

HOUSE BILL REPORT

HB 2355

As Reported by House Committee On:
Business & Financial Services

Title: An act relating to registered service contract and protection product guarantee providers.

Brief Description: Concerning registered service contract and protection product guarantee providers.

Sponsors: Representatives Kirby, Vick and Blake.

Brief History:

Committee Activity:

Business & Financial Services: 1/19/16, 1/20/16 [DPS].

Brief Summary of Substitute Bill

- Amends financial responsibility requirements applicable to service contract providers.
- Amends requirement to prove solvency when registering as a service contract or protection product guarantee provider.
- Provides that the Insurance Commissioner must approve policy rates for insurance policies held by service contract providers only if the provider is domiciled in Washington.
- Provides that certain service contract providers need not submit audited financial statements as part of their annual reporting to the Insurance Commissioner.
- Defines "motor vehicle service contract" for the purposes of exemptions from certain regulations.
- Limits the Insurance Commissioner's authority to request additional information during registration or suspend registrations due to the provider's financial condition.

HOUSE COMMITTEE ON BUSINESS & FINANCIAL SERVICES

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.

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 11 members: Representatives Kirby, Chair; Stanford, Vice Chair; Vick, Ranking Member; Blake, Dye, G. Hunt, Hurst, Kochmar, McCabe, Ryu and Santos.

Staff: David Rubenstein (786-7153).

Background:

Service Contracts.

Insurance and insurance transactions are governed by the Insurance Code (Code). Among other things, the Code requires: (1) that insurers meet certain financial requirements; and (2) that agents, solicitors, and brokers of insurance comply with specified licensing standards. Financial and criminal penalties may result from noncompliance.

Certain products and transactions that fall within the definition of insurance have been addressed by exemptions from the Code or the creation of a specific regulatory structure. Entities regulated under these chapters may not be required to comply with the same capitalization and reserve requirements, reporting and solvency oversight, and claims handling practices as are required of an insurer selling a traditional insurance product. Persons regulated under these chapters may not have to be licensed or have the same degree of training.

Service contracts are one of the types of products that are regulated less stringently than insurance products under the Code. A service contract under the Code is a contract for separate consideration for a specific duration to:

- repair, replace, or maintain property; or
- indemnify for the repair, replacement, or maintenance of property.

Examples of service contracts include motor vehicle service plans offered by auto dealers that provide a period of maintenance or repair or a protection plan offered by an electronics manufacturer.

Registration.

A service contract provider must register with the Insurance Commissioner (Commissioner), the procedures and requirements for which are set forth in the Code. The Commissioner may suspend or revoke the registration of a service contract provider for failure to comply with the specific requirements.

Service contract providers registering with the Commissioner must submit:

- basic organizational documents;
- identities of executive officers and major shareholders;
- audited financial statements for the previous two years as proof of the applicant's solvency; and
- any other pertinent information the Commissioner requires.

If the service contract provider maintains certain insurance on the contracts or has a net worth or is part of a parent company that has a net worth of \$100 million, it has somewhat different obligations as to the third requirement (discussed below).

The Commissioner may refuse to issue a registration if he or she determines that the service contract provider:

- is not competent;
- is not trustworthy;
- is not financially responsible; or
- has had a license denied or revoked for cause in any state.

The Commissioner may immediately suspend a service contract provider's registration without notice if the Commissioner finds that the provider is insolvent, entering receivership, or the financial condition or business practices of the provider pose an imminent threat to public health, safety, or welfare.

Registered service contract providers are required to submit an annual report to the Commissioner with the content required by the Commissioner.

Financial Responsibility for Service Contract Providers.

A service contract provider may choose one of the following options to ensure that all obligations and liabilities are paid:

- a. insure its service contracts with a reimbursement insurance policy, to be approved by the Commissioner (option (a));
- b. maintain a reserve account that includes a portion of the gross consideration received for all service contracts and give the Commissioner a financial security deposit (option (b)); or
- c. maintain or have a parent company that maintains a net worth or stockholder's equity of \$100 million (option (c)).

In addition to providing its own audited financial statements, if the service contract provider relies on option (c) it must also submit audited financial statements for its parent company when it registers with the Commissioner and, on the Commissioner's request, the parent company's form 10-K or form 20-F filed with the United States Securities and Exchange Commission (SEC) or audited financial statements. If the provider relies on option (a) it may satisfy the audited financial statement requirement by submitting financial statements certified by two or more officers of the company.

A provider relying on option (b) must place in trust with the Commissioner a financial security deposit equal to 5 percent of gross consideration received, less claims paid, for the sale of service contracts. The deposit must be at least \$25,000 and may consist of a surety bond, securities, cash, an evergreen letter of credit, or another form of security prescribed by rule.

Motor Vehicle Service Contracts.

Providers of service contracts specifically relating to motor vehicles are subject to similar requirements as other service contract providers. However, motor vehicle manufacturers and import distributors issuing service contracts are exempt from various provisions applicable to other service contract providers. The provisions from which manufacturers and distributors are exempt include:

- submitting organizational documents and identities of corporate officers;
- appointing the Commissioner to receive service of process;
- the Commissioner's authority to immediately suspend registration for cause;
- annual reporting;
- reimbursement insurance policy requirements; and
- various other requirements applicable to service contract providers.

A service contract is defined to include various service agreements for, among other things:

- the removal of certain dents, dings, or creases on a motor vehicle;
- the repair of or replacement of windshields as a result of damage caused by road hazards;
- the replacement of a motor vehicle key or key fob; and
- other services approved by rule of the Commissioner.

Protection Product Guarantee Providers.

A protection product is a substance, device, or system that is designed to protect another product from damage, such as a coating intended to protect paint from sun damage. A protection product guarantee is an agreement to replace or repair the product that the protection product was designed to protect or pay incidental costs resulting from its damage.

A protection product guarantee provider must also register with the Commissioner by submitting:

- the identities of the provider's executive officers and administrators in charge of the guarantees;
- proof of a reimbursement insurance policy for the guarantees;
- a copy of the guarantees to be offered; and
- any other pertinent information the Commissioner requires.

As with service contract providers, the Commissioner may refuse to issue a registration if he or she determines that the protection product guarantee provider:

- is not competent;
- is not trustworthy;
- is not financially responsible; or
- has had a license denied or revoked for cause in any state.

Reimbursement Policy Approval.

A service contract or protection product guarantee provider that uses the reimbursement insurance policy (option (a)) must submit the insurance policy to the Commissioner for approval.

Summary of Substitute Bill:

Financial Responsibility.

A service contract provider that relies on its parent company's net worth of \$100 million to demonstrate financial responsibility must submit the parent company's most recent SEC form 10-K or form 20-F, or the most recent audited financial statement if no forms were filed.

If the service contract provider relies on the reserve account method and posts an evergreen letter of credit with the Commissioner, the letter of credit must be irrevocable.

Registration Requirements.

The requirement that the service contract provider provide any pertinent information required by the Commissioner is deleted.

The requirement that all service contract providers prove solvency is removed. Instead, the service contract provider applicant must demonstrate ability to perform its obligations in one of three ways, depending on how it demonstrates financial responsibility:

1. A provider relying on the insurance method (financial responsibility option (a) above), may submit either:
 - a. audited financial statements for the most recent year demonstrating a net worth of \$200,000 or more; or
 - b. financial statements certified as accurate by two officers of the provider.
2. A provider relying on the reserve account method (option (b) above) must submit audited financial statements proving a net worth of \$200,000.
3. A provider relying on a net worth or parent company net worth or stockholder equity of \$100 million (option (c) above) must submit the most recent audited financial statements or forms filed with the SEC proving that net worth.

The authority of the Commissioner to deny registration to a provider it determines is not financially responsible is replaced with authority to deny if the provider cannot demonstrate net worth or stockholder value as described above.

Annual Reporting.

A registered service contract provider relying on the insurance method of demonstrating financial responsibility may not be required to submit audited financial statements in its annual report but must submit the most recent annual financial statement certified by two officers of the service contract provider or its parent company.

If the provider uses the parent company net worth method of demonstrating financial responsibility, it must submit its parent company's audited financial statements or SEC filings, if requested by the Commissioner. It need not submit its own audited financial statements.

Protection Product Guarantee Providers.

To register as a protection product guarantee provider, the applicant must submit financial statements, certified as accurate by at least two officers, proving a net worth or stockholder equity of \$200,000 or more. The authority of the Commissioner to deny registration to a provider it determines is not financially responsible is replaced with authority to deny if the provider cannot demonstrate the required net worth or stockholder equity.

The requirement that the applicant submit any other pertinent information required by the Commissioner is deleted.

Commissioner's Authority to Suspend Registration.

The Commissioner's authority to immediately suspend a registration if the provider is insolvent is removed. Instead, the registration may be suspended if the provider does not maintain the minimum net worth required by law.

The Commissioner's authority to suspend a registration if the financial condition of the provider poses an imminent threat to the public is eliminated.

Reimbursement Insurance Policy Rates.

If the service contract provider is using the reimbursement insurance policy method to satisfy the financial responsibility requirement, the policy rates must be filed with the Commissioner only if the insured service contract provider is domiciled in Washington.

Motor Vehicle Service Contract.

For the purposes of exemptions from regulation afforded to motor vehicle manufacturers, the term "motor vehicle service contract" is defined to include a contract or agreement for various specific services relating to motor vehicles.

Substitute Bill Compared to Original Bill:

The substitute bill includes a provision stating the requirements applicable to annual reports submitted by service contract providers to the Commissioner and a provision requiring that evergreen letters of credit posted as evidence of financial responsibility must be irrevocable.

Appropriation: None.

Fiscal Note: Available.

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

Staff Summary of Public Testimony:

(In support) Most other states recognize that service contracts are not insurance. Currently, Washington regulates service contracts as if they are insurance, but the Legislature has enacted a web of exemptions. Still, companies trying to do business in Washington are stymied by its regulations. Washington is an outlier in how it regulates service contracts and this bill is a large step in aligning Washington with other states and the model act adopted by the National Association of Insurance Commissioners. The changes in this bill arose from a discussion of the most significant problems in Washington law at the annual convention of service contract providers.

The seasoning requirement in Washington is much longer than in other states and requires a Washington-based company to operate out of state for two years before doing business at home. The solvency requirement in Washington is too vague, and this legislation replaces it with a clear minimum net asset requirement to avoid inconsistent application. The net worth requirement in Washington requires service contract providers to provide their own audited financial statements, even if they are relying on their parent company's net worth. Reimbursement insurance policies must be approved by the Washington's Insurance Commissioner, even though this is inconsistent with United States Supreme Court precedent. Finally, motor vehicle service contracts are not well defined, which is inconsistent with the rest of the country. This bill corrects each of these issues.

Registration should be more efficient. This bill should be amended to clarify that service contract providers need not submit audited financial statements with their annual reports to the Commissioner. This is especially important for smaller companies that are a subsidiary of a much larger parent company.

(Opposed) None.

(Other) The Commissioner supports the changes to the motor vehicle service contract definition. However, the Office of the Insurance Commissioner looks to Florida as a model for its perspective on requirements applicable to seasoning, audited financial statements, and parent companies.

Persons Testifying: (In support) Representative Kirby, prime sponsor; Mel Sorensen, Property Casualty Insurers Association of America and Allstate Insurance Company; Stephen McDaniel, Service Contract Industry Council and Motor Vehicle Ancillary Products Association; Cliff Webster, American Insurance Association; Mark Harris, SquareTrade Inc; Steve Gano, CNA Insurance; and Brian Kreger.

(Other) Lonnie Johns-Brown, Office of the Insurance Commissioner.

Persons Signed In To Testify But Not Testifying: None.