



THIS WEEK IN SACRAMENTO

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State Fund vs. Garamendi

A highly anticipated hearing of the Senate Insurance Committee relative to the litigation between the State Compensation Insurance Fund (State Fund) and Insurance Commissioner John Garamendi ended with few fireworks and in a relative stalemate.

The three hour hearing was not attended by Republican members of the committee. Only Chairwoman Jackie Speier, Senator Nell Soto and Deborah Ortiz were in attendance.

Insurance Commissioner John Garamendi was joined by Chief Deputy Commissioner Rick Baum and General Council Gary Cohen. State Fund President Dianne Oki was accompanied by Executive Vice President Jim Neary and Assistant Chief Council Charles Savage. State Fund board member Jay Hansen, representing the State Building and Trades Union and an ex-officio member appointed by Senate Pro Tempore John Burton also attended and testified at the invitation of the chair.

The committee's agenda for the hearing was relatively short allowing for opening remarks by the committee chair and vice-chair and opening comments by State Fund President Dianne Oki and Insurance Commissioner John Garamendi. The last agenda item was questions by members of the committee; however, a lengthy background paper provided by committee staff recited a history of the State Fund and its legislative mission, an analysis of the requirements of Risk Based Capital, a timeline of financial issues affecting the State Fund, issues and questions relative to the KPMG audit report issued on May 17th, and a number of suggested questions relative to the financial status of the State Fund, the State Fund's procedures, claims handling, anti-fraud efforts, and financial issues relative to the State Fund's reserves and surplus position.

Insurance Commissioner John Garamendi did his best to capsule the dispute between his office and the State Fund with the sample notion of "whether the

Department of Insurance should regulate the largest workers' compensation insurer in the nation." In addition, the Commissioner attempted to stake out the high ground by having dismissed his own lawsuit against the State Fund earlier in the week and captioned the issue of one of level playing field for all other insurers. The Commissioner stated "that since the State Fund operates as an insurance company, it should be subject to the laws and regulations governing all other insurers. State Fund either must accept regulation by the Insurance Commissioner as does every other insurance company in the state (with the exception of those provisions in the Insurance Code providing for conservation and liquidation), or it must operate independently of Department of Insurance regulation, with my authority limited to conducting audits of its business and reporting the results to the Legislature and the Governor." The Commissioner testified that this current situation is untenable and that the Legislature, and the Governor, should clarify this situation, not the courts.

To support his actions over the last year, the Commissioner cited financial concerns expressed relative to the State Fund by former Commissioner Harry Low, as well as prior audits of the State Fund by Price Waterhouse Coopers, the department's staff and IBM Consulting. The Commissioner pointed out that the IBM report identified eight areas where the State Fund had operational problems such as fraud detection, missing opportunities in medical provider direction, avoidance of fines, subrogation, legal cost avoidance and return to work opportunities. He also noted that the KPMG audit expressed no opinion as to the appropriate level of the State Fund's surplus.

In its defense, State Fund President Dianne Oki testified to the committee that the State Fund had active responsibility dealing with the financial and marketplace issues of the last several years and that the KPMG audit demonstrated that the State Fund's financial position had weathered the storm. Ms. Oki stressed that the events of the last few years relative to the high number of workers' compensation insurer insolvencies, changes in the workers' compensation marketplace in California and the financial position of the State Fund were all history. She indicated that the current dispute with the Insurance Commissioner was all about whether the State Fund would be capable of responding to the next workers' compensation crisis in 5, 10 or 20 years from now.

Ms. Oki opined (or stated) that the public policy question with regard to the application of Risk Based Capital standards to the State Fund is "should the State Fund have the ability to expand capacity in tough times to fulfill its constitutional mandate to provide workers' compensation insurance to California employers or will the State Fund be restricted in its ability to provide workers' compensation insurance to California employers by the strict application of Risk Based Capital standards?" She testified that the State Fund viewed its mission to provide a shock absorber to California employers and the California economy in times of a hard insurance market. She indicated that the State Fund was between 20-30% of the California workers' compensation market until 28 insurers were declared insolvent over the last several years. Since many of the private insurers withdrew from California, State Fund simply absorbed the marketshare of the 28 solvent carriers. This raises the question

that if the State Fund could not expand capacity to write additional policies due to restrictions imposed by Risk Based Capital, what would have happened to California employers in need of coverage and what affect would the higher cost had on the California economy?

Chairwoman Jackie Speier raised the question of the clear intent in AB 1985 to apply Risk Base Capital standards to the State Fund. Charles Savage, Assistant Chief Council for State Fund, testified that there were legitimate questions in the drafting of AB 1985 as to whether it applied to the State Fund. In addition, he reiterated the public policy question as to whether AB 1985, if applicable to the State Fund, conflicts with the State Fund's constitutional mandate.

Relative to charges by the Commissioner that the State Fund had been uncooperative since last May, Ms. Oki testified that the State Fund had cooperated with every audit and/or examination requested by the Insurance Commissioner relative to market conduct, its fraud efforts, claims handling, underwriting and financial condition. She indicated that the State Fund had spent \$2 million on such examinations and audits. She testified that the State Fund disputed the Insurance Commissioner's request to employ CPB Group to audit the funds implementation of the recommendation of the IBM study because the costs were excessive, estimated to be approximately \$500,000, the CPB Group did not have a qualified financial analyst, and the study/exam went beyond what the Legislature requested the Commissioner to do relative to AB 227/SB 228.

Lastly, State Fund Board Member Jay Hansen testified on a number if issues, including the number and length of State Fund board meetings, the work ethic of board members and opinions of the board relative to the litigation involving the application of Risk Based Capital. He confirmed that the board had requested that the State Fund try to settle the litigation between the State Fund and the Insurance Commissioner and the several board members had tried to assist in that regard. However, he indicated that if Risk Based Capital were to apply strictly to the State Fund that the next 1.5 billion in profit would have to be added to surplus rather than go to reducing the cost of workers' compensation premiums to California employers. Mr. Hansen indicated it was more important to him and the union workers he represents in his day job to lower the cost of workers' compensation insurance to California employers. Mr. Hansen also indicated that he opposed the appointment of any State Fund board member that were not policyholders.

In the end, although interesting in a number of respects, the hearing did not bring the parties to the litigation any closer to resolution and/or settlement and will not likely end the current litigation. We expect amendments to an existing bill to resolve the role of the Insurance Commissioner in regulating the State Fund and/or the Governor to appoint two new board members to fill expired terms of two current members of the State Fund Board.

Homeowners Insurance Legislation

A number of bills relating to homeowners insurance coverage continue to move through both houses of the California Legislature.

This week, the Senate passed **SB 1369** by Senator Sheila Kuehl (D-Santa Monica), which relates to firebreaks around homes and dwellings. The bill would require firebreaks of at least 100 feet around homes in areas where the state has firefighting responsibilities and in high-fire-risk areas patrolled by local firefighters. Insurers would even be allowed to require homeowners to clear at least a 30-foot firebreak in such high-risk areas. Current state law requires homeowners to clear at least a 30-foot firebreak in those areas. The bill passed the Senate with a vote of 25-12.

The Senate also passed **SB 1323** by Senator Deborah Ortiz (D-Sacramento), relating to consumer's credit information. The bill, as currently drafted, would prohibit homeowners' insurers from using customer's credit scores in their underwriting decisions. In addition, the bill would bar insurers from reporting inquiries about the scope of policyholder's coverage to insurance support databases such as C.L.U.E. SB 1323 passed off the Senate Floor with a vote of 22-13.

In addition to these bills, the Senate heard two of the Insurance Commissioner's "Homeowner's Bill of Rights" measures, **SB 1474** by Martha Escutia (D-Whittier) and **SB 1855** by Dede Alpert (D-San Diego). SB 1474 (Escutia) would prohibit insurance companies from refusing to issue or renew a homeowners' insurance policy based upon the fact the applicant or the insured made two claims in the last three years. Claims resulting from natural causes and fires that started elsewhere would not be counted under this proposal. The bill passed off the Senate floor with a vote of 24-12.

SB 1855 (Alpert) would require homeowners insurers to provide policyholders with additional information about the extent of their coverage or be forced to pay the full replacement value if the home was to be destroyed. The bill passed off the Senate Floor with a vote of 24-10.

Representatives from the insurance industry, including representatives from the Liberty Mutual Group, Nationwide Insurance Company, The First American Corporation, and the Agents and Brokers Legislative Council (ABL), are currently working to incorporate amendments to SB 1855 that would edit the existing Petris Disclosures and add a statement reminding the consumer to ensure their policy provides the appropriate amount of insurance coverage and advises the consumer that additional coverage is available. The statement would further state that policyholders that are interested in purchasing additional coverage to contact their local insurance agent or broker. Senator Alpert has expressed her willingness to work with the industry on this bill.

Vehicle/Cell-Phone Bills

Two bills that would restrict the use of cellular phones while driving were heard this week. **SB 1800**, authored by Senator Kevin Murray (D-Los Angeles) and sponsored by the CSAA, would prohibit persons driving from smoking, eating, drinking, reading, grooming, and other specific actions. Drivers caught participating in these distracting activities would receive a \$35 first offense violation. The goal of the bill, as expressed by the company spokesman, is to get people to drive more safely, not to write tickets. The sponsors point to the recent studies performed by the National Traffic Safety Administration, which found that 25 to 30 percent of police reported crashes involve driver inattention, including distractions. SB 1800 passed the Assembly with a vote of 22-14.

SB 1582, by Senator Deborah Bowen (D- Marina Del Rey), also would ban teenagers with provisional licensees from driving while talking on a cell phone. This bill is currently on the suspense file in the Assembly Appropriations Committee. **AB 1828**, by Joseph Simitian (D-Palo Alto), would make it an infraction to operate a motor vehicle while using a cell phone unless utilizing a hands-free device. The fine would be \$20 for the first violation and up to \$50 for each subsequent violation. AB 1828 has not yet been heard by the committee at this time.