

# HOUSE BILL REPORT

## HB 3052

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### As Amended by the Senate

**Title:** An act relating to self-audits by insurers.

**Brief Description:** Authorizing self-audits by insurers.

**Sponsors:** Representatives L. Thomas, Smith, Mielke, Grant, DeBolt, Dyer, Hickel, Sullivan and Robertson.

**Brief History:**

**Committee Activity:**

Financial Institutions & Insurance: 2/2/98, 2/5/98 [DP].

**Floor Activity:**

Passed House: 2/12/98, 65-31.

Senate Amended.

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### HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS & INSURANCE

**Majority Report:** Do pass. Signed by 8 members: Representatives L. Thomas, Chairman; Smith, Vice Chairman; Zellinsky, Vice Chairman; Grant, Assistant Ranking Minority Member; Benson; DeBolt; Sullivan and Wensman.

**Minority Report:** Do not pass. Signed by 3 members: Representatives Wolfe; Constantine and Keiser.

**Staff:** Jim Morishima (786-7191).

**Background:** Insurance and insurance transactions are governed by state law. Generally speaking, a person who files reports or furnishes information required by the insurance code is immune from civil liability. Likewise, the insurance commissioner and the National Association of Insurance Commissioners are generally immune from civil liability for publishing insurance information.

An insurer must file an antifraud plan with the commissioner. The plan, which must be approved by the commissioner, must establish specific procedures to prevent insurance fraud, including internal fraud involving employees or company representatives. Each year, an insurer must file a summary of the actions it took under its antifraud plan. Both

the plan and the annual reports are not public records, are proprietary, are not subject to public examination, and are not discoverable or admissible in civil litigation.

Currently, however, an insurer's internal audits, designed to improve compliance with state and federal law, are not privileged from discovery or admissibility in court.

**Summary of Bill:** Section I of this summary will begin with a description of the new privilege granted to an insurer's internal compliance audit. Section II will describe the exceptions to this privilege.

### I. The Insurance Compliance Self-Evaluative Privilege

Subject to certain exceptions, documents connected with an insurer's internal compliance audit are privileged. This does not include documents created as a result of a claim involving personal injury made against an insurance policy. Testimony that is connected with the insurer's internal insurance compliance audit is also privileged; i.e., testimony from individuals who helped prepare/conduct the audit.

If an insurer voluntarily submits its documents to the commissioner, the privilege is not waived. The commissioner also cannot disclose the documents under provisions that would otherwise permit the commissioner to do so.

### II. Exceptions

When an insurer claims the privilege, it has the initial burden to show that the privilege applies. Once the insurer has done this, it is up to the party seeking disclosure to prove that an exception to the privilege applies. There are three areas where an exception to the privilege may apply: in a civil court or administrative proceeding, in a criminal court, and when the commissioner or attorney general requests disclosure.

#### A. In Civil Court

In a civil court or in an administrative proceeding, the court may require disclosure after an in camera hearing if the privilege is asserted for a fraudulent purpose, the material is not properly a subject for the privilege, or the insurer failed to take reasonable corrective action to alleviate the problems identified in the material within a reasonable time.

#### B. In Criminal Court

In a criminal court, the court may require disclosure after an in camera hearing for any of the same reasons as a civil court or administrative proceeding above. A criminal court may also require disclosure when the material contains evidence relevant to the commission of a crime, the commissioner or the attorney general has a compelling need for the information, the information is not otherwise available, and the commissioner or

attorney general is unable to obtain the substantial equivalent without undue cost or delay.

C. By Request of the Commissioner or the Attorney General

The commissioner or the attorney general may request that an insurer disclose its insurance compliance self-evaluative documents. The insurer has 30 days to file a petition of protest with the appropriate court which must contain specific information. If the insurer does not file the petition, the privilege is waived. The court may require disclosure for the same reasons as a criminal or civil court can. This disclosure must be confined to the issue at hand and is not a waiver of the privilege in any other circumstance.

The commissioner or the attorney general can get the following information free and clear of the insurance compliance self-evaluation privilege: documents maintained for a regulatory agency, information obtained by observation or monitoring by any regulatory agency, or information obtained from a source independent of the audit.

**EFFECT OF SENATE AMENDMENT(S):** The House Financial Institutions and Insurance committee and the Senate Financial Institutions, Insurance, and Housing committee must study insurance compliance self-evaluative audits and recommend whether the Legislature should recognize a limited privilege for such audits. The two committee chairs must organize a study group that includes voluntary participation by the insurance industry, the Office of the Insurance Commissioner, and other interested parties. The ranking minority members of each committee must also participate in the study group. If the committees recommend that the Legislature should recognize the privilege, the study must develop a bill for consideration in the 1999 legislative session.

**Appropriation:** None.

**Fiscal Note:** Requested on February 5, 1998.

**Effective Date:** Ninety days after adjournment of session in which bill is passed.

**Testimony For:** Insurer's are concerned that their internal audits will be disclosed in court. Without the privilege established by this bill, there will either be no audits at all, or audits that do not disclose any wrongdoing on the part of the insurer. The privilege in this bill is narrowly drawn and will not prevent parties from discovering the facts underlying the audit.

**Testimony Against:** This bill will make enforcement of the insurance law more difficult by enabling insurers to conceal information. This bill would put an end to the practice of investigators using an insurer's internal audits as a "road map" to investigate wrongdoing. Furthermore, many insurers do not act on their internal audits. Therefore,

encouraging more internal audits is not necessarily a good idea. Protections for certain internal documents already exist; e.g., the attorney work product privilege.

**Testified:** Mike Kapphahn, Farmers Insurance (pro); Jim Odiorne, Office of the Insurance Commissioner (con); Pam Martin, Office of the Insurance Commissioner (con); Mel Sorensen, National Association of Independent Insurers (pro); Larry Shannon, Washington State Trial Lawyers Association (con); and Jean Leonard, Washington Insurers (pro).