

SENATE BILL REPORT

ESSB 5717

As Passed Senate, March 7, 2007

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: Financial Institutions & Insurance: 2/13/07, 2/27/07 [DPS].
Passed Senate: 3/07/07, 47-0.

SENATE COMMITTEE ON FINANCIAL INSTITUTIONS & INSURANCE

Majority Report: That Substitute Senate Bill No. 5717 be substituted therefor, and the substitute bill do pass.

Signed by Senators Berkey, Chair; Hobbs, Vice Chair; Benton, Ranking Minority Member; Franklin, Hatfield, Parlette and Schoesler.

Staff: Diane Smith (786-7410)

Background: The Office of Insurance Commissioner (OIC) has authority to conduct financial examinations of insurance companies that it regulates. The examinations must be conducted at least every five years for each insurance company and are in a form that is applied uniformly to each company. Market examinations are conducted under the same authority. These examinations include consideration of the company's conduct in the marketplace.

Since statutory authority to conduct examinations was first granted in 1947 and last partially updated in 1993, the National Association of Insurance Commissioners (NAIC) has developed a market analysis program. Part of that program includes the submission of annual statements to the NAIC from participating states. As of 2007, 25 states participate in this annual statement process that contributes to the NAIC's database.

In the NAIC model, market analysis is used to create a baseline understanding of the insurance marketplace to which individual companies can be compared. Only those companies, and

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only to the extent warranted, that exhibit outlier status to some degree are subjected to the market examination, or some lesser examination.

Summary of Engrossed Substitute Bill: Financial examinations are differentiated from market conduct examinations. Market conduct examinations are conducted on an as-needed basis and consider market activities from the past, to the present and into the future.

The Office of the Insurance Commissioner must gather data from insurance companies and elsewhere to establish a baseline understanding of the marketplace's patterns and practices. The OIC must use this baseline to identify and prioritize the seriousness of any insurers' marketplace activities that deviate significantly from the norm or that may pose a potential risk to the insurance consumer.

Insurers must file market conduct statements annually on NAIC forms. An insurer may voluntarily conduct an internal insurance compliance self-evaluation audit. The purpose of this self-evaluation audit is for the insurance company to identify or prevent noncompliance or to promote compliance.

The OIC has a range of responses that can be tailored to the individual insurance company's needs. The OIC determines the frequency and timing of market conduct actions. The OIC must select the least intrusive and most cost-effective market conduct action that provides the necessary protections for the consumer. The range of responses runs, in eight graduated steps, from correspondence with the insurer to examinations. Examinations include the comprehensive market conduct examination, targeted examination, and on-site examination. The OIC need not use all these steps, or use them in the stated order. The OIC is not limited to just these steps.

The NAIC's existing mechanisms are used to communicate and coordinate market conduct actions among state insurance regulators. Market data is collected and reported to the NAIC's market information systems. The insurers' annual market conduct statement is made according to the time frames and on the forms of the NAIC. The OIC must use the NAIC standard data request for market conduct examinations and the announcement of the examination must be posted on the NAIC's examination tracking system.

The NAIC market regulation handbook is one resource used by the OIC in performing the analysis necessary to develop the baseline understanding of the marketplace. It must be followed in market conduct examinations. Exit conferences must also be conducted according to the NAIC handbook.

The OIC must use information collected by the NAIC in conducting market analysis and may receive documents, including otherwise confidential information, from the NAIC and its affiliates or subsidiaries.

If the continuum of graduated regulatory responses from the OIC has not sufficiently addressed the issues raised concerning the insurer's activities in Washington State, the OIC has discretion to conduct market conduct examinations according to the NAIC market conduct uniform examination procedures and the NAIC market regulation handbook. This decision is not subject to appeal. The market conduct examinations may be either comprehensive or targeted.

At the time that the OIC takes any action along the continuum, the insurance company must be given an opportunity to verify the data that triggered the response.

Market conduct examinations are conducted according to a process. This process includes notification, a work plan, provisions for questioning a conflict of interest of the assigned market conduct oversight personnel, preexamination conference, exit conference, full written report, a hearing to consider objections, a mediation form of alternative dispute resolution, and appeal of the hearing decision under the Administrative Procedure Act.

Rule making is required to establish the system of mediation and for the OIC to adopt procedures and documents substantially similar to the NAIC work products, in accordance with which, market analysis, market conduct actions, and market conduct examinations must be performed.

The market conduct examination report is confidential and not filed for public inspection until after the hearing. Once adopted, the report is held private and confidential for five days and then the OIC may open the report for public inspection. The OIC may withhold any examination or investigation report for so long as it deems it advisable. No waiver of any privilege or confidentiality occurs as a result of the insurer's disclosure of information to the OIC. The OIC may share confidential and privileged documents with any regulatory agency, law enforcement authority, or the NAIC if that entity agrees to and asserts it has the legal authority to maintain the confidentiality and privilege.

The self-evaluation audit document is confidential and privileged, as are all documents in the possession of the OIC or NAIC in the course of any market conduct action or examination or market analysis. These same documents are exempt from disclosure under a public records request.

In making market conduct examinations, the OIC may contract with attorneys, appraisers, CPAs, actuaries, and others. The compensation and per diem paid to them must not exceed 125 percent of the NAIC guidelines, if possible. Certain contract terms are required. They include dispute resolution or arbitration to resolve conflicts with insurers, disclosure of fees and hourly rates, and that the OIC must review and affirmatively endorse detailed billings before the billings are sent to the insurer.

The work plan for a market conduct examination must include a budget for the examination if the cost is to be billed to the insurer. This budget must identify factors that will be included in the billing. One of the factors the OIC must consider in determining the personnel costs for employees examining insurers domiciled outside the state is the NAIC's recommended salary and expense schedule for zone examiners.

The company examined is liable to reimburse the state upon presentation of an itemized statement for travel, living expenses, per diem, salary and benefits for the employee doing the examination. The itemized bills are to be provided monthly for prior review by the insurance company. The OIC must maintain active management and oversight of examination costs.

Whistleblower protection is provided by the OIC for employees who report violations of laws or rules by their employers who are insurers. Information provided by the employees to the OIC is confidential and not open to public inspection.

Fines and penalties are to be consistent, reasonable, and justified. The OIC must take into consideration the insurers' membership in best practices organizations, its self-assessments, and reporting. Any insurer that fails to file its market conduct annual statement on time is subject to the penalty and enforcement provisions of the insurance code.

The OIC must report to the appropriate legislative policy committees after rules are adopted to implement NAIC provisions.

Appropriation: None.

Fiscal Note: Available.

Committee/Commission/Task Force Created: No.

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

Staff Summary of Public Testimony: PRO: The OIC's office gets 100,000 calls from consumers a year. Company supervision is part of the licensing responsibility of the OIC. Fourteen thousand insurance companies do business in Washington. The rates and forms division reads the fine print on 15,000 filings made per year on company policies and rates. Market analysis looks at how companies perform in the marketplace itself. Market conduct, used now, is an antiquated, retrospective tool from the nineteenth-century compared to market analysis which is a twentieth-century tool. Market analysis is less intrusive, less costly and prospective. The question is whether states should keep the market regulation responsibility, or should the federal government preempt this function. All three hot-spots have been or are being addressed, including market conduct changing to market analysis. This bill repeals the requirement that market conduct examinations be performed every five years. It provides more standardization among states and requires deference to other states' market analysis work. We are still working on how to make the transition from market conduct to market analysis.

The OIC only charges for examinations done out of state. If any consultants are hired to examine a domestic insurance carrier, the OIC pays that cost. The dispute resolution process is adequate in the bill so as to not bring the examination process to a halt. The OIC will proceed with rule making on the complaint verification procedure. Washington being on the cutting edge is good for consumers.

There are four areas of concern with the bill. First is the overlap of existing market conduct and the new market analysis. Second is the Alternative Dispute Resolution language, which needs to be an informal process that is more speedy and less costly, such as arbitration or mediation. Third is that the consultants must have a maximum of hours and very close monitoring and control. The NAIC guidelines are appropriate. Fourth is the data verification.

CON: The language we choose, especially as it bears on uniformity, ease of administration and cost, should be what we can take to all 50 states.

OTHER: The confidentiality provisions must be kept in tact. This is a change in the way of doing business in Washington and we are working cautiously. We cannot allow an otherwise discoverable document to become undiscoverable just by being put into an insurer's self-audit.

Persons Testifying: PRO: Beth Berendt, OIC Deputy Commissioner; Mike Kreidler, OIC Commissioner; Brad Tower, Optometric Physicians of Washington; Mel Soresnsen, America Health Insurance Plans, American Council on Consumer Interests, PCI.

CON: Cliff Webster, American Insurance Association.

OTHER: Michael Temple, Washington State Trial Lawyers Association; Jean Leonard, Washington Insurers State Farm.