

**STATE  
FISCAL IMPACT**

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| <b>Drafting Number:</b> LLS 14-0899                     | <b>Date:</b> February 28, 2014   |
| <b>Prime Sponsor(s):</b> Sen. Cadman<br>Rep. Sonnenberg | <b>Bill Status:</b> Senate SVMA<br><b>Fiscal Analyst:</b> Alex Schatz (303-866-4375) |

**SHORT TITLE:** INSURER MARKET CONDUCT EXAMS ACTUAL HARM INSURED

| Fiscal Impact Summary*                         | FY 2014-2015   | FY 2015-2016 |
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| <b>State Revenue</b>                           |  |              |
| Revenue Change<br>General Fund                 | Potential reduction.<br>See State Revenue section.   |              |
| State Diversions<br>General Fund<br>Cash Funds | Potential diversion for increased Division of Insurance costs.<br>See State Revenue section. |              |
| <b>State Expenditures</b><br>Cash Funds        | Potential increase.<br>See State Expenditures section.                                       |              |
| <b>FTE Position Change</b>                     |  |              |
| <b>Appropriation Required:</b> None.           |  |              |

\* This summary shows changes from current law under the bill for each fiscal year.

**Summary of Legislation**

This bill modifies the authority of the Division of Insurance (DOI) in the Department of Regulatory Agencies (DORA) to assess penalties related to insurance examinations and modifies certain procedures related to the regulation of licensed insurers in market conduct actions.

**Fines and penalties related to financial and market conduct examinations.** Under current law, fines and penalties based on the results of insurer examinations must be levied in a consistent, reasonable, and justified manner following consideration of an insurer's participation in industry groups that promote high standards of conduct. The bill requires the DOI to consider actual harm to consumers documented in the examination report, to ensure a rational relationship between actual harm and any fines or penalties, and to disregard administrative errors and errors that do not harm consumers. The total amount of fines for any market conduct action must not exceed one year of reported profit of an insurer.

**General procedure for market conduct actions.** Under current law, after a market analysis, market conduct actions are initiated at the discretion of the Commissioner of Insurance (commissioner), and focus on general business practices and compliance activities rather than infrequent or unintentional random errors. Under the bill, market conduct actions must focus on general business practices and compliance activities that cause actual harm to consumers. In addition, other than a market analysis, the DOI may not initiate a new market conduct action within five years of the insurer's last market conduct action unless:

- the commissioner finds clear and convincing evidence of imminent risk to consumers; and
- the commissioner serves the insurer with a written statement of his or her findings.

***Procedure for targeted, on-site examinations.*** Under current law, if the commissioner determines that no other market conduct action is appropriate, the DOI may commence a targeted, on-site market conduct examination after offering the insurer an opportunity to clarify expectations in a pre-examination conference. The bill requires that such a pre-examination conference comply with relevant provisions of the National Association of Insurance Commissioners (NAIC) Market Conduct Examiner's Handbook, including discussion of ways to expedite the examination.

## **Background**

The DOI regulates approximately 1,640 insurers. From this population of regulated insurers, the DOI performs approximately 10 market conduct examinations each year. Such examinations involve an intense period of DOI effort prior to the preparation of the examination report. Following the issuance of the examination report, the DOI remains in contact with insurers as needed to verify compliance with corrective actions.

As defined in statute, a market conduct action is any activity initiated under the authority of the Commissioner of Insurance in DORA to address market practices of insurers, ranging from market analysis to on-site examinations. Colorado statute authorizes, but does not limit, market conduct actions in the form of desk examinations, correspondence with the insurer, insurer interviews, policy and procedure reviews, formal interrogatories, and other evaluations that may or may not involve insurer participation and response. In practice, insurance regulators use market conduct action to verify insurers' compliance with applicable law, evaluate fulfillment of contractual obligations to insured parties, review forms and rates, and identify problems that may indicate the insurer's financial solvency is at risk.

An insurer that is subject to enforcement action by the DOI may file a district court complaint concerning the findings of a financial or market conduct examination, while any legal action concerning associated fines and legal penalties is within the original jurisdiction of the court of appeals. Within the last four years, the Attorney General's Office (AG) has defended multiple cases against the DOI related to financial examinations and market conduct actions. Based on extensive discovery and motions advocacy, the state's cost of litigation has exceeded \$100,000 per case in some of these recent insurance cases.

## **State Revenue**

The bill potentially reduces state revenue credited to the General Fund from fines and penalties collected by the DOI. By limiting fines to one year of profits, the amount of potential fines revenue, especially in larger enforcement actions undertaken by the DOI, may be reduced relative to current law. The number of cases and amount of fines affected by this provision are not estimated, as no source of information comparing insurers subject to fines and reported profits was available for this analysis.

***Assumptions.*** A rational relationship between actual harm to consumers and DOI fines and penalties is generally found where such fines and penalties are consistent, reasonable, and justified in accordance with current law. This provision of the bill does not limit fines and penalties in a manner that is possible to quantify or apply in a significant number of cases.

**State diversions.** To the extent that the bill increases expenditures in the DOI in any future fiscal year, the bill results in the diversion of an equivalent amount of revenue from the General Fund. All costs in the DOI are funded with premium tax revenue deposited in the Division of Insurance Cash Fund, which would otherwise be credited to the General Fund.

### **State Expenditures**

The bill potentially increases workload and expenditures in the Department of Law and DORA.

**Assumptions.** Based on the size of the insurance market and DORA's appropriated resources, the DOI engages a typical insurer in a new market conduct action only once in a five-year period. Once a market conduct action is initiated, subsequent actions by DOI to ensure compliance are either effectively part of the same market conduct action or provide adequate ("clear and convincing") basis for the DOI to initiate a new market conduct action. Therefore, the bill does not have a significant impact on the frequency of market conduct actions by DORA.

Some amount of litigation involving insurers and issues within the scope of the bill are contemplated by current appropriations to DORA's legal services budget. Any increase in the demand for legal service appropriations by DOI is based on the bill increasing the number of insurers that seek legal recourse in a given year.

**Department of Regulatory Agencies.** The DOI will experience a minimal workload increase for the DOI to document the basis for fines and penalties affected by the bill, including consideration of actual harm and insurer profits. This workload may be greater than estimated if insurers routinely protest fines on the basis of the bill's one-year profit limit.

The DOI will support the AG in any increase in litigation related to the bill, and will fund the AG's defense of the DOI through the DORA legal services budget. The fiscal note does not estimate any specific increase in litigation-related activities.

If a significant increase in litigation or DOI workload occurs as a result of the bill, any need for additional resources will be addressed in the annual budget process.

**Department of Law.** For any increase in litigation related to the bill, the AG will appear on behalf of the DOI, compile the agency record, review all discovery materials, and resolve the case through settlement, trial, or other legal process. Costs related to such litigation vary depending on the merit of the insurer's complaint, length of record, and other factors, but may require client agency fees in excess of the budgeted amount, as well as an increase in the Department of Law FTE allocation. Any increase in budget resources by the Department of Law will utilize funds reappropriated from the legal services budget line in DORA and will be addressed in the annual budget process.

### **Effective Date**

The bill takes effect August 6, 2014, if the General Assembly adjourns on May 7, 2014, as scheduled, and no referendum petition is filed.

**State and Local Government Contacts**

Regulatory Agencies  
Law

Personnel and Administration  
Judicial Branch