create a uniform system of collecting market-related information among participating states.

In September 2004, the NAIC adopted the Market Conduct Surveillance Model Law based on a version put forth by the National Conference of Insurance Legislators.

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### **Summary of Bill:**

#### **Overview**

A market conduct oversight program is established within the OIC. Detailed provisions are included related to market analysis procedures, market conduct actions, market conduct examinations, personnel and immunity for personnel, access to records and information, penalties, and coordination with other state insurance regulators.

Insurer is defined as every person engaged in the business of making contracts of insurance. Health care service contractors, health maintenance organizations, fraternal benefit societies, and self-funded multiple employer welfare arrangements are insurers.

Existing statutory provisions related to examinations are limited to financial analysis and examination of insurers and other regulated entities.

#### **Market Analysis Procedures**

Market analysis is defined as a process whereby market conduct oversight personnel collect and analyze information from filed schedules, surveys, required reports, and other sources to develop a baseline understanding of the marketplace and to identify insurer patterns or

practices that deviate significantly from the norm or that may pose a risk to the insurance consumer.

### Gathering Information

Generally, the OIC must collect and report market data information to the NAIC's market information systems, including a complaint database system, an examination tracking system, and a regulatory retrieval system. This information must be compiled and submitted in a manner that meets NAIC requirements. Insurers must file annual market conduct statements on NAIC forms unless there is not an existing form for a particular line of business. The OIC has authority to grant an extension of time for filing if written request for an extension is received at least five business days before the filing due date.

In conducting market analysis, the OIC must gather information from data currently available, surveys, required reports, information collected by the NAIC, other sources in both the public and private sectors, and information from within and outside the insurance industry. The OIC has the authority to request insurers to submit necessary data and information.

The OIC must adopt rules, with respect to gathering information, that provide for access to records and compliance with the request, and do not cause undue burden or cost to the consumer or insurer.

In addition, the OIC must not ask for information or data that has been provided as part of other official documents, such as an insurer's annual financial statement or the NAIC market conduct annual statement.

### Analyzing Information

The OIC is required to analyze gathered information to develop a baseline understanding of the marketplace and to identify insurers or practice for further review. The OIC is required to use the NAIC market regulation handbook as one analytical resource.

The OIC must adopt rules creating a process for an insurer to verify Washington-specific complaint information related to the insurer before using the complaint information for market conduct surveillance or transmitting it to the NAIC.

### **Market Conduct Actions**

Market conduct action is defined as any of the full range of activities that the OIC may initiate to assess and address the market conduct practices of insurers admitted to do business in Washington, and entities operating illegally in Washington, beginning with market analysis and extending to examinations. The OIC's activities to resolve an individual consumer complaint or other report of a specific instance of misconduct are not market conduct actions.

### Continuum of Actions

A continuum of market actions is established for the OIC to use when market analysis determines that further inquiry into a particular insurer or practice is needed. An insurer must have reasonable opportunity to resolve matters that arise as a result of market analysis to the

satisfaction of the OIC before any additional market conduct actions are taken. As part of a market conduct action, the OIC must discuss with the insurer the data used to choose the market conduct action and must provide the insurer with an opportunity for data verification.

Market conduct actions must be taken as a result of market analysis and must focus on general business practices and compliance activities of insurers instead of identifying obviously infrequent or unintentional random errors that do not cause significant consumer harm.

The actions include, but are not limited to:

- correspondence with the insurer;
- insurer interviews;
- information gathering;
- policy and procedure reviews;
- interrogatories;
- review of insurer self-evaluation and compliance programs. This may include consideration of the insurer's membership in a best practices organization, if the OIC is satisfied that the organization's qualification process is likely to provide reasonable assurance of compliance with pertinent insurance laws;
- desk examinations; and
- investigations.

The OIC is not required to follow a particular sequence of actions and is not required to use all of the actions. However, except in extraordinary circumstances, the OIC must select the least intrusive and most cost-effective action to provide necessary consumer protection. The OIC must make reasonable efforts to coordinate with other state insurance regulators.

The OIC may determine the frequency and timing of market conduct action, depending on the specific market conduct action. The OIC may schedule and coordinate multiple examinations simultaneously.

The OIC may examine or conduct a market conduct action on any managing general agent or other person.

The OIC is required to adopt rules that are substantially similar to the NAIC.

### **Market Conduct Examinations**

Market conduct examination is defined as the examination of the insurance operations of an insurer licensed to do business in Washington and entities operating illegally in Washington to evaluate compliance with applicable laws and regulations. A market conduct examination may be either a comprehensive examination or a targeted examination.

When other market conduct actions do not sufficiently address issues, the OIC may engage in market conduct examinations in accordance with the NAIC market conduct uniform examination procedures and the NAIC market regulation handbook. If the insurer to be examined is part of an insurance holding company system, the OIC may also seek to

simultaneously examine any affiliates of the insurer under common control and management that are licensed to write the same lines of business in Washington.

The OIC generally retains the authority to terminate or suspend any examination and pursue other legal or regulatory action under the Insurance Code. Findings of fact and conclusions made under any examination are prima facie evidence in any legal or regulatory action.

#### Pre-Examination Requirements

A work plan must be prepared by market conduct oversight personnel prior to beginning a market conduct examination. The work plan must consist of the following:

- the name and address of the insurer being examined;
- the name and contact information of the examiner-in-charge;
- the name of all market conduct oversight personnel initially assigned to the market conduct examination;
- the justification for the examination;
- the scope of the examination;
- the date the examination is scheduled to begin;
- notice of any non-insurance department personnel who will assist in the examination;
- a time estimate for the examination;
- a budget for the examination if the cost of the examination is billed to the insurer; and
- an identification of factors that will be included in the billing if the cost of the examination is billed to the insurer.

Within 10 days of receiving the work plan, insurers may request the OIC to review any alleged conflict of interest of market conduct oversight personnel and non-insurance department personnel assigned to a market conduct examination. A request for review must specifically describe an alleged conflict of interest. The OIC must notify the insurer of any action in response to a request for review within five business days of the request.

Market conduct examinations must use desk examinations and data requests before an on-site examination. The OIC must use NAIC standard data requests.

Announcements of an examination must be sent to the insurer and posted on the NAIC's examination tracking system as soon as possible but in no case later than 60 days before the estimated commencement of the examination, unless the exam is conducted in response to extraordinary circumstances. An announcement sent to an insurer must contain an examination work plan and a request for the insurer to name its examination coordinator. If an examination is expanded beyond original reasons provided to the insurer in the notice, the OIC must provide written notice to the insurer explaining reasons for the expansion.

The OIC must conduct a pre-examination conference with the insurer at least 30 days before beginning the examination.

The OIC must accept an examination report done by another state in lieu of examining an insurer except in situations where the OIC determines that the other state does not have a comparable market oversight system.

### Examination Reports

Written report requirements are created that are similar to examination report requirements contained in current law under current examination authority.

Before the conclusion of field work for a market conduct examination, the examiner-in-charge must review examination findings to date with insurer personnel and schedule an exit conference, in accordance with procedures in the NAIC market regulation handbook. No later than 60 days after completion of a market conduct examination, the OIC must make a full written report of each market conduct examination containing only facts, conclusions, and recommendations.

The written report must be certified by the OIC or by the examiner-in-charge of the examination, and must be filed with the OIC. The OIC must provide a copy of the market conduct examination report to the person examined not less than 10 days and not more than 30 days prior to filing the report for public inspection. If the entity requests in writing, the OIC must hold a hearing to consider objections to the report as proposed, and must not file the report until after the hearing and until after any modifications in the report deemed necessary by the OIC have been made. The OIC has the authority to extend timeframes.

### Examination Orders

Examination order requirements are established that are similar to requirements contained in current law under current examination authority.

Within 30 days of the end of the period of time in which the entity examined has a copy of the report prior to filing, the OIC must consider the report, together with any written submissions or rebuttals and any relevant portions of the examiner's work papers and enter an order:

- adopting the market conduct examination report as filed or with modification or corrections. If the market conduct examination report reveals that the company is operating in violation of any law, rule, or order of the OIC, the OIC may order the company to take any action the OIC considers necessary and appropriate to stop the violation;
- rejecting the market conduct examination report with directions to the examiners to reopen the examination for purposes of obtaining additional data, documentation, or information, and refiling; or
- calling for an investigatory hearing with no less than 20 days notice to the company for purposes of obtaining additional documentation, data, information, and testimony.

An order must be accompanied by findings and conclusions from the OIC's consideration and review of the market conduct examination report, relevant examiner work papers, and any written submissions or rebuttals. An insurer's response must be included in the OIC's order

adopting the final report as an exhibit to the order, but the insurer is not obligated to submit a response. The order is a final administrative decision and may be appealed.

The order must be served to the company by certified mail, with a copy of the adopted examination report. A copy of the adopted examination report must be sent by certified mail to each director at the director's residential address.

After adopting the market conduct examination report, the OIC must continue to hold the content of the examination report as private and confidential for a period of five days, except that the order may be disclosed to the person examined. Thereafter, the OIC may open the report for public inspection so long as no court of competent jurisdiction has stayed its publication. However, the OIC may withhold from public inspection any examination or investigation report for as long as he or she deems it advisable. The OIC is not required to disclose any information or records that show the existence or content of any investigation or activity of a criminal justice agency.

If the OIC determines that regulatory action is appropriate as a result of any market conduct examination, he or she may initiate any proceedings or actions.

#### Examination Costs

Cost and fee provisions are created that are similar to requirements contained in current law under current examination authority.

The OIC market conduct examinations that take place within the state of any domiciled insurer, other than a title insurer, must be at the expense of the state, except for witness fees, mileage, and expenses. If an examination of any entity domiciled or having its home offices in this state requires travel and services outside the state, the travel and services must be made by the OIC or by examiners designated by the OIC at the expense of the person examined. However, a domestic insurer is not liable for the compensation of examiners employed by the OIC for services outside the state.

The OIC must present an itemized statement to the entity examined and that entity must reimburse the state for the actual travel expenses of the OIC's examiners, their reasonable living expenses allowance, and their per diem compensation, including salary and the employer's cost of employee benefits. Reimbursement must be at a reasonable rate approved by the OIC. Per diem, salary, and expenses for employees examining insurers domiciled outside the state must be established by the OIC on the basis of the NAIC's recommended salary and expense schedule for zone examiners, or the salary schedule established by the Director of the Department of Personnel and the expense schedule established by the Office of Financial Management, whichever is higher.

The OIC may contract, in accordance with applicable state contracting procedures, for qualified attorneys, appraisers, independent certified public accountants, contract actuaries, and other similar individuals who are independently practicing their professions as examiners. The OIC may do so even though those persons may from time-to-time be similarly employed or retained by entities subject to examination. The compensation and per diem



allowances paid to contract persons must be reasonable in the market and time incurred. Compensation and per diem allowances for contracted entities is capped. The cap is set at 125 percent of the compensation and per diem allowances for examiners set forth in the NAIC guidelines, unless the OIC demonstrates that 125 percent is inadequate under the circumstances of the examination.

The OIC must maintain active management and oversight of market conduct examination costs, including costs associated with the OIC's own examiners, and with retaining qualified contract examiners necessary to perform an examination. Any agreement with a contract examiner must:

- clearly identify the types of functions to be subject to outsourcing;
- provide specific timelines for completion of the outsourced review;
- require disclosure to the insurer of contract examiners' recommendations;
- establish and use a dispute resolution or arbitration mechanism to resolve conflicts with insurers regarding examination fees; and
- require disclosure of the terms of the contracts with the outside consultants that will be used, specifically the fees and/or hourly rates that can be charged.

The OIC must review and affirmatively endorse detailed billings from the qualified contract examiner before detailed billings are sent to the insurer.

## **Market Conduct Oversight Personnel**

### Qualifications

Market conduct oversight personnel must be qualified by education, experience, and, where applicable, professional designations. The OIC may supplement in-house market conduct oversight staff with qualified outside professional assistance.

### Conflicts of Interest

Market conduct oversight personnel are deemed to have a conflict of interest, either directly or indirectly, if they are affiliated with the management of, and have, within five years of any market conduct action, been employed by, or own a pecuniary interest, in the insurer subject to any examination. Market conduct oversight personnel are not automatically precluded from being:

- a policyholder or claimant under an insurance policy;
- a grantor of a mortgage or similar instrument on the individual's residence from a regulated entity, if done under customary terms and in the ordinary course of business;
- an investment owner in shares of regulated diversified investment companies; or
- a settlor or beneficiary of a "blind trust" into which any otherwise impermissible holdings have been placed.

### Immunity

Market conduct personnel are generally granted immunity for any statements made, or conduct performed in good faith, while carrying out market conduct activities. In addition, no cause of action arises for communicating or delivering information or data to the OIC, the OIC's authorized representative, market conduct oversight personnel, or an examiner, if the act of communication or delivery was performed in good faith and without fraudulent intent or the intent to deceive.

Market conduct personnel, the OIC, authorized representatives, or an appointed examiner are entitled to an award of attorneys' fees and costs if they are the prevailing party in a civil cause of action for libel, slander, or any other relevant tort arising out of market conduct activities.

If a claim is made or threatened, the OIC must provide or pay for the defense of himself or herself and the examiner or representative, and must pay a judgment or settlement, until it is determined that the person did not act in good faith or acted with fraudulent intent or the intent to deceive.

### **Coordination with Other State Regulators**

The OIC must share information and coordinate market analysis, market conduct actions, and examination efforts with other state insurance regulators in accordance with guidelines adopted by the NAIC.

If a market conduct examination or action performed by another state insurance regulator results in a finding that an insurer should modify a specific practice or procedure, the OIC must, in lieu of conducting a market conduct action or examination, accept verification that the insurer made a similar modification in this state, unless the OIC determines that the other state does not have laws substantially similar to those of this state, or does not have a comparable market conduct oversight system.

### **Records, Information, and Confidentiality**

Market conduct oversight personnel are granted free, convenient, and full access to all books, records, employees, officers, and directors, including the details of third-party models or products upon request, during regular business hours.

Each officer, director, employee, and agent of an insurer is required to facilitate and aid in a market conduct action or examination. No waiver of any applicable privilege or claim of confidentiality in the documents, materials, or information occurs as a result of disclosure to the OIC, any employee of the OIC, or any agent retained by the OIC to assist in the market conduct examination.

The OIC may take depositions, subpoena witnesses or documentary evidence, administer oaths, and examine under oath any individual about the affairs of any person being examined, or about the subject of any hearing or investigation. Witness fees and mileage, if claimed, are allowed the same as for testimony in a court.

Provisions related to sharing and receiving documents are included. In order to assist in the performance of the OIC's duties, the OIC may:

- share documents, materials, market conduct examination reports, preliminary market conduct examination reports, and other matters related to the reports, or other information, including confidential and privileged documents, materials, or information, with other state, federal, and international regulatory agencies and law enforcement authorities, and the NAIC and its affiliates and subsidiaries, if the recipient agrees to and asserts that it has the legal authority to maintain the confidentiality and privileged status of the document, material, communication, or other information;
- receive documents, materials, communications, or information, including otherwise confidential and privileged documents, materials, or information, from the NAIC and its affiliates or subsidiaries, and from regulatory and law enforcement officials of other foreign or domestic jurisdictions, and maintain as confidential or privileged any document, material, or information received with notice or the understanding that it is confidential or privileged under the laws of the jurisdiction that is the source of the document, material, or information; and
- enter into agreements governing the sharing and use of information.

If certain data or documents are in the possession of the OIC or the NAIC, the data or documents are considered confidential and privileged. This applies to data and documents, including but not limited to working papers, third-party models or products, complaint logs, and copies thereof, created, produced, or obtained by or disclosed to the OIC, the OIC's authorized representative, or an examiner appointed by the OIC, or obtained by the NAIC. These documents are not subject to the Public Records Act, subpoena, or discovery. These documents are not admissible in evidence in any private civil action.

If the OIC issues an examination report, the preliminary or draft report is confidential and not subject to disclosure nor is it subject to subpoena or discovery. The OIC maintains the authority to use a preliminary or draft market conduct examination report and related information in furtherance of any legal or regulatory action, or to release it in accordance with the Insurance Code.

An insurance compliance self-evaluative audit document in the possession of the OIC is confidential by law and privileged, and must not be:

- made public by the OIC;
- subject to the Public Records Act;
- subject to subpoena;
- subject to discovery; and
- admissible in evidence in any private civil action.

The disclosure of any self-evaluative audit document to the OIC and the citation to the document in connection with agency action do not constitute a waiver of any privilege that may otherwise apply.

Documents, materials, or information obtained by the OIC during a market conduct examination are exempt from public disclosure.

## **Dispute Resolution**

An insurer may, at any point in market analysis or in the market conduct examination, request a review and resolution of issues at any point in the market analysis or market conduct examination. The insurer must request the review orally or in writing and a response must be provided to the insurer within five days. After response, the insurer may request mediation. In mediation, the OIC selects a panel of pre-approved mediators, the insurer identifies an alternative mediator from the pre-approved list, and the party requesting mediation must pay the costs of the mediator.

### **Fines and Penalties**

Fines and penalties under the Insurance Code apply. The OIC must take into consideration membership in best practices organizations, and the extent to which insurers maintain regulatory compliance programs to self-assess, self-report, and remediate problems.

### **Other**

The OIC must designate a specific person or persons within the OIC's office to receive information from employees of insurers and licensed entities concerning violations of laws or rules by their employers. These persons shall be provided with proper training on handling this information. The information must be confidential and not open to public inspection, and is exempt from public disclosure.

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**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect 90 days after adjournment of session in which bill is passed.

### **Staff Summary of Public Testimony:**

(In support) The OIC worked for months with the industry to develop this bill and industry worked with the OIC for months to make adjustments to the original bill. The Engrossed Substitute Senate bill is different in two ways from the version that passed this committee earlier this session. One change is a technical change and the other change is a requirement that the OIC report to the Legislature on rules developed under the bill. It is important to make sure that the confidentiality provisions in the bill are not altered because confidentiality is very important.

(Opposed) None.

**Persons Testifying:** Mary Clogston, Office of the Insurance Commissioner; Mel Sorensen, Property Casualty Insurers; and Jean Leonard, Washington Insurers.

**Persons Signed In To Testify But Not Testifying:** None.