

PROPERTY AND CASUALTY INSURANCE (C) COMMITTEE

Property and Casualty Insurance (C) Committee, Dec. 7, 2009 Minutes

Catastrophe Insurance (C) Working Group Dec. 7, 2009 Minutes (Attachment One)

Chinese Drywall Information from Eric Nordman (Attachment One-A)

Comment on Chinese Drywall from Property Casualty Insurers Association of America (Attachment One-B)

Chinese Drywall Presentation from United Policyholders (Attachment One-C)

Chinese Drywall Presentation from Charles Miller (Attachment One-D)

FEMA Letter to Kevin McCarty Nov. 30, 2009 (Attachment One-E)

Title Insurance Issues (C) Working Group, Dec. 6, 2009 Minutes (Attachment Two)

Crop Insurance (C) Working Group, Dec. 5, 2009 Minutes (Attachment Three)

Memo from Eric Nordman to the Property and Casualty Insurance Committee, Dec. 2, 2009 (Attachment Four)

Revisions to the *Market Regulation Handbook* Nov. 23, 2009, (Attachment Five)

Property and Casualty Insurance (C) Committee Nov. 16, 2009 Conference Call Minutes (Attachment Six)

Center for Economic Justice and Consumer Federation of America Letter Regarding 2010 Charges, Nov. 12, 2009 (Attachment Six-A)

Proposed 2010 Charges, Property and Casualty Insurance (C) Committee (Attachment Six-B)

Marketcore News Release Regarding Insurance Exchange, October 15, 2009 (Attachment Seven)

Council of Insurance Agents and Brokers Insurance Exchange Announcement, Oct 12 2009 (Attachment Eight)

Memo from Director Michael McRaith to Eric Nordman, June 18, 2009 (Attachment Nine)

Property and Casualty Insurance (C) Committee  
San Francisco, CA  
December 7, 2009

The Property and Casualty Insurance (C) Committee met in San Francisco, CA, Dec. 7, 2009. The following Committee members participated: Michael T. McRaith, Chair (IL); Scott H. Richardson, Vice Chair (SC); Linda S. Hall (AK); Thomas R. Sullivan (CT); Kevin M. McCarty (FL); J.P. Schmidt represented by Gordon Ito (HI); James J. Donelon (LA); Joseph G. Murphy (MA); Mila Kofman represented by Eric Cioppa (ME); Mike Chaney represented by John Wells (MS); Morris J. Chavez represented by Alan Seeley (NM); James J. Wrynn represented by Michael Moriarty (NY); and Merle D. Scheiber (SD). Also participating were: Richard Marcks (CT); and John Kissling (IN).

1. Consider Motion to Adopt Minutes of the Nov. 16 Conference Call

Upon motion by Commissioner Donelon, and second by Commissioner McCarty, the Committee adopted the minutes of its Nov. 16 conference call (Attachment Six).

2. Consider Motion to Adopt Proposed Changes to Chapter 25 of the *Market Regulation Handbook*

Commissioner McCarty said one of the charges for the Advisory Organization Examination Oversight (C) Working Group is to: “Develop protocols for examination of national or multi-state rating organizations to be more comprehensive, efficient, and possibly less frequent than the current patchwork of single-state exams.” To respond to the charge, the Working Group determined that changes to the *Market Regulation Handbook* are necessary—specifically to Chapter 25 titled: Conducting the Advisory Organization Examination.

Commissioner McCarty distributed the revisions and a detailed summary to the Committee. He said revision highlights include changes to pages 23 and 24 where the National Council on Compensation Insurance (NCCI) proposed to include a reference to rating rule manuals in addition to the materials already referenced. The standard currently applies to all lines of business and previously referenced loss costs, forms and rating factors. Changes were also made to pages 75 and 76, again at the suggestion of NCCI. The proposal was to add inspection standards, a task only performed with respect to workers’ compensation. Pages 77 through 82 contain new sections and standards for residual market functions performed by advisory organizations. In addition, several pages contain revisions to the Information System Questionnaire (ISQ) proposed by Alaska.

Commissioner McCarty made a motion to adopt the Nov. 23 revisions to the *Market Regulation Handbook* as proposed by the Advisory Organization Examination Oversight (C) Working Group (Attachment Five) and to refer the changes to the Market Regulation and Consumer Affairs (D) Committee for inclusion in the *Market Regulation Handbook*. Mr. Moriarty seconded the motion. Commissioner Sullivan asked if the proposed changes were vetted with interested parties. Commissioner McCarty said they were. The motion passed.

3. Discuss Public Policy Issues Related to Regulatory Exclusions in Directors and Officers (D&O) Policies

Director McRaith referred the Committee to three documents—a memo to the Committee from Eric Nordman (NAIC) (Attachment Four), a memo from himself to Mr. Nordman (Attachment Nine), and a memo from Jim Mumford (see Attachment One to the Property and Casualty Insurance (C) Committee meeting minutes of March 17, 2009). He advised that the Receivership and Insolvency (E) Task Force had requested assistance from the Committee regarding the use of exclusionary language that hinders the receiver’s ability to collect all monies due for the benefit of claimants. He said the case involved former Nebraska Insurance Director Tim Wagner, who sought to have the courts invalidate the exclusionary language contained in a Directors and Officers (D&O) insurance policy. Director McRaith said the Nebraska Supreme Court upheld the decision of the lower courts to allow the regulatory exclusion in the policy to stand.

Director McRaith said Director Wagner had brought an action seeking to have the court consider two possibilities. First, the regulatory exclusion does not apply to the Director in his capacity as liquidator. Second, the regulatory exclusion was void as against Nebraska public policy. He said Director Wagner lost on both counts. Mr. Nordman added that the case was complicated by the fact that the Nebraska Insurance Department had either approved or not disapproved the policy language in question.

Mr. Cioppa said he had his staff review several D&O policy forms and advised that they found 12 filings containing similar exclusions. Commissioner Sullivan wondered if this was a matter where a uniform outcome was desirable. If so, he

suggested, perhaps development of a model law should be considered. Director Hall suggested that states should consider withdrawing approval of the policy forms containing the exclusions. Director McRaith suggested that two parallel paths might be warranted. The initial step would be to advise states of the problem and, on a parallel track, investigate the development of a model law. Commissioner McCarty observed that identification of each policy form on file containing the exclusionary language and then withdrawing approval would be a Herculean task. He suggested that it might be easier and more uniform to amend the *Insurer Receivership Model Act* (#555) because it is one of the model laws required for accreditation. Director McRaith and Commissioner Sullivan agreed.

Commissioner Richardson commented on similar problems in South Carolina. Director McRaith asked the Committee if it wished to pursue the *Insurer Receivership Model Act* rather than addressing the matter through a model addressing the policy language.

Commissioner Sullivan made a motion to have the Committee alert all states regarding the exclusionary language and to recommend that the matter be referred to the appropriate committee or task force to develop appropriate changes to the *Insurer Receivership Model Act*. Director Scheiber seconded the motion. Commissioner McCarty asked for clarification regarding whether the Committee would work on the model law amendment or refer it to another committee. Director McRaith said it would be referred to another committee. The motion passed.

#### 4. Discuss Plans for Addressing the Use of Credit-Based Insurance Scores

Director Richardson said that he and Director McRaith had been discussing the use of credit-based insurance scores in light of the things learned from the hearings. He added that information gaps that still remain. He observed that the use of credit-based insurance scores is a social issue. He said there is agreement, and plenty of evidence, that the scores correlate with regard to predicting insurance losses, but nobody has been able to explain why that occurs. There are questions as to whether the scores have a racial or ethnic component to them.

Director Richardson said he conducted a data call in South Carolina to gain more insight regarding how insurers used the scores for pricing of auto and home insurance policies. He said he was shocked to find the range of values. He said discounts for home insurance ranged from 7.6% to 51% and that surcharges ranged from 1% to 86%. For auto insurance, the discounts were as high as 36% and the surcharges ranged from 12% to 99%.

Director Richardson said there are three options to deal with the matter. First, one could choose to ignore it. Next, one could choose to get rid of it. Finally, one could look for some common ground—in other words, allow the insurers to use credit-based insurance scores, but limit the magnitude of them. He said it is also important for the Committee to review other risk classifications used for auto and home insurance. He said increasing use of occupation and income along with an evaluation of some of the new risk matrix approaches is warranted. He said it behooves regulators to be prepared to address where the power of technology takes the risk classification system. At the extreme, the insurance system becomes a risk financing, rather than a risk transfer, mechanism. If everyone simply pays his or her own costs, there concept of risk sharing is lost.

Director McRaith said that during the Fall National Meeting, the matter was discussed with the Market Conduct and Consumers Affairs (D) Committee, and the two committees agreed to pursue separate paths. The Committee plans to investigate the range of premium differences related to the use of credit-based insurance scores. He said the Committee will collect the necessary data and publish the results in the form of a report in 2010.

Commissioner Donelon expressed surprise at the magnitude of the factors reported by Director Richardson. He supported the effort to collect data from insurers to evaluate the range of premium differences. He stated that information is power, and that regulators need information.

Commissioner Sullivan asked about the purpose of the data collection and how it would be used. Director McRaith advised that there was much rhetoric about the use of credit-based insurance scores and that the purpose of the data collection was to collect some factual information about the use of the scores. He said the goal is to provide information to the regulator so that an informed public policy discussion could ensue. Commissioner Sullivan said he could support its collection and use for regulatory purposes, but was concerned about what comes next.

Director Richardson said he views the use of credit-based insurance scores from a consumer perspective. He said the use of credit FICO (formerly known as Fair Isaac Corporation) scores by lenders is understood and accepted by the public, but it makes less sense to them when failure to maintain a good credit rating changes the price they pay for auto or home insurance. They do not connect failure to pay your bills with the ability to drive a car. He said there must be a point where there are some outer bounds of what is reasonable for insurers to charge. Commissioner McCarty said there is much misinformation on

both sides of the issue. He said people misunderstand how credits and debits apply. He said people think of credits or discounts as being a good thing, when they are mathematically equivalent to debits or surcharges. He said the legislators ask the same thing. They think if they enact legislation that only allows an insurer to give a discount; they have done a good thing. In reality, what they have done is encourage the insurer to change the risk classification upon which the base rate is calculated so that discounts can be applied instead of surcharges off a lower base rate. He said collecting information to evaluate the range of risk classification rate relativities would be valuable.

Mr. Wells said he was aware of an individual who received a rate increase because he agreed to finance his premium. Director McRaith added that Commissioner Chaney received a 10% increase in premium simply because he was eligible to have his premium financed.

Director McRaith proposed addressing the credit-based insurance scoring issue in two ways. First would be a data call to see if some of the questions concerning the range of credits and debits among the insurers using credit-based insurance scores could be addressed. Second would be considering whether to clarify state insurance regulatory authority over the entities that provide information that insurers use in constructing their credit-based insurance scoring formulas. He said perhaps a model law or guideline would be necessary to allow states to regulate credit scoring vendors.

Commissioner Sullivan said he would support a one-time data collection effort. Director Richardson said he collected information on the range of values, but later thought it might be helpful to also have the number of people that fall into each rating cell. Director McRaith said it was important for states to perform the data collection in concert with a single data set, along with appropriate assurances of confidentiality.

The Committee agreed to conduct a conference call in January and consider a list of questions that will be used for a data call of all companies using credit-based insurance scores in all participating jurisdictions. The results of the data call will be compiled and evaluated to provide policymakers with information on the use of credit-based insurance scores.

#### 5. Update on Chinese Drywall Public Hearing

Commissioner McCarty said the Catastrophe Insurance (C) Working Group conducted a public hearing to assess the extent of the problem related to the installation of defective drywall generally believed to be manufactured in China. He said a transcript of the hearing would be made available. He added that the record of the hearing was kept open for further comments. He asked that comments be submitted by Jan. 15, 2010.

#### 6. Information on Takaful Insurance

Mr. Nordman said takaful insurance has its origins in the Arabic word Kafalah, meaning joint guarantee. It addresses the Islamic belief that traditional insurance is a form of gambling. Takaful insurance is a system based on mutual cooperation, shared responsibility, assurance, protection and assistance between groups of participants. It is based on the concept of people guaranteeing one another, or a mutual sharing of risk. At the core of takaful insurance is Tabarru, the system that makes it free from uncertainty and gambling. Tabarru means donation, gift or contribution.

Mr. Nordman said takaful insurance works on the principle that each participant needing protection must participate with the sincere intention to donate to other participants faced with difficulties. Therefore, Islamic insurance exists where each participant contributes into a fund used to support one another with each participant contributing sufficient amounts to cover expected claims. The objective of takaful is to pay a defined loss from a defined fund. It is similar to the early U.S. system that used firemarks and neighborhood fire brigades to form early mutual insurance mechanisms.

Mr. Nordman said Muslim jurists conclude that insurance in Islam should be based on principles of mutuality and cooperation and should encompass the elements of shared responsibility, joint indemnity, common interest and solidarity. The principles of takaful insurance are as follows: policyholders cooperate among themselves for their common good; every policyholder pays his subscription to help those that need assistance; losses are divided and liabilities spread according to the community pooling system; uncertainty is eliminated in respect of subscription and compensation; and it does not derive advantage at the cost of others. Thus, in theory, takaful is perceived as cooperative insurance, where members contribute a certain sum of money to a common pool. The purpose of this system is not profits but to uphold the principle of "bear ye one another's burden."

Mr. Nordman said takaful insurance is based on the sayings of the Islamic prophet Muhammad as found in hadith and Quranic verses. Islamic scholars deemed there should be a cooperative effort to implement the takaful concept as the best way to resolve the need arising from mutual protection and assistance among people. According to Reuters' Oct. 12, 2009,

article, *Takaful Dilemma Facing European Insurer*, “Major European insurers eyeing a move into the market for Islamic insurance, or takaful, face a tough decision whether to use diminished resources to secure an upper hand or risk losing ground to niche providers. ... Some of the bigger players in Europe definitely have plans to offer takaful products.” He added that the *Insurance Journal* reported Dec. 2, 2008, that AIG through its subsidiary Risk Specialists Companies, Inc. (RSC), would offer a homeowners product compliant with Islamic tenets and based in takaful concepts. The Islamic Insurance Company (Sudan) is believed to be the first takaful insurance company in the world.

Director Scheiber wondered why the takaful concept was being discussed by the Committee. Mr. Nordman said it was for educational purposes. Director McRaith said some states have regulatory exceptions for religious-based non-profits and that takaful might fall into that category. Mr. Kissling said Indiana has some experience with this exception with regard to the Amish. In particular, he mentioned concerns with workers’ compensation insurance coverage. He said if an Amish person is hurt on the job, the Amish take up a collection to cover the expenses. Thus, they tend to mix the act of doing with the act of paying for it, while traditional insurance concepts take up the financial consequences of the acts. Director McRaith agreed, noting that there are sizable Amish communities in central Illinois.

7. Consider Motion to Adopt Reports of the Property and Casualty Insurance (C) Committee Task Forces and Working Groups

Director McRaith said all of the Committee task force and working group reports would be considered in a single motion. He invited comments from task force and working group chairs on items they considered to important for the Committee to hear.

Mr. Marcks reported that the Casualty Actuarial and Statistical (C) Task Force adopted proposed revisions to the *Catastrophe Modeling Handbook* (Handbook) to reflect advancements in modeling that have occurred since the Handbook was originally created in 2001. He said significant changes included: updated questions a regulator could consider when reviewing a company’s catastrophe model (Section VII); updated Appendices 11 (hurricane interrogatories) and 12 (earthquake interrogatories), each with two parts—Part A for an insurer or a rating organization and Part B for a modeler; a new Section VIII titled, “Regulatory Review and Acceptance” to discuss proprietary information; a new appendix to provide an annotated bibliography of resources available about catastrophe modeling; and additional terms and corresponding definitions to add to the Working Definitions Section in the Handbook (e.g., demand surge, shake intensity, dip slip faults). He said the Task Force also adopted the *2007 Dwelling Fire, Homeowners Owner-Occupied, and Homeowners Tenant and Condominium/Cooperative Unit Owner’s Insurance* (Homeowners Report). He asked the Committee to adopt the recommendations from the Task Force on the Handbook and the Homeowners Report.

Upon motion by Commissioner Sullivan, and second by Mr. Seeley, the Committee adopted the changes to the Handbook and the Homeowners Report.

Commissioner Donelon said the Surplus Lines Task Force discussed the NAIC Online Premium Tax for Insurance (OPT<sub>ins</sub>) being used by some states to collect surplus lines premium taxes. The Task Force believes OPT<sub>ins</sub> might be more widely used to streamline the processing of surplus lines premium taxes. The Task Force continues to discuss various ways to address the state nuances in calculation and collection of surplus line taxes, including federal legislation, standardizing business process and developing an interstate compact.

Director Scheiber said work on a best-practices guidance document to help states in implementing the *Guidelines for Regulations and Legislation on Workers’ Compensation Coverage for Professional Employer Organization Arrangements* was nearing completion and should be available for the Committee at the next meeting. He said the medical component of the workers’ compensation system is now accounting for greater than 50% of the losses for the first time ever. He said the Task Force sent written comments to the National Conference of Insurance Legislators (NCOIL) on its Construction Industry Workers’ Compensation Coverage Act. He said NCOIL did not take any of the suggestions presented.

Commissioner McCarty said the Advisory Organization Examination Oversight (C) Working Group has drafted a memorandum of understanding (MOU) that will allow the domestic regulator and the lead state or states to examine advisory organizations and statistical agents with one comprehensive coordinated exam covering all issues for all jurisdictions. Each of the participating jurisdictions would have to agree to accept the results from the examination. The MOU is expected to be distributed by the NAIC Legal Division within the next few weeks, and it is hoped that everyone will sign it. It is important for this to occur, as it is needed to begin the multi-state examination of the NCCI.

Mr. Moriarty reported that the Catastrophe Reserve (C) Working Group did not meet during the quarter. He said the Working Group has reached out to the Casualty Actuarial and Statistical (C) Task Force for assistance in evaluating the impact of establishing a tax-deferred catastrophe reserve.

Mr. Seeley reported that the Consumer Guides (C) Working Group has not met since the Fall National Meeting. However, the Working Group has worked with NAIC staff on the final edits to the *A Consumer's Guide to Home Insurance*, which is expected to be approved by the membership during the Winter National Meeting. The final guides will be distributed to all insurance departments soon. He added that a work plan has been developed to address the auto insurance guide, and that conference calls would be scheduled starting January 2010 to begin the work.

Director Scheiber reported that the Crop Insurance (C) Working Group continues to work with states so states can avoid possible federal preemption of crop adjuster licensing. Through the Working Group's efforts, all 14 affected states plan to implement changes so that federal preemption will not occur. The Federal Crop Insurance Corporation's Risk Management Agency recently approved the Crop Adjuster Proficiency Program (CAPP) providing the proficiency examination that will be used instead of state-based testing. National Crop Insurance Services is responsible for developing and administering the CAPP.

Mr. Moriarty said the Terrorism Insurance Implementation (C) Working Group did not meet during the quarter, but stands ready whenever called upon by the Department of the Treasury's Terrorism Risk Insurance Program.

Mr. Seeley reported that the Title Insurance Issues (C) Working Group reviewed compiled results from a survey of state laws on the collection of title agent data. He said every state responded to the survey. The majority of the states are able to collect data directly from title insurance agents. The next step is to develop a statistical plan to identify the data elements that would be required of title insurance agents. Developing a national statistical plan could be challenging, given the many variations from state to state in the market structure and corresponding regulation.

Upon motion by Director Hall, and second by Commissioner Donelon, the Committee adopted the reports of its task forces and working groups including the Catastrophe Insurance Working Group (Attachment One); the Title Insurance Issues Working Group (Attachment Two) and the Crop Insurance Working Group (Attachment Three).

#### 8. Any Other Matters Brought Before the Committee

Mr. Nordman said the Council of Insurance Agents and Brokers (CIAB) and LexisNexis recently announced that they had formed a partnership to develop an insurance exchange (Attachment Eight). The purpose of the exchange would be to automate the transmission of information between insurance distributors and insurance intermediaries and, in addition to workflow efficiencies, enable access to key market information and analytics for better decision-making. The exchange apparently uses a patented business process developed by Marketcore, Inc. (Attachment Seven).

Nicole Allen (CIAB) said the two news releases included in the handouts (see Attachments Seven and Eight) describe the project at a very high level. She said more descriptive information is available in the CIAB *Leader's Edge Executive Report*. She agreed to provide a link to Mr. Nordman so that information could be distributed to anyone interested in the project. She also pledged to keep the Committee informed at future meetings.

Director McRaith observed that the formation of an insurance exchange was a novel and important development in the marketplace. He asked for a formal presentation at a future meeting. Ms. Allen said she would try for the next meeting, but was not sure the project would be far enough along by then for a meaningful presentation.

Having no further business, the Property and Casualty Insurance (C) Committee adjourned.

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Draft: 12/21/09

Catastrophe Insurance (C) Working Group  
San Francisco, CA  
December 7, 2009

The Catastrophe Insurance (C) Working Group of the Property and Casualty Insurance (C) Committee met in San Francisco, CA, Dec. 7, 2009. The following Working Group members participated: Kevin M. McCarty, Chair, (FL); Jim L. Ridling represented by Charles Angell (AL); Linda S. Hall represented by Sarah McNair-Grove (AK); Steve Poizner represented by Bruce Patton and Ron Dahlquist (CA); Thomas R. Sullivan (CT); Michael T. McRaith (IL); James J. Donelon (LA); Mike Chaney (MS); Ann Frohman represented by Alan Wickman (NE); Kim Holland represented by Kathie Stepp (OK); and Mary Bannister (VA).

1. Discuss Uniform Treatment for Flood Adjusters

Harriett Kinberg (Federal Emergency Management Association—FEMA) gave a presentation on uniform treatment for flood agents and adjusters. Ms. Kinberg provided updates on the National Flood Insurance Program (NFIP). At the end of October, Congress passed an extension of the authorization of NFIP through Dec. 18. FEMA is hopeful that Congress will discuss program reforms and provide a longer extension, as this would afford greater stability to the program. The alleviation of the program's current debt burden is the biggest obstacle currently being faced, as the debt to the United States Treasurer now stands at \$19 billion. Of that, \$300 million was paid down this year due to the mild hurricane season and the currently low interest rates on the Treasury debt. Neither of these is expected to continue indefinitely, and that is why the program continues to ask for debt forgiveness. The program's borrowing authority limit is \$20.775 billion, which is believed to be sufficient to address the program's needs for the foreseeable future.

FEMA kicked off a 30-day comment period with a two-day listening session that began Nov. 5. FEMA invited approximately 175 stakeholders representing environmental and historic preservation groups, fair housing groups, and representatives from the lending, insurance, emergency management, real estate, land use, planning, and engineering industries, as well as representatives from state, local, and tribal governments. It is anticipated that these listening sessions and comment periods will allow the collection of input regarding the NFIP, such as flood map modernization, reducing repetitive loss properties and other program topics. Ms. Kinberg invited the Working Group to submit comments via the FEMA Web site so they may be included in the final compendium of input.

Ms. Kinberg said significant flooding occurred in the Great Plains, the Midwest, the Southeast and the Northeast in 2009. The NFIP continues to offer affordable flood insurance to help Americans rebuild their homes and communities. In 2009, the NFIP paid out over \$113 million in claims, with an average paid claim amount exceeding \$45,000. There are 5.5 million NFIP policies in force in over 20,000 communities.

Ms. Kinberg also discussed the highlights of the Nov. 30 letter from Ed Connor (NFIP) to Commissioner McCarty (Attachment One-E). She said less than 25% of the homes located in the nation's special flood hazard areas are insured; the poor economy contributes to this problem. Currently, the Flood Smart campaign is being aggressively promoted. Opportunities exist to improve oversight of the Write Your Own (WYO) program. FEMA is working closely with the NAIC to find a way for the WYO companies to more accurately report financial experience to the NAIC.

Ms. Kinberg said the NFIP continues in its effort to educate and train insurance agents with regard to the program's rules, procedures and policies. They are asking that the NAIC consider waiving the fee required for the filing of the NFIP paperwork for continuing education (CE) credits for agents who have attended NFIP workshops. The NFIP will continue to provide the labor to file the records necessary for insurance agents to obtain CE credits. Ms. Kinberg said there is a precedence for this, as the NAIC recognizes the Federal Crop Insurance Corporation as a federal program not subject to certain state training requirements. The NFIP asks that the NAIC consider this request, as well as the other requests stated in Mr. Connor's letter.

Ms. Kinberg said the NFIP also sent a letter to Anne Marie Narcini (NJ), Chair of the Producer Licensing (D) Working Group, as the NFIP wants to coordinate with any NAIC committee that might be involved. The NFIP provides funds to nearly all of the state insurance departments through state premium taxes collected for every flood insurance policy sold. The NFIP estimates that \$63.5 million was generated in fiscal year 2009 through these sales. This calculation is based on the NFIP fiscal year total premium of \$3.5 billion, times an average tax rate of 2.04%, that was calculated using NAIC premium

tax data published in 2007. Ms. Kinberg said she is willing to update this information. The money collected for the state premium taxes is transferred to states' general funds. The NFIP provides critical insurance protection for states' residents, which provides less drain on state resources for flood disaster relief. Additionally, it contributes funds that support state departments of insurance staff and activities.

Ms. Kinberg said that, in summary, the NFIP is asking for assistance with waiving the fee that the NFIP is paying currently for filing the CE credits with state insurance departments for insurance agents who attend NFIP courses; electronic mailing lists from the state departments of insurance to help the NFIP communicate with agents and adjusters in regard to upcoming courses; and requirement of annual or bi-annual training for insurance agents to be put in the *Producer Licensing Model Act*.

Ms. Kinberg said FEMA is currently involved in a five-year effort to update maps across the country—the map modernization program—and they are including other hazard information with the maps so that local governments have more tools available to identify and reduce risk.

Commissioner McCarty asked Ms. Kinberg how the elevation levels on the maps were determined. She said they are determined by the engineers assisting with the FEMA study. FEMA then provides the information to the local agencies so that they may enforce ordinances. If violations to the ordinances are found, FEMA works with the local officials in asking for documentation. If the violations are a pattern of practice, the community is put on probation or suspension from the NFIP. A surcharge is imposed on all flood insurance policy sales in the event of probation, and no policy sales are allowed in the case of suspension. The WYO company is responsible for notifying the lender of policy non-renewal.

Commissioner McCarty said the Working Group will work with the Producer Licensing (D) Working Group to obtain advice on how to proceed.

## 2. Chinese Drywall Hearing

A hearing convened regarding the Chinese drywall problems that have arisen. Testimony was received from Eric Nordman (NAIC) (Attachment One-A), David Kodama (Property Casualty Insurers Association of America—PCI) (Attachment One-B), Amy Bach (United Policyholders) (Attachment One-C) and Charles Miller (Insurance Law Center) (Attachment One-D).

Having no further business, the Catastrophe (C) Working Group adjourned.

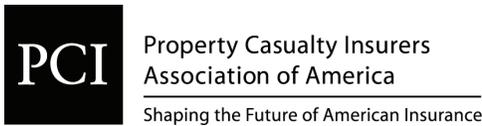
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# Chinese Drywall

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- The facts:
  - Over 550 million pounds of Chinese drywall imported between 2004 and 2007
  - Possibly installed in over 100,000 homes in the USA
    - Current empirical data does not reflect this
  - The Consumer Product Safety Commission has recorded over 2,091 reports of defective drywall in 32 states
- The problem:
  - Most common is the smell of rotten eggs
  - Property damage claims:
    - Failure of air conditioning equipment
    - Corrosion of pipes, coils and wiring
    - Damage to furniture, fixtures and jewelry
  - Bodily injury claims:
    - Respiratory problems and sinus infections
    - Headaches, persistent cough and bloody noses
    - Asthma attacks and fatigue
- What's being claimed?
  - Cost to repair the house
  - Cost of health effects
  - Legal fees for the plaintiffs' lawyers
  - Defense costs
  - Indirect costs
    - Loss of use
    - Diminished value
- So how much?
  - Cost to repair the house (\$8 to \$10 Billion)
  - Cost of health effects (Anybody's guess)
  - Legal fees (\$5 to \$10 Billion)
  - Indirect costs
    - Loss of use (\$2 to \$5 Billion)
    - Diminished value (Not much)
  - TOTAL COSTS (\$15 to \$25 Billion)
- Drywall investigation is expanding into the US
  - National Gypsum
  - Georgia Pacific Group

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**TESTIMONY OF DAVID KODAMA  
ON BEHALF OF  
THE PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA  
BEFORE THE  
CATASTROPHE INSURANCE WORKING GROUP OF THE  
PROPERTY AND CASUALTY INSURANCE COMMITTEE  
NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS**

**PUBLIC HEARING ON THE IMPLICATIONS TO REGULATORS AND INSURERS REGARDING ALLEGEDLY  
DEFECTIVE CHINESE DRYWALL**

**DECEMBER 7, 2009**

Chairman McRaith, Commissioner McCarty and members of the Catastrophe Insurance Working Group, my name is David Kodama and I am senior director of research and policy analysis for the Property Casualty Insurers Association of America (PCI). PCI is a trade association representing over 1,000 property casualty insurers that write over 30 percent of the homeowners insurance sold in the United States. Because of that, we have a deep interest in the issues that affect that market. The following are statements regarding your effort to obtain information on the implications arising from the alleged defective Chinese drywall installed in many of our nation's homes.

Chinese drywall is at the center of a complicated issue for all concerned. It is complicated because at the moment there are many questions and few answers. It is complicated because there is *correlation* between the drywall and problems in people's homes but no demonstrated chain of *causation* thus far. It is complicated because people are reporting physical health symptoms but not consistent symptoms. It is further complicated because neither homeowners nor general liability policies are construction warranties. As insurers, PCI members want to help their customers, but must do so within the confines of each insurance contract, as that contract applies to each individual claim situation.

Chinese drywall became a public policy issue early in 2009, with early news media reports of problems in houses containing Chinese drywall. Throughout the year, PCI has worked to provide our members with timely, *factual* information. As with many complicated issues, separating fact from hype has been a key to determining the best response for both consumers and insurers.

An unfortunate controversy arose when a state-run insurer of last resort announced that it would not renew homeowner's policies on homes containing Chinese drywall. While this was a state-owned insurer and the action was rescinded, our entire industry's public reputation suffered in the resulting news media coverage. Private insurers continue to operate under the terms of their policy contracts and state-regulated insurance practices.

Insurers are familiar with a concept called "the chain of causation." Problems rarely just spontaneously happen; they are usually the result of a chain of causes. Removing just one link generally breaks the chain and prevents the problem. A fire resulting from careless smoking is a classic example. A person is smoking in bed and falls asleep, dropping the cigarette. The cigarette smolders for some time before igniting the bedding, but the battery in the smoke detector is dead. The resulting fire burns down the house and kills the occupant. If just one component of the scenario changes – not smoking in bed, not falling asleep while smoking, the smoke detector working, the fire is averted.

Something similar will likely be found true with Chinese drywall. We just do not know all of the links in the chain yet. The Consumer Product Safety Commission and the Florida Department of Health have taken the lead in coordinating the work of



many government agencies that are searching for the actual cause-and-effect relationships so that solutions can be developed that will allow people to enjoy living in their homes. Once the *actual* cause or causes of the odors, metal corrosion and health complaints are found, all stakeholders can properly evaluate how they can best make the situation better. As I said at the beginning of my comments, this is complicated issue. We have correlation but we must find causation in order to truly resolve the real problem.

Government investigators have completed preliminary testing of drywall samples. They have found differences in the makeup of domestic and Chinese drywall but not exactly how that may impact gaseous emissions reported by homeowners. They have tested air inside and outside houses, but found the highest levels of sulfur outside rather than inside. They reported finding hundreds of thousands of sheets of drywall in warehouses but did not report sulfurous odors in those warehouses. They recommended expanding their investigation to include chemical reactions, which is only logical since drywall is not left bare inside living spaces. We hope that these and other investigations will quickly lead to practical alternatives that will minimize disruption to families when the odor problems are addressed. Research results to date are helping to identify the links in the chain of causation concerning Chinese drywall.

Even with these preliminary results, federal and state investigators have developed recommendations to help families stay in their homes. These include bringing fresh air into the building, dehumidifying (often through the air conditioning system), keeping the indoor temperature cooler, and spending time outdoors. As more definite research results come in, we expect that these recommendations will be refined and become more focused.

While research into breaking the chain of causation continues, several sources of financial assistance have emerged for homeowners. Some affected homeowners will have discovered a problem within the warranty period on new or renovated homes. At least one state government has set aside funds to help homeowners and legislation has been proposed that would make low-interest loans available to help homeowners make repairs, if needed. We applaud the Knauf Plasterboard Tianjin Company's willingness to respond in U.S. court to at least one class action lawsuit and hope that other drywall manufacturers will actively engage in solving the causation riddle. Determining why problems emerge in some houses and not others should lead to cost-effective ways to stop problems by breaking the weakest link in the chain of causation.

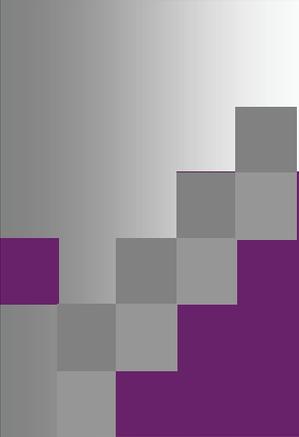
Many here will see the similarities between the current situation and the early months of the mold issue a decade ago, including the rush to litigation. As with mold, we expect scientific, *factual* knowledge will lead to the most effective ways to deal with the challenges associated with Chinese drywall.

In the meantime, insurers will continue to evaluate each claim presented based on the individual claim investigation and the provisions of the applicable insurance contract, within the context of state insurance regulations. The same is true for any underwriting actions that insurers may contemplate. Everyone must remember that an insurance policy is a legal contract that spells out the duties and options of each party, and that it is not a construction warranty.

As I said at the beginning of these comments, Chinese drywall presents a complicated issue for all concerned. It is complicated because there are many questions and few answers. It is complicated because there is correlation between the drywall and problems in people's homes, but no demonstrated chain of causation thus far. It is complicated because people are reporting physical health symptoms but not consistent symptoms. It is further complicated because neither homeowners nor general liability policies are construction warranties. As insurers, PCI members want to take care of their customers, but must do it within the confines of each insurance contract as that contract applies to each claim situation.

Again, let me thank you on behalf of PCI and our members for the opportunity to appear before you today and provide you with our input on this issue. PCI and its members look forward to working with you further.

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Insurance Issues Related to Chinese Drywall:  
The Consumer Perspective

National Association of Insurance Commissioners/  
Winter Meeting, San Francisco, CA. Dec. 7th, 2009

12/21/2009



united policyholders



## About UP:

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- A national 501 (c) (3) non-profit with 18 years of experience helping solve insurance problems and advocating for fairness in insurance transactions
- Advisors include:
  - Individual insureds
  - Commercial insureds
  - Insurance Industry Professionals
  - Attorneys
  - Other Financial Services Professionals
  - Construction Professionals
- Funded by donations, foundation grants and book sales



united policyholders

## Three programs:

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- **Roadmap to Recovery™** [*Post-disaster*] Tools and resources for disaster victims, case managers/aid workers.
- **Roadmap to Preparedness** [*Pre-disaster*] Tools and resources aimed at promoting financial preparedness and loss mitigation.
- **Amicus Project and Advocacy work** [*Legal and Other*] Advancing the interests of policyholders in courts of law, regulatory agencies and legislative proceedings.



## Background facts:

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- Imported from 2005 through 2007, when a housing boom and two active hurricane seasons created a shortage of building materials in the southern United States
- Stamped "Made in China"
- It is believed no new shipments entered U.S. in 2009
- Some has been recycled and may be mixed in w/U.S. made
- Damage includes odor, corrosion, pitting



## Home not so sweet home:

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- The suspect building materials have been found by state and federal agencies to emit "volatile sulfur compounds" and produce a rotten-egg odor. Homeowners complain the fumes are corroding copper pipes, destroying TVs and air conditioners, blackening jewelry and silverware, and making them sick. *Source: "Chinese drywall linked to corrosion, federal consumer agency finds" The Associated Press, 11-23-09*



## CPSC/EH&E Study released 11-09:

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- 3 preliminary scientific reports:
  - a fifty-one home indoor air study;
  - an electrical component corrosion study;
  - a fire safety component corrosion study.
- The fifty-one home study found a strong association between the problem drywall, the hydrogen sulfide levels in homes with that drywall, and corrosion in those homes. The two corrosion studies support that finding.



## Ongoing data gathering:

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- November 19<sup>th</sup> the CPSC reached out to the Governors of all 50 states seeking CD complaint data by Dec. 14<sup>th</sup>, 2009.



## The Scope of the Problem:

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- The CPSC has received nearly 2,276 reports from 32 states -- mostly from Florida, Louisiana and Virginia
- Florida has been the state hardest hit. 1,522 of the CPSC drywall complaints have come from Florida homeowners. It is estimated that as many as 35,000 homes in the state may contain Chinese drywall. Source: South Florida Business Journal, 9-24-09
- An estimated @ 500 million lbs entered US, enough to construct an average of 60,000 average sized homes



## Cost to repair:

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- The National Association of Home Builders testified before Congress that it will probably cost between one-third of a home's value and \$100,000 to repair. Meanwhile, a major builder, Lennar Homes, disclosed in a recent financial filing that it had set aside about \$100,000 per home to remediate houses that it built with Chinese drywall.



## Commercial and residential insureds impacted:

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- Property owners
- Renters
- Builders
- Contractors
- Materials suppliers



## “Insurance headaches”

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- “Insurance has been one of the major headaches for consumers with Chinese drywall, because carriers have universally been denying claims, and in some cases, dropping coverage for people who make them.” Source: Times-Picayune, 12-3-09



## Already in financial straits, need insurance money to repair:

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“ Those of us affected by it are already stuck in a bad spot between our mortgage and not being able to live in a home that was paid for...It’s one more scary thing to worry about”

Source: FL resident quoted in the Bradenton Herald, Oct. 8, 2009



## Home destroyed in a hurricane, battled back, now hit again:

- After Hurricane Katrina dropped three trees on the roof of her home in Folsom, Lucille Bourdon built a new home in Covington and moved in December 2006.
- Since building the home, she says, her air conditioning has failed several times, her water heater split and she feels constantly fatigued. Since then, her air conditioning has failed several times, her hot water tank split, her water faucets have developed strange pockmarks, her mirrors and silverware have turned black, and she constantly feels fatigued. In August, Bourdon figured out that her new home is filled with Chinese drywall.
- Like most Chinese drywall victims, Bourdon filed a claim on her homeowners insurance without success. Her insurer, State Farm Fire & Casualty Co., sent an inspector to thoroughly document the damage, then denied the claim.
- "My insurance won't take care of it," said Bourdon, 79, who is now living in a trailer on her property until she figures out how to fix her home. "They say they don't cover pollution. We can't get any help from anybody."

Source: Times-Picayune, 10-18-09



## Need insurance money to repair and fearing losing coverage;

Homeowners living in houses with suspect Chinese drywall are already in a bind. Now, some of them could lose their property insurance coverage.

Many homeowners have filed claims with their home insurers to repair the drywall damage. That's turning out to be a dead end: Most property insurers are denying the claims saying homeowners policies don't cover contamination or building material defects.

But once an insurer knows there is drywall damage in a home, the existing damage could be the trigger for not renewing a policy unless repairs are made.



Source: Miami Herald, 12-6-09

## Doesn't or doesn't want to cover?

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- "State Farm and Allstate, Louisiana's largest residential insurers with about half of the households in the state, said they have denied claims because they believe that coverage would be excluded because the drywall is a defective material.

But George Sutton, a representative of Louisiana Farm Bureau, a top-five insurer in the state, said Farm Bureau believes that while the drywall wouldn't be covered because it's defective, any losses caused indirectly by the drywall, such as corroded appliances and wiring or soft furniture that absorbed the toxins, would be covered.

**"It is my opinion, that ensuing losses under drywall would be covered," Sutton said.**

That's good news. While people may be disappointed that drywall wouldn't be covered, the cost of replacing wallboard pales in comparison with the cost of rewiring a house, or possibly demolishing it if the studs have been corroded.

Source: Times-Picayune, 12-3-09



## Re: HO policies, insurers are arguing no coverage b/c:

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- Defective product
- Latent defect
- Pollutant



## Residential coverage forms:

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- All risks

- HO-3 forms (HO 00 03)
- Typically limited to dwelling coverage
- Riddled with exclusions

- Named perils

- Personal property coverage
- 16 specific perils



## Commercial insureds are battling coverage denials:

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- CGL coverage disputes underway

- Commercial property form (CP 00 17)

- Issues include:

- "Your work/ Your product" exclusions
- Pollution exclusions
- Impaired property exclusions
- Single or Multiple Occurrences?



## Policyholders are countering:

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- Not excluded b/c not pollution
- Not excluded as a defective product b/c ensuing loss
  
- Chinese Drywall damage is covered b/c it is **direct physical loss or damage to property**:
  - Odor (which causes illness and/uninhabitability)
  - Physical damage to pipes, fixtures, etc.
  
- Ensuing or resulting loss is covered even if a defective product was the “but for” cause (subject to ACC clause)



## Courts will determine but regulators can help

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- “The policies define property damage as both ‘[p]hysical injury to tangible property, including all resulting loss of use of that property,’ and ‘[l]oss of use of tangible property that is not physically injured.’”

“we are persuaded both that odor can constitute physical injury to property under Massachusetts law, and also that allegations that an unwanted odor permeated the building and resulted in a loss of use of the building are reasonably susceptible to an interpretation that physical injury to property has been claimed.”

Source: Essex Ins. Co. v. Bloomsouth Flooring Corp., 562 F.3d 399, 401, 406 (1<sup>st</sup> Cir. 2009).



Reasons why Chinese Drywall is unlikely to be determined  
by courts to be a pollutant:

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1. Only applies to industrial waste.
2. Only applies to widespread environmental contamination.
3. Only applies to active polluters.
4. Agent does not constitute a “pollutant”.
5. No release into the atmosphere.



Policyholders' Perspective  
My insurer should:

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- Pay for safe removal
- Repair/Replace
- Pay for the fix
- Restore my home to a habitable condition
- Go after whoever you think is responsible



## Regulators can:

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- Issue formal opinions and file amicus briefs supporting policyholders arguments as to why drywall claims are/should be covered
- Act swiftly to stop non-renewals of drywall claimants' policies
  - Use existing authority
  - Seek additional authority
- Be responsive to consumer complaints
  - See e.g. "Commissioner Donelon Says Help Available For Victims of Chinese Drywall:  
*News Release dated: November 23, 2009*
- Assist in data gathering



## Acknowledgments:

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- Robert Horkavich, Esq., Anderson, Kill & Olick, P.C.
- Colleen Repetto, FIRM
- Ed Eshoo, Jr., Childress Duffy Goldblatt



## Reference sources:

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- The Drywall Information Center  
<http://www.cpsc.gov/info/drywall/index.html>
- CPSC 51 Home Study:  
<http://www.cpsc.gov/info/drywall/51homeStudy.pdf>



## United Policyholders

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**Amy Bach**  
Executive Director

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**PRESENTATION BEFORE THE NAIC  
CATASTROPHE INSURANCE WORKING GROUP  
MONDAY, DECEMBER 7, 2009**

**CHINESE DRYWALL INSURANCE ISSUES**

**BY  
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**I. INTRODUCTION**

A. My background

18 years in the insurance industry

19 years practicing law—insurance

Retained throughout the country to consult on insurance issues and testify on insurance industry claims handling practices and standards including how insurance companies commonly interpret and apply their insurance policies.

B. Purpose of presentation

Not to review all the detailed factual issues

We all recognize that this is a widespread problem, potentially afflicting hundreds of thousands of homeowners and potentially costing billions of dollars in damages.

My purpose here today is to discuss some of the more important insurance issues that are arising out of the Chinese drywall cases.

C. Many policyholders have turned to their insurers for help.

It appears that insurers, whether personal or commercial lines, are denying coverage for property damage or defense and indemnity for the Chinese drywall claims for a variety of reasons.

Today, I want to focus on how the insurance industry itself interprets and applies some of the key insurance policy provisions that are at issue in these cases.

From an insurance perspective the issues presented are two fold:

1. Are the insurers properly applying the insurance policies to the claims presented, and
2. Are the insurers properly investigating and evaluating these claims?

These two go hand in hand. Without a proper and thorough investigation there cannot be a proper coverage evaluation of the claim.

From regulatory perspective, the issues are somewhat different:

1. What role can the insurance regulator take in helping to assure that insurers are properly evaluating and applying their insurance policies, and

2. What role can the insurance regulator take in addressing the overall problem presented to homeowners arising from Chinese drywall?

## II. INSURANCE INDUSTRY STANDARDS FOR INSURANCE POLICY INTERPRETATION

An insurance company must interpret its policies reasonably, pursuant to the well recognized insurance industry rules for insurance policy construction, which include the following:

- exclusions are to be interpreted narrowly,<sup>1</sup>
- insuring agreements are to be interpreted broadly,<sup>2</sup>
- the insurance company must resolve doubts concerning coverage in favor of the policyholder,<sup>3</sup>
- policy language should be given its plain, ordinary and popular meaning;<sup>4</sup>
- ambiguous policy provisions should be interpreted against the insurer and in favor of coverage,<sup>5</sup> and
- “[T]he burden is on the insurer to establish the fact that the exclusions apply. The insurer simply stating that coverage is excluded is not enough to settle the issue; the insurer must prove its case,” and “if there is any reasonable doubt as the applicability of the exclusion, the insured is entitled to the benefit of the doubt. Exclusions are to be construed strictly against the insurer...” (Fidelity, Casualty & Surety Bulletin (“FC&S”), “That Particular Part,” June 2004)<sup>6</sup>

It is critically important, in my view, that the insurance industry apply its policies to the Chinese drywall claims in accordance with these insurance industry standards.

## III. HOMEOWNERS’ COVERAGE ISSUES

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<sup>1</sup> How to Draft and Interpret Insurance Policies, Wollner, Kenneth S. (Cas. Risk Pub, LLC 1999), p. 19 (“Exclusions and other limitations are strictly construed against the party seeking to impose the limitation.”) All the insurance texts referenced herein are either used in training insurance claims professionals or as reference materials for claims professionals.

<sup>2</sup> Insurance Contract Analysis, Wining, Eric A., and Malecki, Donald S., (Am. Inst. for CPCU, 1<sup>st</sup> Ed 1992) p. 76 (“[I]nsurance agreement provides a broad statement of coverage.”).

<sup>3</sup> Property Loss Adjusting, Popow, Donna J. (Am Inst. of CPCU, 3<sup>rd</sup> ed., 2004) § 5.34.

<sup>4</sup> Adjustment of Property Losses, Thomas, Paul & Reed, Prentiss, (McGraw Hill, 4<sup>th</sup> ed., 1977) p. 48.

<sup>5</sup> *Id.*, p. 50.

<sup>6</sup> The FC&S Bulletins have been published by the National Underwriter for over 50 years to assist insurance companies in the interpretation and application of a wide variety of insurance policy provisions. The FC&S Bulletins are used frequently by insurance industry claims professionals to interpret and apply insurance policy provisions. As one Court has noted: “The FC & S bulletin, which is published by the National Underwriters Association, is used by insurance agents and brokers to interpret standard insurance policy provisions. (citation omitted) “[R]eliance on [an] FC & S bulletin is appropriate under Civil Code section 1645 which provides: ‘Technical words are to be interpreted as usually understood by persons in the profession or business to which they relate, unless clearly used in a different sense.’ (citations omitted) “[I]nsurance industry publications are particularly persuasive as interpretive aids where they support coverage on behalf of the insured. Ultimately, the test is whether coverage is ‘consistent with the insured’s objectively reasonable expectations.’ [Citation omitted.]” *Golden Eagle Insurance Co. v. Ins. Co. of the West*, 99 Cal.App.4<sup>th</sup> 837, 838 (Cal. App. 2002)

A. Potentially applicable exclusions

Insurers are relying on a number of exclusions commonly found in homeowners' policies to deny coverage. These exclusions have, however, been found not apply to the types of claims arising from Chinese drywall.

1. Pollution

Was the pollution exclusion intended to apply to pollution within a residence in a non-industrial setting?

Many courts have noted that the exclusion only applies to traditional environmental damage and not to damage arising from the release of gases or similar substances in a home.

These courts note that the exclusion is only intended to apply to industrial type pollution.

See e.g., American States Ins. Co. v. Koloms, 177 Ill.2d 473, 687 N.E.2d 72 (1997), Whitmore v. USAA Cas. Ins. Co., Civ. Act. No. 07-5162, 2008 WL 4425227 (E.D. Pa. Sept. 30, 2008) (pollution exclusion did not apply to the discharge of heating oil in the policyholder's basement), and MacKinnon, et al. v. Truck Insurance Exchange, 31 Cal.4<sup>th</sup> 635 (pollution exclusion does not apply to spraying by landlord of pesticide).

FC&S has called this to the attention of insurers nationwide.

Insurers should carefully consider these decisions, even if they are in other states, when evaluating coverage for Chinese drywall claims.

2. Wear, tear and deterioration exclusion

As pointed out elsewhere in an insurance industry publication, the "purpose of an exclusion for wear and tear, marring and gradual deterioration is to exclude maintenance type losses that **naturally** occur over time." ("Forms & Substance-Coverage Concerns, Quirks and Solutions," Wilson, Bill, ed., *Independent Agent*, May 2004, p. 12)(emphasis added)

The FC&S notes that, "[t]he purpose of the wear and tear exclusion in property coverage policies is to eliminate insurance recovery in situations where claim is made on property, which has been damaged through normal use, abuse, or has simply been "**used up**."" (FC&S Bulletin, "Wear and Tear Exclusion")(emphasis added)

Chinese drywall claims would not appear to fall within these insurance industry interpretations of the wear, tear and deterioration exclusion. There is nothing "natural" about the problems arising from Chinese drywall. Rather, the damages resulting from Chinese drywall are clearly unexpected from the standpoint of the policyholder. Further, there is no evidence that Chinese drywall is subject to being "used up" over time.

3. Inherent vice, latent defect exclusion

In the insurance industry, the latent defect or inherent vice exclusion is defined "as a quality within an object which **makes it tend to destroy itself**. The tendency of rubber to deteriorate whether or not it is in use is an inherent quality of the material and an inherent vice."(Fire and Property Insurance, Rodda, William H. (Prentice-Hall Inc., 1956) p. 298.)(emphasis added)

FC&S Bulletin in "Processors Coverage Form," p. 5, notes that the exclusion applies to "a loss due to any quality in the property that causes the property to **damage or destroy itself**...that results from something within the property itself as opposed to some outside force." (emphasis added)

The first party policies contain such an exclusion so that the insurer does not have “to compensate for the fact that most property has its own shelf life and will eventually wear out or break down because of intrinsic nature or quality.” (“Risks Not Taken,” Wollan, Eugene, *John Liner Review*, Fall 2006, p. 86)

There is no evidence that I am aware of that the Chinese drywall is damaging or destroying itself.

What we can draw from these comments concerning these exclusions, is that the exclusions are intended to apply to maintenance type damage claims; not to claims arising from unexpected and accidental damage from causes which are not within the policyholder’s ability to prevent or cure, such as the Chinese drywall claims.

4. Construction defects: faulty materials or workmanship exclusion

This exclusion contains an ensuing loss exception.

FC&S has noted that any ensuing loss “as a result of the faulty drywall would be covered, for example if the drywall caused corrosion damage to wires or pipes.”(FC&S, “Chinese Drywall”) (Also See e.g., Rosenberg v. First State Ins. Co., 280 Cal.Rptr. 388 (Ca. App. 1991) (damage resulting from defective workmanship is covered under the policy) And See FC&S, “Chinese Drywall: The Next Big Issue?” p. 3(There is coverage for ensuing losses from faulty workmanship))

B. Litigation

Already litigation has been commenced by homeowners against their insurers.

See Baker v. American Home Assurance Co., Mid. Dist of Fl. Filed March 30, 2009

Alleged in the complaint that insurer had the insured's home tested by Rimkus consulting group, but refused to turn over report to the insured.

It is also alleged in the complaint that the insurer failed to provide written denial but only denied coverage verbally.

If true, these allegations should cause great concern among insurance regulators as this conduct is certainly contrary to insurance industry claims handling requirements, as set forth in the NAIC Model Unfair Claims Settlement Practices Act and Regulations, which have been adopted in several states.

**IV. COMMERCIAL PROPERTY COVERAGE ISSUES**

Many of the same issues that arise under the homeowner policies also arise under the commercial property policies.

**V. COMMERCIAL GENERAL LIABILITY COVERAGE ISSUES**

Insurers have also relied upon many exclusions in the standard Commercial General Liability policy to deny coverage for the defense and indemnity of their policyholders in Chinese drywall related suits brought against their policyholders.

A. Exclusions

1. Pollution Exclusion

FC&S has noted: “The exclusion was intended to limit or exclude coverage for environmental contamination, not product liability claims. The damages from drywall aren’t environmental pollution but, rather, bodily injury or damage caused by products containing the sulfur compounds.” (FC&S, “Chinese Drywall: The Next Big Issue?” p. 3)

This exclusion also contains an important exception. The exclusion does not apply to:

“Bodily injury or property damage sustained within a building and caused by the release of gases, fumes or vapors from materials brought into that building in connection with operations being performed by you or on your behalf by a contractor or subcontractor.”

FC&S has noted that, “even if the vapors are considered to be a pollutant, there is coverage because of this exception.”

2. Your work exclusion

Does not apply if the work performed by a subcontractor.

Therefore, if a general contractor hires a subcontractor to install Chinese drywall, claims against the general contractor for the defective Chinese drywall will not be excluded under this exclusion.

3. Exclusion for Property you sell, give away or abandon if the property damage arises out of any part of those premises.

Although possibly applicable to the owner it would not apply to the general contractor.

Further, many courts have held that the exclusion does not apply where the contractor/developer constructs the building with the intent of selling it upon its completion.

4. Exclusion for That particular part of any property that must be restored, repaired or replaced because your work was incorrectly performed on it.

This exclusion does not apply to property damage in the products completed operations hazard.

B. Litigation

As with homeowners’ claims, litigation by policyholders against their commercial general liability insurers has already commenced.

See Builders Mutual Ins. Co., Fireman’s Fund Ins. Co. & Hanover Ins. Co. v. The Dragas Co., Fed. Ct. Virginia, filed April 23, 2009

Insurer brought action against insured contending that it did not owe duty to defend and indemnify insured for actions brought against the builder arising from Chinese drywall cases

It is alleged in the complaint that Builders Mutual Ins. Company denied coverage less than two months following the tender based on the pollution exclusion. This raises a question of whether the insurer conducted a complete and thorough investigation of the claim before it denied coverage.

It is also alleged that the drywall was installed by a subcontractor to Dragas, and that the denial was based, in part, on the “your work” exclusion, which, as noted, has an exception for work performed by a subcontractor.

## VI. POSSIBLE RESPONSES BY REGULATORS

1. The importance of the relationship between the insurer’s investigation and coverage decision cannot be overlooked. That investigation must contain two important elements:
  - a. A timely investigation, and
  - b. A thorough investigation—not cursory.

These elements of the insurance claims handling process can and are regulated by the insurance commissioners under such statutes as the Model Unfair Claims Settlement Practices Act and Regulations.

Commissioners may want to consider a multi-state market conduct exam to assure that the minimum standards for proper investigations are being followed.

Such a multi state examination could include a representative of insurance consumers. Authority is commonly provided to commissioners under their respective state statutes regarding market conduct exams to hire such outside consultants. This would tend to add greater assurance to the general public that their interests were being considered in the examination process.

Of course, the results of any market conduct exam should in no way be prejudicial to or determinative of the issues that may arise in any private litigation brought by a policyholder against its insurer and I would urge the commissioners to make that clear in any report regarding their market conduct examination.

2. I would also suggest that the commissioners explore the possibility of developing a model guidance document to be issued to the insurers regarding the manner in which the commissioners expect the applicable insurance policy provisions to be interpreted and applied.

This has been done by state insurance commissioners in other settings. (See e.g., Texas Department of Ins., Commissioner’s Bulletin #B-007-09 (concerning application of pollution exclusion to situations and claims that are not intended to be excluded))

3. The commissioners may also want to consider supporting a model settlement mechanism along the lines of the plan developed in the late 1970’s and early 1980’s to pay for asbestos claims. This plan was funded by asbestos manufacturers and their insurers to provide funds for the victims of asbestos. A similar fund could be created to provide funds for the repair of homes containing Chinese drywall.
4. Because of the urgency of this problem any steps the commissioners take should be taken as soon as possible.

## VI. CONCLUSION

There are too many policyholders out there today who no longer can live in their homes.

These policyholders have little hope that they will be able to move back into their homes any time in the near future.

Many of them have lost significant value in their homes solely because of the installation of Chinese drywall.

These policyholders commonly do not have the resources themselves to rebuild their homes and therefore they have turned to their insurers for help.

The insurance commissioners can assist these policyholders in returning to their homes, and I urge you to take immediate steps to provide that assistance.

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U.S. Department of Homeland Security  
500 C Street, SW  
Washington, DC 20472



**FEMA**

November 30, 2009

The Honorable Kevin McCarty  
Commissioner, Office of Insurance Regulation  
Chair, NAIC Catastrophe Insurance Working Group  
Florida Department of Financial Services  
Larson Building  
200 East Gaines Street, Room 101A  
Tallahassee, FL 32399

Dear Commissioner McCarty:

The partners and stakeholders of the National Flood Insurance Program (NFIP) appreciate the continued support provided by the National Association of Insurance Commissioners (NAIC). The NAIC has been of great value in fostering quality NFIP training for insurance agents nationwide. In an effort to continue to meet the goals of the NFIP, the U.S. Congress, and the insurance industry, we are once again calling upon the NAIC for assistance.

As you are aware, the NFIP is a Federal insurance program established by Congress in 1968 and overseen by the Federal Emergency Management Agency (FEMA). The Flood Insurance Reform Act of 2004 (FIRA 2004), Section 207, placed special emphasis on NFIP training for insurance agents. It is our understanding that the NAIC recognizes the Federal Crop Insurance Corporation (FCIC) as a Federal program not subject to certain State training requirements whereby an FCIC-approved vendor administers training, testing and continuing education. We are asking for your consideration in recognizing the NFIP in the same way.

Through a contract with GeoLearning, Inc., FEMA provides instructor-led workshops, webinars, and online training covering basic and advanced flood insurance topics. Each year, FEMA assists over 10,000 insurance agents in obtaining continuing education credits as required by their State for licensing. This is accomplished by filing NFIP course completion documentation with individual State Departments of Insurance. The associated cost to file this documentation is, on average, \$3.36 per record. We are requesting that the NAIC encourage State Departments of Insurance and their vendors to waive the fee for filing continuing education credits for NFIP training. The financial impact on individual States is expected to be small.

In addition, we would like to open a dialog with you on other ways that the NAIC can encourage State Departments of Insurance to give special consideration to NFIP training related issues. We have identified the following possibilities:

- 1) Provide FEMA with updated electronic mailing lists of licensed insurance agents, free of charge. We will use the list to notify agents of upcoming NFIP training.
- 2) Afford continuing education credits for NFIP webinar classes completed by insurance agents.
- 3) Expand the one-time NFIP education requirement for insurance producers to a biannual requirement.

[www.fema.gov](http://www.fema.gov)

The Honorable Kevin McCarty  
November 30, 2009  
Page 2

We believe that these actions will help the NFIP to meet its goals in advancing agent knowledge, consumer awareness, accurate calculation of flood insurance premiums, and accurate flood insurance claim settlements. These actions will also assist in lowering the costs associated with the implementation of Section 207 of FIRA 2004.

As always, the NAIC is a valued NFIP partner, and it is a pleasure working with you. I look forward to your response and to future discussions concerning these training-related issues.

Sincerely,



Edward L. Connor  
Acting Federal Insurance Administrator  
National Flood Insurance Program

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Draft: 12/18/09

Title Insurance Issues (C) Working Group  
San Francisco, CA  
December 6, 2009

The Title Insurance Issues (C) Working Group of the Property and Casualty Insurance (C) Committee met in San Francisco, CA, Dec. 6, 2009. The following Working Group members participated: Alan Seeley, Chair (NM); Sarah McNair-Grove (AK); Bill Lacy (AR); Jill Jacobi and Louis Quan (CA); Paula Sisneros (CO); Steve Parton (FL); Margaret Witten (GA); Doug Webber (IN); Dudley Ewen and Randi Johnson (MD); Paul Hanson (MN); Tamara Kopp (MO); Christy Neighbors (NE); Marie Holt (NV); and Lee Barclay (WA).

1. Update on Consumer Financial Protection Agency Act of 2009

Tom Montgomery (NAIC) reported on H.R. 3126, the Consumer Financial Protection Agency (CFPA) Act of 2009. The proposal has passed two House committees and was merged into the larger House financial regulatory reform package. It was expected on the floor this week. The bill would establish an independent federal agency or group of regulators to regulate consumer financial issues. It was designed to address predatory lending and credit card company abuses, and generally exempts insurance. The comprehensive proposal in the Senate includes credit, title and mortgage insurance, with troubling definitions that threaten to extend to other lines of insurance. Both House and Senate are in the process of moving major financial regulatory packages, with the House moving more quickly. It is hoped that insurance will be exempted from the Senate bill.

Justin Ailes (American Land and Title Association—ALTA) said that although insurance is exempted from the House bill, the bill still includes real estate settlement practices and Real Estate Settlement Procedures Act (RESPA) transactions, so title insurance is not fully exempted.

2. Results of Survey of State Laws on Collectability of Title Agent Data

Mr. Seeley said all jurisdictions have responded to the Working Group survey of jurisdiction laws on the collection of title agent data and other information. A copy of the draft Zoomerang results containing the information from every jurisdiction except Pennsylvania was distributed; the Pennsylvania results are available to members. Some of the significant survey results include: jurisdictions authorized to require data reporting from 81% of the title companies and 61% of the title agents (the results are dramatically lower for attorneys, abstractors and escrow/settlement agents); jurisdictions are authorized to require title insurers to obtain the participant's data and report it in 62% of the cases for title agents; only eight jurisdictions currently collect data on a regular basis and 19 jurisdictions collect on an ad hoc basis; most jurisdictions that collect data do not aggregate or compile the results; and 32% of the jurisdictions reported that data is kept confidential. The survey results included information regarding the processes that are regulated; the rate regulation method and applicable rate standards; the type of participants that are regulated and what duties each performs; where title plants are required; information on closing protection letters; information on escrow and trust accounts; and whether surety bonds are required.

Birny Birnbaum (Center for Economic Justice—CEJ) said that since responses to questions five and six indicated that 19% of the jurisdictions regularly collect and compile data, perhaps the Working Group should determine what the various jurisdictions are currently collecting. In discussing the survey results, the Working Group agreed with Mr. Hanson that each jurisdiction should be provided with another copy of the actual questions and the responses from each jurisdiction. NAIC staff will send the individual jurisdiction responses to each jurisdiction and allow each jurisdiction to review the responses to make any necessary corrections. As suggested by Mr. Barclay, jurisdictions will have one week to amend the response. The final survey responses will be re-compiled as necessary. Mr. Seeley and NAIC staff will consider the best delivery method of the aggregated and individual jurisdiction results to distribute to everyone.

The Working Group agreed to add a disclaimer to the final compiled results indicating that the individual jurisdiction responses are not a binding legal opinion, as these are the opinions of the respondents to an informal survey. NAIC staff will coordinate with the Legal Division on the wording. The final survey results, in state-specific detail, will be made public pending the approval of NAIC legal staff.

3. Consider Feasibility of Creating a Uniform Database of Title Agent Data

Mr. Seeley said the results of the aforementioned survey indicate that 61% of the jurisdictions are authorized to require data reporting by title agents, and that 62% of jurisdictions are authorized to require title insurers to obtain and report title agent data. Mr. Parton said the results showed that a majority of the states can collect title agent data, and if title agent data is included in the title premium, there should be some centralized process. Mr. Seeley said the three previous goals the Working Group discussed were to review profitability, review the reasonableness of rates and measure the level of competition. If most of the premium is kept with the title agent, then to properly measure the reasonableness of the rates and profitability, the Working Group will need to collect additional data from the agent. In other lines of business, agent compensation is low compared to the premium companies receive. Mr. Parton said the challenge in Florida is that 70% of the title premium goes to the title agent, as there was prior legislation deregulating closing costs. Mr. Barclay said Washington has a strong interest in this area and believes a national plan would be beneficial. Commission percentage would be helpful, as Washington is moving to the prior approval rate system for title insurance, and perhaps obtaining title agent data reported by the company is necessary. Mr. Hanson said a concern is the number of agents that are involved in many jurisdictions, as an attorney can be an agent and there is a vast array on the type of business that can be conducted.

The Working Group considered whether all jurisdictions will collect the data and if the effort would be worthwhile. Mr. Parton suggested that since Florida, New Mexico and Texas currently collect data, those states can be used as a template to expand upon. Mr. Barclay agreed that it would be a good starting point to include other reporting agents currently perform, such as IRS information. Ms. Sisneros agreed the information would be helpful in Colorado. Mr. Ailes said ALTA members have been discussing the issue, and there are concerns in collecting and using/comparing the data, but some members felt there would be value in collecting the information. He indicated that the ALTA Agents Research Committee has reviewed the elements currently being collected and has come up with additional elements to collect. He suggested that if agent data were to be collected, the purpose needs to be clear. The data collected should be on a going-forward basis; it should be simple reporting due to the vast number of smaller agents with limited resources and the need to recognize that no information needs to be reported if it is below a certain threshold. For example, ALTA recognizes \$300,000 or less in revenue for small agent and NAIC contains \$1 million or less in revenue. The template of data elements should perhaps start where New Mexico or Texas begin. He further believed it would be helpful to include the number of title corrections that are identified from the searches performed.

Mr. Hanson said that conceptually, there should be a uniform approach, which would help in the understanding of the marketplace. Mr. Parton said perhaps there should be uniformity, and perhaps a cut-off point would be helpful, as overall there will be value in collecting information. He said perhaps information can be collected directly from a title company rather than from each title agent. Mr. Birnbaum said the variances between jurisdictions on the number of agents are incredible, and he provided an example whereby Pennsylvania has greater than 4,000 licensed agents and California has less than 100 agents. He suggested that perhaps a fourth goal to be added to what was mentioned earlier (the review of profitability, review of reasonableness of rates and measurement of the level of competition) would be to evaluate how title business operates. In doing so, the information gathered would be different. For instance, if looking for reasonableness of expenses, perhaps look at the larger agents, as they represent the bulk of the expenses. For smaller agents, one would get limited information on how they operate and get basic information like general revenue and general expense and what their basic functions are. There is currently a lot of information available, and analyzing what is available in relation to the desired goals would be beneficial.

The Working Group agreed that the survey results and effort would be worthwhile for the Working Group to assist jurisdictions in developing a statistical plan that will help in analyzing the marketplace, and work should begin with identifying the data elements to collect. The Working Group agreed to establish a subgroup, including interested parties, to consider the purpose and data elements of a uniform database of title agent data. Ms. Sisneros will chair the subgroup, with participants including Florida, Maryland and Missouri. Mr. Seeley encouraged anyone having ideas to submit them. Diane Evans (Land Title Guarantee Company and Governor of ALTA) expressed concern on the data collected and appropriateness of the data, and expressed an interest in participating on the subgroup. Ms. Kopp suggested that perhaps another item to consider is the evaluation of the marketplace and how agents perform their business.

4. Update on Proposed Conversion of the Working Group into a Task Force

Joe Bieniek (NAIC) said the Property and Casualty Insurance (C) Committee made a recommendation during the Fall National Meeting that the Working Group be changed to a task force. The recommendation will be considered by the Executive (EX) Committee. Mr. Barclay said the annual selection forms were sent to all jurisdictions and the form lists a title

task force rather than a working group. He encouraged everyone to be certain that if members are serving on the Working Group, they should select the Task Force if they want to continue as a member if the Executive (EX) Committee approves the change.

5. ALTA Licensing Initiative for Policy Forms

Mr. Ailes stated that ALTA recently decided to start charging title insurers and agents an annual copyright “licensing fee” to use (i.e., issue) their title policies and forms that were developed by ALTA if the title insurer or agent is not an ALTA member. ALTA is not filing the forms with the insurance departments; it is still the responsibility of the user to file the form(s) as they wish, and in most cases the insurer making the filing is using SERFF. Bureaus file the ALTA forms where necessary. This is the first time in 80 years that ALTA has decided to charge the industry for the service. This service does not appear any different than any consultant, attorney, third party, or other entity may perform in developing/promulgating forms for other lines of business.

6. Consider 2010 Draft Work Plan

Mr. Seeley provided an overview of the draft 2010 work plan and prioritization. The draft work plan components include: 1) develop a nationwide title statistical plan; 2) modernize and improve the solvency regulation of title insurers; 3) consider ways to mitigate the impact of insolvencies on policyholders; 4) consider ways to maintain or improve competitive markets; 5) explore ways to promote effective consumer shopping for title agents and insurers; 6) promote fair, compliant and transparent real estate settlement practices by title agents and insurers; 7) assist in combating mortgage fraud; and 8) consider revisions to title model acts.

Mr. Barclay made a motion to adopt the 2010 Work Plan. Ms. Neighbors seconded. Caroline Scott (Casey, Gentz and Magness LLP) expressed concern with an RBC approach and would like a rules-based approach in the solvency regulation of title insurers. Mr. Hanson said the plan is a process and is not what to do or what will be; the item is broadly written. The motion passed.

7. Any Other Matters Brought Before the Working Group

Mr. Seeley said that David Cox (MO) suggested a subgroup be appointed to review the title annual statement in relation to providing improved instructions and crosschecks. Mr. Seeley and Mr. Cox believes a subgroup of regulators and insurers would be beneficial, and the end product would lead to a Blanks proposal. This should be viewed only as routine maintenance. The Working Group will consider this during the Spring National Meeting.

Having no further business, the Title Insurance Issues (C) Working Group adjourned.

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Draft: 12/18/09

Crop Insurance (C) Working Group  
San Francisco, CA  
December 5, 2009

The Crop Insurance (C) Working Group of the Property and Casualty Insurance (C) Committee met in San Francisco, CA, Dec. 5, 2009. The following Working Group members participated: Merle D. Scheiber, Chair (SD); Joe Musgrove (AR); Ted Clark (KS); Mary Kempker (MO); David Browning (MS); Rebecca Ternes (ND); Alan Wickman (NE); Michele Brugh (OH); and Russell Valorey (OK). Also participating were Treva Wright-Donnell (KY), Glenn Wilson (MN), and Teresa Miller (OR).

1. Update on States Avoiding Federal Preemption for Adjuster Licensing

Director Scheiber said the Working Group and the states have made some great strides the last few years on uniformity of crop adjuster licensing and he hopes the Working Group can be used a model within the NAIC as an example of what can be accomplished when states work together.

Joe Bieniek (NAIC) provided a report on states' efforts to avoid federal preemption of crop adjuster licensing. One of the problems with crop adjuster licensing is that most states require a crop adjuster to obtain a property/casualty license. As a result, there is no proficiency in handling crop insurance claims, and there is a lack of uniformity across the states. In addition, most states do not require the licensing of insurance company personnel. The U.S. Congress, through the federal Risk Management Agency (RMA), could preempt the states' licensing authority for adjusters handling Multi-Peril Crop Insurance (MPCI), on a state-by-state basis, beginning as early as July 1, 2011. The NAIC previously surveyed all of the states to assess whether they could allow a third party to test crop adjusters to obtain a crop insurance license. These results appear to indicate that as many as 14 states could be preempted. NAIC staff and the Crop Insurance (C) Working Group continue to work with the states to assist those that have questions or problems. All 14 states plan to implement changes so that federal preemption will not occur.

The problems that could occur for any state that becomes preempted would be a bad precedent for any state and reflect poorly on the states' ability to uniformly regulate the business of insurance. For most states, there would be a loss of related revenue. Concerns might arise in the event of a catastrophe in having out-of-state adjusters assist in handling claims.

RMA has received signatures on the Standard Reinsurance Agreement (SRA) Amendment from the 16 companies writing MPCI beginning July 1 for the 2010 reinsurance year. With these signatures, all states without crop-specific requirements stand to be preempted in July 2011. According to RMA, crop-specific includes two categories: 1) the states must recognize crop as a special line of business; and 2) the majority of the material in education and testing on adjuster licensing must be crop-related procedures.

RMA has completed the development of acceptance criteria for entities to be a provider of proficiency training and examination programs. The National Crop Insurance Services (NCIS) is the sole approved entity to administer the proficiency program. The program by NCIS called Crop Adjuster Proficiency Program (CAPP) is currently available and is set up in three parts. Sixty hours of training is required before taking the online examination. There is a bank of questions that are randomly chosen each time an exam is generated, and every question in the system is reviewed for technical accuracy. Beginning Feb. 1, 2010, all CAPP exams will be proctored. NCIS will meet with any state interested in learning more details about the CAPP system.

To avoid preemption, some states are considering the following actions: exempt MPCI adjusters from licensure; exempt MPCI adjusters from examination if they provide proof of completing an RMA-certified program; allow for acceptance of an RMA-certified training and testing program; create a separate license for MPCI adjusters; and develop their own training and testing programs for MPCI licenses.

Mr. Bieniek pointed out that additional considerations the states may want to consider include: an Executive or Commissioner Order until legislation can be enacted; allow for RMA-authorization proficiency training and testing; develop their own training and testing program; and, a statute or regulation might need to allow for out-of-state insurance department licensed adjusters. Or, when states do not license adjusters, then out-of-state adjusters may be allowed if certified by Federal Crop Insurance Corporation (FCIC) in the event of a catastrophe.

Sample language of Oregon's proposed rulemaking and Vermont's statute revision were distributed.

2. Update from the Risk Management Agency (RMA)

David Miller (RMA) reported that the RMA recently released its first draft of the Standard Reinsurance Agreement for the 2011 crop year. He said a comprehensive review of the information technology structure of CAPP was conducted and it is compliant with Section 508 of the Rehabilitation Act which addresses special needs. Mr. Miller said subject-matter experts have reviewed the CAPP test questions and all recommendations suggested by RMA have been modified by NCIS. With CAPP meeting the Section 508 compliance requirements and changes being made to the test questions, Mr. Miller announced that on Dec. 1, the CAPP program was officially approved by the director of the RMA and a press release is expected shortly.

3. Update from National Crop Insurance Services (NCIS)

Laurence Crane (NCIS) reported that there has been substantial improvement in the uniformity of adjuster licensing and training through CAPP. The program consists of three parts: 1) 60 hours of initial training and 18 hours annually of company level training; 2) a series of three CAPP online examinations. Once someone has completed the exams, a proficiency card is issued that would be accepted by state insurance departments for licensing; 3) the annual continuing education requirements of 18 hours of training. The NCIS will communicate with insurers about adjusters that have failed to meet the annual requirements. To date, nearly 3,800 adjusters have passed the examination, with approximately 30 adjusters passing on a daily basis. Beginning February 2010, all CAPP examinations will be proctored; currently it is an elective process by each company.

In responding to an inquiry by Ms. Wright-Donnell, whereby Kentucky requires 24 hours of continuing education, Dr. Crane said NCIS will work with any state on their specific state requirements for continuing education.

Having no further business, the Crop Insurance (C) Working Group adjourned.

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TO: Members of the Property and Casualty Insurance (C) Committee

FROM: Eric Nordman, CPCU, CIE  
Director of Regulatory Services

DATE: Dec. 2, 2009

SUBJECT: Request for Advice from the Receivership and Insolvency (E) Task Force

### Background

In a memo dated March 16, 2009 (see copy attached), the chair of the Receivership and Insolvency (E) Task Force requested assistance from the Property and Casualty Insurance (C) Committee related to certain regulatory exclusions contained in D&O insurance policies pertaining to receivers, conservators, and liquidators. The Task Force expressed concern that the use of the exclusionary language would become more common, and potentially hinder the receiver's ability to exercise and enforce all the rights, remedies and powers of any insured, creditor, shareholder or member. This would result in a limitation of the receiver's ability to collect all monies due to pay claimants.

Director Michael T. McRaith (IL) provided a response and analysis of the Nebraska court case on June 18, 2009 (see copy attached). It provides an analysis of *Wagner v. United National Insurance Company, et al.*, 277 Neb 308 (2009). There are several pertinent facts that the Committee needs to consider as it debates the public policy aspects for state insurance regulators in general. They are:

- The Nebraska Insurance Director's staff either approved or failed to disapprove a policy exclusion in a D&O policy that says, "This policy does not apply to any Claims brought by or on behalf of, any insurance regulatory agency or supervisory authority including but not limited to any state or local insurance department or Commission, or any state or local Insurance Guaranty or Insolvency Fund (any of the foregoing organizations hereafter referred to as an "Agency"), including any type of legal or equitable action which such Agency has the legal right to bring as receiver, conservator, liquidator or assignee of the insured, its security/unit holders or its creditors, or other-wise; whether such action or proceeding is brought in the name of such Agency or by or on behalf of such Agency in the name of any other entity(ies) or solely in the name of any third entity(ies)."
- The insurer became insolvent in 2001.
- The Nebraska Insurance Director was appointed to serve as liquidator for the insurer.

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- The Nebraska Insurance Director filed two separate actions:
  - An action against the directors and officers of the insurer in which the Director alleged that the insurer became insolvent through the wrongful conduct and breach of multiple fiduciary duties of its directors and officers; and
  - An action in which the Director requested that the court invalidate the regulatory exclusions contained in the D&O policy.
- The Nebraska Insurance Director advanced two theories:
  - The regulatory exclusion does not apply to the Director in his capacity as liquidator; and
  - The regulatory exclusion is void as against Nebraska public policy.
- The Nebraska Supreme Court rejected both of the Director's arguments.

**Matters for the Committee to Discuss**

While the matter is seemingly settled for Nebraska, what is left for the Committee to consider is whether it is sound public policy to allow D&O insurers to include a regulatory exclusion in their policies. At issue is whether the receiver, conservator, liquidator or state guaranty funds should be afforded coverage for acts of directors and officers of an insolvent insurer. There are financial implications for the public and all insurers through their participation in guaranty funds.

If the Committee decides that it is not a good idea for such an exclusion to be included in D&O policies, how should the message be delivered to the states? Should a model law or model guideline be developed? Is a white paper necessary? Is a response to the Task Force memo sufficient?

I look forward to the discussion in San Francisco.

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**STANDARDS**  
**ADVISORY ORGANIZATIONS OPERATIONS/MANAGEMENT/GOVERNANCE**

**Standard 3.**

The advisory organization **prepares, submits filings as necessary,** adheres to applicable state filing and/or approval requirements **and written procedures** prior to distribution of prospective loss costs, policy forms, endorsements, factors, classifications or **rating rule** manuals.

**Apply to:** Advisory Organizations that develop and file prospective loss costs, policy forms, endorsements, factors, classifications or **rating rule** manuals.

**Priority:** Essential

**Documents to be Reviewed**

\_\_\_\_\_ Applicable statutes, rules and regulations

\_\_\_\_\_ **Procedural information from the advisory organization**

\_\_\_\_\_ Filings made to applicable states

\_\_\_\_\_ **Communications and manuals provided by the advisory organization to its members and subscribers**

\_\_\_\_\_ Distributed prospective loss costs, policy forms, endorsements, factors, classifications or manuals.

Others Reviewed

\_\_\_\_\_  
\_\_\_\_\_

**NAIC Model References**

**Review Procedures and Criteria**

Review a sample of actual filings and materials distributed to member or subscribing companies.

- The advisory organization makes filings on SERFF or other state approved filing systems;
- The advisory organization follows mandated time requirements (if applicable) following filing or approval before permitting use of materials;
- The advisory organization is responsive to state filing analyst questions regarding filings;
- Distributed materials are the same as those filed with applicable state insurance departments;
- **Prospective loss costs, policy forms, endorsements, factors, classifications or rating rules are filed and approved (as applicable) in accordance with state filing laws;**
- **Instructions are included in the advisory organization’s manuals for all prospective loss costs, policy forms, endorsements, factors, classifications or rating rules;**

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- The advisory organization provides accurate information to its members and subscribers relating to states approval status and approved usage date of prospective loss costs, policy forms, endorsements, factors, classifications or rating rules in a timely manner.

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## **Section 15. Standards for Inspection Services**

### **1. Purpose**

The purpose of this portion of the exam is to review the advisory organization's processes for ensuring proper classification of risks that are subject to inspection and to report the results of this review to carriers and insureds.

### **2. Techniques**

The examiner should review the procedural information from the advisory organization, as well as completed reports. Communications and manuals provided by the advisory organization to its members and subscribers, as well as applicable statutes and rules and regulations should be reviewed to determine that the communications to insurers and insureds are consistent with existing classifications of risk.

### **3. Tests and Standards**

The insurance program development and maintenance standards include, but are not limited to, the following standards. The sequence of the standards listed here does not indicate priority of the standard.

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**STANDARDS**  
**INSPECTION SERVICES**

**Standard 1.**  
**The advisory organization conducts inspection services in accordance with applicable statutes, rules and regulations, and written procedures.**

**Apply to:** All advisory organizations maintaining a workers' compensation classification system

**Priority:** \_\_\_\_\_

**Documents to be Reviewed**

\_\_\_\_\_ Procedural information from the advisory organization

\_\_\_\_\_ Reports to individual state insurance departments providing inspection services information

\_\_\_\_\_ Communications and manuals provided by the advisory organization to its subscribers

\_\_\_\_\_ Applicable Statutes, Rules and Regulations

**Others Reviewed**

\_\_\_\_\_  
\_\_\_\_\_

**NAIC Model References**

**Review Procedures and Criteria**

The advisory organization has an inspection program in place to ensure proper classifications of risks.

The advisory organization communicates inspection results to carriers and insureds.

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## **Section 16A. Standards for Residual Market Functions – Plan Administration**

### **1. Purpose**

The purpose of this portion of the exam is to review all advisory organizations acting as a residual plan administrator in regard to the implementation of rules, procedures, manuals, policy forms, endorsements, pricing programs, application processing procedures, carrier selection, compensation and oversight. The examiner should note that this section will not be applicable to all advisory organizations.

### **2. Techniques**

The examiner should review contracts, designations or agreements with applicable states for which the assigned risk mechanisms are administered as available and/or required. The examiner should also check to be sure that applicable statutes, rules and regulations are addressed in national and/or state rules and/or procedures where appropriate. A sample of actual filings and materials should be submitted for review.

### **3. Tests and Standards**

The insurance program development and maintenance standards include, but are not limited to, the following standards. The sequence of the standards listed here does not indicate priority of the standard.

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## STANDARDS

### Standard 1.

The advisory organization uses objective and established procedures when administering assigned risk plans.

Apply to: All advisory organizations, acting as a residual market plan administrator, that develop file and implement prospective rules, procedures, manuals, policy forms, endorsements, pricing programs, application processing procedures, carrier selection, compensation and oversight.

Priority: Essential – Market of Last Resort

### Documents to be Reviewed

- Administration of the rules and procedures
- Standards of performance for assigned carriers
- Servicing carrier selection, compensation and oversight
- Application processing procedures
- Dispute resolution process
- Contractual agreements with state if applicable

### Others Reviewed

- \_\_\_\_\_
- \_\_\_\_\_

### NAIC Model References

### Review Procedures and Criteria

Contracts, designations or agreements with applicable states for which the assigned risk mechanisms are administered as available and/or required.

Applicable statutes, rules and regulations are addressed in national and/or state approved filing systems and responds to inquiries.

Review a sample of actual filings and materials submitted for approvals.

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The Plan Administrator makes filings on SERFF or other state approved filing systems and responds to inquiries.

The Plan Administrator is responsive to inquiries relating to individual assigned risk policy issues.

The Plan Administrator develops standards of performance for assigned carriers.

The Plan Administrator adheres to an established selection process for choosing and compensating service carriers.

The Plan Administrator handles applications for assigned risk coverage in a timely manner.

The Plan Administrator adheres to an established process for making assignments to assigned carriers.

The Plan Administrator adheres to established audit practices and procedures for auditing an assigned carrier.

The Plan Administrator develops and/or implements a dispute resolution process for resolution of assigned risk policyholder disputes.

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## **Section 16B. Standards for Residual Market Functions – Reinsurance Administration**

### **1. Purpose**

The purpose of this portion of the exam is to review the advisory organization’s processes for preparing and publishing manuals, procedures and/or information for such reinsurance administration. The examiner should note that this section will not be applicable to all advisory organizations.

### **2. Techniques**

The examiner should review communications with insurers and states relating to contracts, designations or agreements with applicable states for which the assigned risk reinsurance pooling mechanisms are administered as available and/or required. Actuarial practices and procedures for developing reserves should also be reviewed, as well as accurate information being reported to member participants relating to the state’s assigned risk deficit or surplus on a timely basis.

### **3. Tests and Standards**

The insurance program development and maintenance standards include, but are not limited to, the following standards. The sequence of the standards listed here does not indicate priority of the standard.

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## STANDARDS

### Standard 1.

**The advisory organization uses established procedures when administering residual market pool assessments or reinsurance pooling mechanisms**

**Apply to:** All advisory organizations, acting as a residual market reinsurance administrator, that manage a reinsurance pooling mechanism required by statute on behalf of member participants

**Priority:** Essential – Market of Last Resort

### Documents and Procedures to be Reviewed

**Manuals, procedures and information prepared or published by the advisory organization that relate to residual market pool assessments or reinsurance:**

Reporting of financial information

Financial and accounting responsibilities

Reserving practices

Deficit/surplus administration

Others Reviewed

### NAIC Model References

### Review Procedures and Criteria

Contracts, designations or agreements with applicable states for which the assigned risk reinsurance pooling mechanisms are administered as available and/or required.

The Reinsurance Administrator adheres to established actuarial practices and procedures for developing reserves.

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The Reinsurance Administrator provides accurate information to its member participants relating to the state's assigned risk deficit or surplus on a timely basis.

The Reinsurance Administrator provides accurate and timely information to applicable state insurance departments relating to state deficit or surplus results on a timely basis.

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a copy of the agreement and the name and phone number of the person who can validate the existence of the equipment at the alternate site.

### **E. Operations and Processing Controls**

The name, title and phone number of the statistical/advisory organization's contact person responsible for providing the answers to this set of questions must be included on the response summary.

- E1. Is there an IS steering committee or other evidence that top management is involved in the IS function and, if so, who are the members? Please provide copies of the steering committee meeting minutes or other evidence (e.g., memos or agendas) of steering committee meetings held during the period under review.
- E2. Does management monitor the level of open requests for changes to applications and the satisfaction of users with changes made? Please provide a copy of reports on application performance, which have been reviewed and approved by management and include information regarding the volume of changes made to applications, application problems, emergency fixes, application related help desk calls, backlog of requests from users for application changes and users' views on the functional and operational quality of applications.
- E3. Is the process used in changing the system architecture documented? Please provide a copy of the documented process and the name and phone number of the person who can demonstrate or validate the process.
- E4. Are there control procedures in place to ensure electronic data transmissions are transmitted and received completely and accurately? Please provide a copy of the control procedures and the name and phone number of the person who can demonstrate or validate the procedures.
- E5. Are there control procedures in place to detect data that is input inaccurately or incompletely? Please provide a description of the control and the name and phone number of the people who can demonstrate or validate the control for each application as directed by the examiner.
- E6. Is there a control that ensures the effective administration of databases including integrity checks (e.g., is it the responsibility of a database administrator)? Please provide a job description for the database administrator and the name and phone number of the administrator.
- E7. Is there a control that ensures that the underlying causes of operational failures are identified and addressed (as opposed to applying short-term fixes)?
- E8. Is there a control that ensures that all changes to preapproved job schedules are appropriate and authorized? Please provide a description of the control and evidence of management's approval of the last job schedule change made during the period under review.
- E9. a) Are there appropriate escalation procedures in place to report and resolve operational failures in a timely manner?

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b) Are appropriate IS staff and, where appropriate, users involved in the resolution of operational failures?

Please provide a copy of the escalation procedures and evidence of compliance with the escalation procedures during the last operational failure.

E10. a) Is there a procedure for independent testing and validation of system changes or corrections?

E10. b) Is there a procedure for independent testing and validation of the accuracy and completeness of data used in ratemaking or in statistical reports?

Please provide a copy of the procedures and evidence of compliance with the procedures for the last change, correction, ratemaking or statistical report cycle.

E11. a) Are there appropriate escalation procedures in place to report operational failures, including failures related to system upgrades, transmissions and receipt of data, migration of data to new tables, completeness and accuracy of data used in ratemaking or statistical reports, to management in a timely manner?

E11. b) Are there appropriate escalation procedures in place for management to report operational failures to regulators in a timely manner?

Please provide a copy of the escalation procedures and evidence of compliance with the escalation procedures during the last operational failure.

Draft: 11/20/08

Market Regulation Handbook

Chapter 25 –Current Title Name is CONDUCTING THE STATISTICAL AGENT EXAMINATION

1

Section	Question	Response		Attachments	Comments
		Yes	No		
<b>C. Application Management</b>					
<b>Contact Name/Phone:</b>					
	<b>1</b>				
	<b>2</b>				
	<b>3</b>				
	<b>4.a</b>				
	<b>4.b</b>				
	<b>5</b>				
	<b>6</b>				
<b>D. Disaster Recovery / Contingency Planning</b>					
<b>Contact Name/Phone:</b>					
	<b>1</b>				
	<b>2</b>				
	<b>3</b>				
	<b>4.a</b>				
	<b>4.b</b>				
	<b>4.c</b>				
	<b>5.a</b>				
	<b>5.b</b>				
	<b>6</b>				
	<b>7</b>				
	<b>8</b>				
	<b>9.a</b>				
<b>9.b</b>					
<b>E. Operations and Processing Controls</b>					
<b>Contact Name/Phone:</b>					
	<b><u>1</u></b>				
	<b><u>2</u></b>				
	<b><u>3</u></b>				
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	<b><u>9.a</u></b>				
	<b><u>9.b</u></b>				
<b><u>10.a</u></b>					
<b><u>10.b</u></b>					

Draft: 11/20/08

Market Regulation Handbook  
Chapter 25 –Current Title Name is CONDUCTING THE STATISTICAL AGENT EXAMINATION

	<u>11.a</u>				
	<u>11.b</u>				

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Draft: 12/21/09

Property and Casualty Insurance (C) Committee  
Conference Call  
November 16, 2009

The Property and Casualty Insurance (C) Committee met via conference call Nov. 16, 2009. The following Committee members participated: Michael T. McRaith, Chair (IL); Scott H. Richardson, Vice Chair, represented by Kendall Buchanan (SC); Linda S. Hall represented by Michael Ricker (AK); Thomas R. Sullivan (CT); Kevin M. McCarty represented by Ray Spudeck (FL); J.P. Schmidt represented by Shelley Santo (HI); James J. Donelon (LA); Mila Kofman represented by Eric Cioppa (ME); and James J. Wrynn represented by Anne Kelly (NY).

1. Discuss Committee 2010 Proposed Charges

Director McRaith said the purpose of the call was to consider the Committee's 2010 Proposed Charges. Mr. Spudeck inquired about new charge number one to the Catastrophe Insurance (C) Working Group related to catastrophe modeling. Eric Nordman (NAIC) said the new charge was intended to add specificity related to catastrophe modeling efforts and to ask the Working Group to review changes proposed to the *Catastrophe Computer Simulation Modeling Handbook*.

Birny Birnbaum (Center for Economic Justice—CEJ) said the CEJ and the Consumer Federation of America had tendered a letter to the Committee (Attachment Six-A) expressing frustration with the pace at which the Committee planned to address consumer concerns over insurers' use of credit-based insurance scores. He said the issues caused for consumers by the economic decline demand immediate attention from insurance regulators. He encouraged regulators to issue a moratorium on the use of credit-based insurance scores for pricing auto and homeowners insurance. He suggested the charges be amended to show completion of the work by March 2010 rather than the end of the year. Director McRaith said the objective with the charges was not to promise something that could not be delivered. He said some of the information needed to properly evaluate the use of credit-based insurance scores is dependent on factors outside the control of the Committee. He offered an alternative of providing substantive status reports at each meeting.

Mr. Birnbaum said his view was that the NAIC could move as fast as it wished on matters important to insurers, but failed to act with haste on matters important to consumers. He said consumers think this matter should have a high priority. He said if the matter could not be addressed by March, it should be dropped from the charges. Director McRaith said if Mr. Birnbaum's reference was to capital and surplus relief requests, those remain active in another venue. He said regulatory reaction to the consumers' request was not a matter of will or motivation, but was based in practicality. He said information provided by industry representatives and credit-scoring vendors suggests that there may be a difference of opinion as to the extent to which the credit-based insurance scores have been affected by the economic downturn. It is incumbent on insurance regulators to evaluate the information provided by both sides rather than to reach a hasty resolution. Mr. Birnbaum said not much time was needed to answer the basic questions; however, if the NAIC plans to collect data from the insurers to reach an answer, it might take years to accomplish. Director McRaith said the Committee was moving in the right direction, but perhaps at a pace that might not satisfy everyone.

Rey Becker (Property Casualty Insurers Association of America—PCI) said the work on credit scores needs to be timely, but also needs to be accurate. He supported the charge as written. Mr. Becker wondered if the new charge number three duplicated the efforts of the Financial Condition (E) Committee to establish a data reporting mechanism. Eric Goldberg (American Insurance Association—AIA) said the charge was intended to go beyond, but not conflict with, the data collection process. It is envisioned to address many other issues such as deadlines, moratoria on things like cancellations and non-renewals, and other administrative issues. Mr. Becker offered to share information on the PCI efforts to encourage uniformity of regulatory response in this area.

Mr. Becker said that new charge number four—to study new and innovative risk classifications—had been examined extensively by the Personal Lines Regulatory Framework (EX) Working Group that reported to the Speed to Market (EX) Task Force. He said there is no need for the Committee to take up this issue.

Upon motion by Commissioner Donelon, and second by Commission Sullivan, the Committee adopted the 2010 Proposed Charges (Attachment Six-B).

Having no further business, the Property and Casualty Insurance (C) Committee adjourned.

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**Comments of the Consumer Federation of America and the  
Center for Economic Justice**

**Proposed Charge on Insurance Scoring for Property Casualty (C) Committee**

**November 12, 2009**

The Center for Economic Justice and the Consumer Federation of America have reviewed the proposed charges for the Property Casualty (C) Committee. We see a charge for the Committee to develop, by November 2010 (the date of the 2010 Fall National Meeting):

- Define what constitutes a credit-based insurance score.
- Evaluate how insurers use credit-based insurance scores.
- Determine how current economic conditions have affected policyholder premiums related to credit-based insurance scores.
- Provide a report documenting findings and including recommendations for regulatory or legislative action, if warranted. Complete the report by the 2010 Fall National Meeting.
- Evaluate the role played by credit-based insurance scoring vendors and consider developing a model law or guideline to provide appropriate regulatory oversight of credit-based insurance scoring vendors.

Consumer advocates have been calling on the NAIC to take action on insurance scoring for many years and, as early as March 2008, called on regulators to promote a moratorium on insurance scoring to protect consumers whose credit histories were damaged by the abusive and predatory lending practices, lenders' responses to the financial crisis and high unemployment and wage cuts resulting from the worst economic conditions since the Great Depression.

In response to this crisis for consumers, the NAIC has done nothing but hold a public hearing. State regulators have collected no data to verify the incredible claims of credit modelers and insurers. State regulators have taken no action to protect consumers who are victims of economic or medical catastrophes or predatory and reckless lending practices of banks.

Instead, state regulators have worked overtime to provide capital and reserve relief to insurers. Starting with a private conference with insurers in 2008, state regulators have formed special committees at the NAIC and assigned state insurance department staff to provide all manners of assistance to insurers in the form of lower capital and reserve requirements – despite no evidence of need by the vast majority of insurers for such relief, despite claims by insurance regulators that the state-based system of insurance regulation kept insurers financially sound and despite the fact that the lower capital and reserve requirements have reduced consumer financial protection.

The proposed charge for insurance scoring rubs salt into the wounds of consumers. To address the crisis faced by consumers in these dire economic times, the NAIC will take another year to study “what is a credit score” – despite the fact that states have been regulating – or were supposed to be regulating – insurance scores for the past decade. While regulators can provide all sorts of capital and reserve relief to insurers in a 12-month period, including the individual credit rating of 18,000 securities, these same regulators need at least two years to learn about something they have been responsible for regulating for the past decade.

It appears that the NAIC does not have the interest or capability to take any action on insurance scoring to help consumers in a timely fashion. It is likely that any action or report by the NAIC will be a regurgitation of unsubstantiated industry claims about insurance scoring.

If the NAIC cannot complete its review within a couple of months, we suggest that the NAIC drop its credit scoring charge. At least, then, state regulators will be honest with consumers that regulators have no interest in taking any meaningful action on insurance scoring – instead of continuing the charade of regulatory interest that has produced no action for years and asks for another year to “study” what “constitutes a credit score.”

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## 2010 PROPOSED CHARGES

**Draft: 11/6/09**

### **PROPERTY AND CASUALTY INSURANCE (C) COMMITTEE**

The mission of the Property and Casualty Insurance (C) Committee is to monitor and respond to problems associated with the products, delivery and cost in the property/casualty insurance market and the surplus lines market as they operate with respect to individual persons and businesses. The committee also is to monitor and respond to problems associated with financial reporting matters for property/casualty insurers that are of interest to regulatory actuaries and analysts and to monitor and respond to problems associated with the financial aspects of the surplus lines market.

#### **New Objectives and Goals (*representing new NAIC programs, services or initiatives*):**

1. Appoint a Catastrophe Insurance Working Group to provide a forum for discussing various issues related to catastrophe modeling, make recommendations for the appropriate regulatory framework for catastrophe modelers and monitor issues that will result in changes to the *Catastrophe Computer Simulation Modeling Handbook...—Essential*
2. Finish work on evaluation of credit-based insurance scores.—*Essential*
  - Define what constitutes a credit-based insurance score.
  - Evaluate how insurers use credit-based insurance scores.
  - Determine how current economic conditions have affected policyholder premiums related to credit-based insurance scores.
  - Provide a report documenting findings and including recommendations for regulatory or legislative action, if warranted. Complete the report by the 2010 Fall National Meeting.
  - Evaluate the role played by credit-based insurance scoring vendors and consider developing a model law or guideline to provide appropriate regulatory oversight of credit-based insurance scoring vendors.
3. Following a catastrophe, diverse regulatory mandates increase insurer uncertainty and might divert insurer resources that are needed to respond to claims. To provide added certainty for insurers and regulators in advance of a major disaster, procedures need to be in place so that regulators and insurers know what to expect and insurers are prepared to comply. To address these concerns, develop a model law, regulation or guideline to standardize insurer premium collection procedures, underwriting limitations, claims handling processes, and claims data reporting requirements that a state could adopt in advance of a catastrophe and activate after a catastrophe.—*Important*
4. Discuss and evaluate the use of new and innovative risk classifications and risk evaluation tools used by the insurance industry to classify personal lines risks for rating and underwriting purposes. Provide a report documenting findings and including recommendations for regulatory or legislative action, if warranted. Complete the report by the 2010 Fall National Meeting.—*Important*

#### **Ongoing Support of NAIC Programs, Products or Services:**

1. Discuss issues arising and make recommendations with respect to advisory organization and insurer filings for personal and commercial lines, as needed. Report at each national meeting, as needed.—*Ongoing*
2. Appoint a Catastrophe Insurance Working Group to report progress on the following catastrophe insurance issues Report on a at each national meeting.—*Ongoing*
  - Monitor and recommend measures to improve the availability and affordability of insurance and reinsurance related to catastrophe perils for personal and commercial lines.
  - Evaluate potential state, regional and national programs to increase capacity for insurance and reinsurance related to catastrophe perils.
  - Monitor and assess proposals that address disaster insurance issues at the federal and state levels; assess concentration-of-risk issues and whether a regulatory solution is needed.
  - Provide a forum for discussing issues and recommending solutions related to insuring for catastrophic risk, including terrorism, war and natural disasters.

## 2010 PROPOSED CHARGES

- Update the *State Disaster Response Plan*, as needed, so that it provides a blueprint for action by the states to respond to catastrophic events.
  - Investigate the regulatory, financial and economic impacts of defects reported in Chinese drywall imported between 2004 and 2007. Examine property damage and bodily-injury claims related to exposure to defective Chinese drywall.
3. Appoint a Risk Retention Working Group.—*Ongoing*
- Review developments in case law and rehabilitation proceedings and the findings contained in the U.S. Government Accountability Office's report on risk-retention groups; if warranted, make appropriate changes to the *Risk Retention and Purchasing Group Handbook*.
  - Review the recommendation from the Risk Retention Group (E) Task Force related to corporate governance standards and advise whether to pursue a model law to implement the corporate governance standards. Report at each national meeting.
4. Appoint a Crop Insurance Working Group.—*Ongoing*
- Monitor the activities of the Federal Crop Insurance Corporation (FCIC) that affect state insurance regulators;
  - Serve as a forum for discussing issues related to the interaction of federal crop insurance programs with state regulation;
  - Review law changes and court decisions and, if warranted, make appropriate changes to the *Crop Insurance Handbook: A Guide for Insurance Regulators*.
  - Monitor the regulatory information exchanges between the FCIC and state regulators, as well as the FCIC and the NAIC, and make recommendations for improvement or revisions, as needed. Report at each national meeting.
  - Facilitate regulators' concerns and assist the states, as necessary, in enacting regulatory changes to avoid the preemption given the inevitable preemption of crop insurance adjuster licensing by the U.S. Congress, through the federal Risk Management Agency (RMA), on a state-by-state basis, beginning as early as July 1, 2011.
5. Coordinate with the Federal Insurance Administrator on the regulation of flood insurance.—*Important*
- Continue developing a handbook or white paper to assist state insurance regulators in understanding the federal flood insurance program and how it interacts with state insurance regulation;
  - Complete work on a handbook or white paper by the 2010 Fall National Meeting. Report progress on the handbook or white paper, and any other activities. Report at each national meeting.
6. Monitor the activities of the Workers' Compensation Task Force.—*Essential*
7. Monitor the activities of the Casualty Actuarial and Statistical Task Force.—*Essential*
8. Monitor the activities of the Surplus Lines Task Force.—*Essential*
9. Appoint an Advisory Organizations Examination Oversight Working Group.—*Essential*
- Revise the protocols, as necessary, for the examination of national or multi-state rating organizations to be more comprehensive, efficient and possibly less frequent than the current system of single-state exams. Solicit input and collaboration from other interested and affected task forces and committees.
  - Monitor data reporting of rating and/or advisory organization data-collection processes to determine if rating and/or advisory organizations implement appropriate measures to ensure data quality. Report the results of this ongoing charge as needed.
  - Actively assist with and coordinate multi-state examinations of advisory organizations and statistical agents.
10. Appoint a Title Insurance Issues Working Group to study issues related to title insurers and title insurance producers, including the impact of current real estate settlement practices on policyholders, recognizing that typically, settlement providers, not policyholders, are the title entity's customers. The Working Group should:
- Complete a study on the ability to undertake a uniform data-collection system to capture title insurance premium and expense data that would allow for cross-jurisdiction premium comparisons. Report the results by

## 2010 PROPOSED CHARGES

the 2010 Spring National Meeting and make a recommendation to develop a nationwide title statistical plan.—*Essential*

- Study ways to improve consumers' ability to comparison shop for title insurance. Report the results by the 2010 Summer National Meeting.—*Essential*
  - Consider issues raised by consumer representatives and the April 2007 GAO study.—*Essential*
  - Consider ways to improve the solvency regulation of title insurers. Coordinate with the Financial Condition (E) Committee to determine the attributes of recent title company financial failures and to identify property/casualty solvency requirements (e.g., risk-based capital) and early warning tools (e.g., IRIS ratios) not currently applied to title insurers and consider whether they should be introduced. Report the results by the 2010 Fall National Meeting.—*Essential*
  - Investigate ways to mitigate the impact of insolvencies on policyholders, including whether to revive work on the 1992 draft of the Title Insurance Guaranty Fund Model Act. Consider the merits of promoting the use of blanket lenders' policies and individual owners' policies to replace policies issued by now-insolvent insurers. Report the results by the 2010 Fall National Meeting.—*Essential*
  - Investigate ways to maintain and improve competitive title markets, including examining and evaluating the original purposes and current effectiveness of monoline title insurance laws. Report the results by the 2010 Fall National Meeting.—*Essential*
  - Determine an appropriate format for communicating the various findings of the Working Group, such as writing a white paper, crafting best practice guidelines, or revising the Title Insurers Model Act (#628) and Title Insurance Agent Model Act (#230), by the 2010 Fall National Meeting. Produce a draft document in the chosen format by the 2010 Fall National Meeting.—*Essential*
  - Monitor the developments of the U.S. Department of Housing and Urban Development (HUD) proposed changes to its Real Estate Settlement Procedures Act (RESPA) and provide comments to HUD or to the U.S. Congress, if necessary. Respond to RESPA or HUD proposals by the due dates established by HUD. Monitor, facilitate and report on the HUD Collaborative Enforcement Group, which involves monthly conference calls between state insurance regulators and HUD on investigations.—*Important*
  - Consider whether or how to assist in combating mortgage fraud. Report the results by the 2010 Fall National Meeting.—*Important*
  - Study whether the title insurance industry is undertaking additional financial risks at the request of institutional lenders and owners.—*Deferrable*
  - Study the issuance of mortgage impairment products by non-title insurers to determine whether they should be classified as title insurance.—*Deferrable*
  - Study captive reinsurance arrangements that title insurers maintain and determine if they are legitimate reinsurance transactions or simply gimmicks to avoid the application of laws that would prohibit rebating and, if necessary, make recommendations for needed reform.—*Deferrable*
  - Study affiliated business arrangements (ownership arrangements between and among settlement providers and title entities) to determine which types of arrangements are legitimate and which types of arrangements are "shams"; i.e., those structured mainly to capture referral business and provide kickbacks to settlement providers, and that do not perform essential core title services.—*Deferrable*
  - Study the appropriateness of title insurance rates in light of the current competitive environment and, in particular, determine what constitutes appropriate justification for rates, determine the affect affiliated business arrangements should have on rates, and determine the feasibility of interactive rate comparisons among title entities to enhance competition.—*Deferrable*
11. Appoint a Terrorism Insurance Implementation Working Group to coordinate the NAIC efforts to address insurance coverage for acts of terrorism. Work with the U.S. Department of the Treasury's Terrorism Risk Insurance Program Office on matters of mutual concern. Discuss long-term solutions to address the risk of loss from acts of terrorism.—*Essential*
12. Appoint a Consumer Guides Working Group to review and make modifications to the NAIC *Consumer's Guide to Auto Insurance* and recommend revisions by the 2010 Summer National Meeting. Develop best practices for the design and implementation of consumer premium comparison guides for personal auto and homeowners insurance by the 2010 Fall National Meeting.—*Essential*

## 2010 PROPOSED CHARGES

13. Appoint a Catastrophe Reserve Working Group to review the current NAIC catastrophe reserve proposal and make a recommendation whether to move the proposal forward, even if the IRS tax code is not amended to allow insurers to establish a tax-deferred catastrophe reserve. The Working Group will make a formal recommendation on whether to proceed with a catastrophe reserve requirement regardless of its tax-deferred status prior to the 2010 Spring National Meeting.—*Essential*
14. Appoint an Earthquake Study Group to study, in coordination with other NAIC working groups and task forces, earthquake matters of concern to insurance regulators. Report at each national meeting.
- Review and update *The Final Report of the Earthquake Study Group (February 2000)*, so that it provides a basis for understanding and outline for action to be taken by states to respond to earthquake events and risks.
  - Work with seismic and actuarial experts to develop recommendations for measures designed to mitigate losses caused by earthquakes.
  - Study earthquake modeling assumptions and meet with catastrophe modeling vendors to determine if models adequately handle regional differences in loss exposure.
  - Explore multi-state risk-sharing, mitigation and coordination strategies. This includes meeting, as needed, with officials from the Central United States Earthquake Consortium (CUSEC), Western States Seismic Policy Council (WSSPC) and the California Earthquake Authority (CEA).
  - Assist state insurance regulators in determining the availability and affordability of earthquake coverage in their states and assist in dealing with market dislocations and effects on rate level caused by exposure to the earthquake peril. This includes developing, distributing and evaluating a survey to all NAIC members designed to access availability and affordability.
  - Identify strategies to communicate earthquake risk awareness, preparation, loss mitigation and recovery measures to insurers, producers and consumers. This includes developing a consumer brochure to be finalized in December 2010 and exploring the feasibility of developing a consumer-awareness video.—*Essential*

**Sponsors for 2010 Charges**  
*(Except as noted, I support all charges)*

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Staff Support:

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**Marketcore, Inc. Licenses a Portion of its IP  
to LexisNexis to Build an Insurance Exchange**

**NEWS RELEASE – Thursday, October 15, 2009**

*NEW YORK, N.Y., October 15, 2009 -- Marketcore Inc., an intellectual property development company, has entered into a licensing agreement with LexisNexis to license a portion of its intellectual property in the development of an insurance exchange.*

*Under the arrangement, Marketcore is licensing a portion of its intellectual property to LexisNexis, which will be developing and commercializing an insurance exchange. The insurance exchange aims to improve the efficiency and transparency of the independent agent-based distribution system.*

*Marketcore has developed a suite of intellectual property over the last decade that includes issued patents and pending patents, trade secrets, market know-how, trademarks and trade names. That work has received international recognition as an acknowledged solution to the financial crisis. A "CRS Report for Congress" noted, Marketcore "identified the problems in the financial markets that led to the credit and liquidity crisis and devised a solution." The Report offers a detailed explanation of Marketcore's intellectual property. (The CRS is the neutral, public policy-focused arm of the Library of Congress.)*

*Marketcore's intellectual property is available to be licensed outside of the insurance-related fields of use being licensed to LexisNexis.*

**About Marketcore.com, Inc.**

*Founded in 2000, Marketcore ([www.marketcore.com](http://www.marketcore.com)) is a privately-held intellectual property development company, owned by roughly 60 shareholders, that focuses on creating transparency, operating efficiencies, liquidity, value enhancement and risk assessment for the financial services industry. Its work and website have received international recognition and the company has consulted to, and been recognized by, financial market regulators, as well as state and federal government agencies to whom it has consulted. It first introduced its approach to the insurance industry regulatory, trade and technology interests in 2004*

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**The Council of Insurance Agents & Brokers and LexisNexis  
Form Partnership to Build Insurance Exchange**

Oct 12 2009

*New Insurance Exchange to Automate Insurance Intermediary/Insurer Distribution Workflow and Enable Access to Key Market Information and Analytics for Better Decision Making*

WASHINGTON, DC — The Council of Insurance Agents & Brokers (The Council), representing the leading commercial insurance brokers and agents in the United States and abroad, and LexisNexis, a leading global provider of content-enabled workflow solutions, today announced the creation of an insurance exchange directed at improving the efficiency and transparency of the independent agent-based distribution system. The new exchange will combine both technology and information at each of the key workflow steps of the insurance transaction process to reduce redundant work and costs, as well as to enable agents and brokers to offer clients a broader choice of insurance products. This development is the result of a partnership formed through The Council with the agent/broker community and LexisNexis to ensure all types and sizes of industry participants can utilize the exchange.

LexisNexis® Risk Solutions worked with The Council to develop the plan for the new Web-based system that enables agents and brokers to submit insurance applications in a one-step, real-time process. The new exchange solution also allows brokers to see insurance product availability, pricing, and coverage differences from multiple insurance carriers, enabling them to place business that best matches client needs. Prior to this new exchange, intermediaries had to separately interface with the computer systems of insurance companies, causing a significant amount of redundant work. The exchange will also provide a single-entry gateway to wholesalers to broaden and provide more efficient access to additional markets.

Drawing on more than three decades of database and analytics modeling experience, LexisNexis has developed a technology platform allowing insurance carriers and brokers to track recent trends in insurance product pricing and coverage, in turn helping the industry align itself more rapidly to customer needs. LexisNexis will also provide key risk-related data on a secure basis into the exchange workflows, which will improve underwriting and reduce broker data-entry time.

"Our agent/broker members see this exchange as vital to addressing inefficiencies inherent in the multi-carrier distribution system that otherwise has worked so well for our industry," said Ken A. Crerar, president of The Council of Insurance Agents & Brokers. "The Council worked very closely with LexisNexis to ensure that openness and objectivity were the cornerstones of the exchange. The key to the success of the exchange is trust—together, we have strived to ensure the new exchange serves the insurance industry as a whole."

"The enthusiasm of the broker community and the clear opportunity to improve their day-to-day processes made this a compelling business case for us," said James M. Peck, CEO, LexisNexis Risk Solutions. "Our technology behind the insurance exchange is a great fit for helping this industry overcome some of its current challenges."

The insurance exchange will initially concentrate on commercial lines. All sizes and lines of property/casualty insurance will eventually be supported as will, potentially, other non-property/casualty implementations (e.g., group benefits). The exchange will heavily leverage the industry standards built by the Association for Cooperative Operations Research and Development (ACORD) organization.

"Our expertise in commercial lines rating and policy processing has positioned us to address this important commercial lines automation priority for the exchange," said Jeffrey Glazer, senior vice president and general manager LexisNexis® Insurance Solutions. "We have also been able to bring together some very strong, relevant technology partners to accelerate our product launch timing." The exchange plans to start pilot programs for selected lines beginning in the summer of 2010, with full production scheduled for early 2011.

The insurance exchange will be supported by a broker-controlled and operated entity called The Insurance Exchange Trust (IET). The purpose of the IET will be to provide a vehicle for agents and brokers to ensure the exchange operates according to its founding principles of fairness, neutrality and protection of data. It also will serve as an advisory board to LexisNexis on exchange issues.

"While this exchange was spearheaded by Council members, make no mistake—it is for the entire industry—every size and shape firm will benefit from participating," said Markham McKnight, president of BancorpSouth and Council chairman. Wade Reece, chairman and CEO, BB&T Insurance Services and Council vice chairman, further added, "We, as brokers, have created a powerful partnership with LexisNexis that portends well for our combined ability to serve our customers. Now we need to move rapidly forward together to build something that really makes a difference on our daily workloads and get it in the hands of our agents and brokers who have been wanting it for so long."

### **About The Council of Insurance Agents & Brokers**

Founded in 1913, The Council ([www.ciab.com](http://www.ciab.com)) is the premier association for commercial insurance and employee benefit intermediaries. The Council represents the leading commercial brokers and agents in the United States and abroad. Council members annually place 80 percent of all commercial property/casualty premiums in the United States and administer billions of dollars of employee benefits accounts.

### **About LexisNexis**

LexisNexis® ([www.lexisnexis.com](http://www.lexisnexis.com)) is a leading global provider of content-enabled workflow solutions designed specifically for professionals in the legal, risk management, corporate, government, law enforcement, accounting and academic markets. LexisNexis originally pioneered online information with its Lexis® and Nexis® services. A member of Reed Elsevier [NYSE: ENL; NYSE: RUK] ([www.reedelsevier.com](http://www.reedelsevier.com)), LexisNexis serves customers in more than 100 countries with 18,000 employees worldwide.

### **About LexisNexis® Risk Solutions**

LexisNexis Risk Solutions is the leader in providing essential information that helps advance industry and society. Building on the legacy of proven LexisNexis® services from the past 30 years, our cutting-edge technology, unique data and advanced scoring analytics provide total solutions that address evolving client needs in the risk sector while upholding high standards of security and privacy. LexisNexis Risk Solutions serves commercial organizations and government agencies and is comprised of several affiliated corporations, each offering premier customer-focused solutions. For more information, visit [risk.lexisnexis.com](http://risk.lexisnexis.com).

**For information about the insurance exchange visit [risk.lexisnexis.com/insurancesolutions](http://risk.lexisnexis.com/insurancesolutions) or contact:**

Maura Nelson  
The Council of Insurance Agents & Brokers  
202-662-4432 or 703-963-5549 (cell)  
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LexisNexis Risk Solutions  
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## Illinois Department of Insurance

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PAT QUINN  
Governor

MICHAEL T. McRAITH  
Director

TO: Eric Nordman  
FROM: Michael McRaith  
CC: Andrew Stolfi  
DATE: June 18, 2009  
RE: Nebraska Supreme Court's Validation of Regulatory Exclusion in Directors and Officers Insurance Policy

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### I. Holding

On March 6, 2009, the Nebraska Supreme Court issued a decision affirming a lower court's finding that a regulatory exclusion in a Directors and Officers (D&O) insurance policy applied to the State's Insurance Director acting in his capacity as liquidator and that the regulatory exclusion was not void as against public policy. Wagner v. United National Insurance Company, et al., 277 Neb. 308 (2009).

### II. Facts

In 1999, Amwest, a Nebraska insurance company, purchased a D&O policy from National Union, United National, and GAINSCO. The policies, which were in excess to each other, carried a limit of \$5 million each.

In 2001, Amwest was placed under supervision by the Nebraska Department of Insurance and, shortly thereafter, a court found Amwest to be insolvent and placed it in liquidation. Pursuant to state law, the Nebraska Director of Insurance was appointed to serve as liquidator for Amwest. In his capacity as liquidator, the Director filed two separate actions: (1) an action against the directors and officers of Amwest in which the Director alleged that Amwest became insolvent through the wrongful conduct and breach of multiple fiduciary duties of its directors and officers; and (2) the instant action in which the Director requested that the court invalidate the regulatory exclusions contained in the United National and GAINSCO policies, which provide as follows:

This policy does not apply to any Claims brought by or on behalf of, any insurance regulatory agency or supervisory authority including but not limited to any state or local insurance department or Commission, or any state or local Insurance Guaranty or Insolvency Fund (any of the foregoing organizations hereafter referred to as an "Agency"), including any type of legal or equitable action which such Agency has the legal right to bring as receiver, conservator, liquidator or assignee of the insured, its security/unit holders or its creditors, or other-wise; whether such action or proceeding is brought in the name of such Agency or by or on behalf of such Agency in the name of any other entity(ies) or solely in the name of any third entity(ies).

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In arguing against the validity of the regulatory exclusion, the Director advanced two main contentions:

**1. The regulatory exclusion does not apply to the Director in his capacity as liquidator.**

The Director first argued that the express and unambiguous language of the regulatory exclusion applies to preclude only those claims that are brought by, or on behalf of, an agency, authority, department, or fund. According to the Director, the regulatory exclusion could not preclude coverage for the claims he was making in either case because he was asserting such claims solely in his capacity as liquidator. The Director stressed the critical legal distinction between his roles and duties as Director of the Department of Insurance and his separate roles and duties as the statutory and court appointed liquidator of Amwest. The Director also noted how most states mirror Nebraska's statutory scheme whereby the state's insurance regulator, as receiver, conducts liquidations of insurance companies under the supervision of a liquidation court.

**2. The regulatory exclusion is void as against Nebraska public policy.**

The Director also argued that the regulatory exclusion is unenforceable because it violated Nebraska public policy. In support of this argument, the Director claimed that: (i) the regulatory exclusion conflicts with provisions of the state's Liquidation Act and therefore deprives the liquidator of rights granted under that statute; (ii) the public policy interests underlying and established by the state's Liquidation Act and Nebraska's other insurance regulatory statutes outweigh the public policy favoring freedom of contract in this instance; (iii) the liquidator's approval of insurance policy forms containing the regulatory exclusion in his separate capacity as Director is irrelevant to the public policy interest raised; and (iv) cases from other jurisdictions involving the enforceability of regulatory exclusions in different contexts are irrelevant and distinguishable from the instant controversy.

**III. Court's Analysis.**

In a four short pages, the Nebraska Supreme Court rejected both of the Director's arguments. First, the court found unpersuasive the Director's argument that the role of liquidator is legally separate from the role of Director of Insurance. In so doing, the court began by citing a state statute which provides that the Director shall be appointed as liquidator of an insolvent domestic insurance company and that the liquidator shall have the power to appoint a special deputy to act for him. The court then noted the lower court's declaration that while the roles of liquidator and Director are not identical, "the Director while serving as Liquidator still carries out regulatory and supervisory functions in an effort to oversee the business of insurance in Nebraska." Wagner, 277 Neb. at 313. The court then simply concluded that the language of the regulatory exclusion clearly applies to the liquidator and that because the terms are clear and unambiguous they must be enforced.

The court then summarily dismissed the Director's arguments that the regulatory exclusion is void as against public policy. Specifically, the court held:

There is no direct conflict between the statutory provisions and the regulatory exclusion. The liquidator argues that the statute grants the liquidator any remedies available to an insured, creditor, shareholder, or member and that the regulatory exclusion strips one of those remedies from the liquidator. The regulatory exclusion does not conflict with the

statute, because under the terms of the policy the liquidator may still have a claim against the personal assets of the directors and officers.

Wagner, 277 Neb. at 314.

The court continued by noting how the liquidator, as Director of Insurance, “approved, or did not disapprove,” numerous similar regulatory exclusions and that the Director conceded in his deposition that there is no stated public policy addressing regulatory exclusions in Nebraska. Wagner, 277 Neb. at 315. Because of the lack of a stated public policy and the fact that Nebraska does not require that an insurance company even carry D&O coverage, the court concluded that voiding the provision as against public policy would undermine Nebraska’s policy to support freedom to contract.

## H

Supreme Court of Nebraska.  
STATE of Nebraska ex rel. L. Tim WAGNER, Director of Insurance of the State of Nebraska, as Liquidator of Amwest Surety Insurance Company, Appellant,  
v.  
UNITED NATIONAL INSURANCE COMPANY et al., Appellees.  
**No. S-07-1160.**  
March 6, 2009.

**Background:** Director of Insurance, as liquidator of insolvent insured insurance company, brought action seeking to invalidate the regulatory exclusions contained in directors, officers and corporate liability (D & O) insurance policies issued to insured. The District Court, Lancaster County, [John A. Colborn, J.](#), granted summary judgment to insurers. Director appealed.

**Holdings:** The Supreme Court, [Heavican, C.J.](#), held that:

(1) regulatory exclusion in D&O policies applied to Director of Insurance, acting as liquidator of insured;  
(2) regulatory exclusion in D&O policies was not in direct conflict with provisions of the Insurers Supervision, Rehabilitation, and Liquidation Act; and  
(3) regulatory exclusion in D&O policies was not void as against public policy.

Affirmed.

West Headnotes

### [\[1\]](#) Judgment 228 185(6)

#### [228](#) Judgment

[228V](#) On Motion or Summary Proceeding

[228k182](#) Motion or Other Application

[228k185](#) Evidence in General

[228k185\(6\)](#) k. Existence or Non-

Existence of Fact Issue. [Most Cited Cases](#)

Summary judgment is proper when the pleadings and evidence admitted at the hearing disclose no genuine issue as to any material fact or as to the ultimate inferences that may be drawn from those facts and that the moving party is entitled to judgment as a matter of law.

### [\[2\]](#) Appeal and Error 30 842(1)

### [30](#) Appeal and Error

[30XVI](#) Review

[30XVI\(A\)](#) Scope, Standards, and Extent, in

General

[30k838](#) Questions Considered

[30k842](#) Review Dependent on Whether

Questions Are of Law or of Fact

[30k842\(1\)](#) k. In General. [Most Cited](#)

[Cases](#)

When reviewing a question of law, an appellate court reaches a conclusion independent of the lower court's ruling.

### [\[3\]](#) Insurance 217 2380(2)

#### [217](#) Insurance

[217XVII](#) Coverage--Liability Insurance

[217XVII\(B\)](#) Coverage for Particular Liabili-

ties

[217k2377](#) Directors' and Officers' Liabili-

ties

[217k2380](#) Particular Exclusions

[217k2380\(2\)](#) k. Regulatory Exclu-

sions. [Most Cited Cases](#)

Regulatory exclusion in insolvent insured insurance company's directors, officers and corporate liability (D&O) insurance policy, which stated that policy did not apply to any claims brought by or on behalf of any insurance regulatory agency or supervisory authority, applied to Director of Insurance, acting as liquidator of insured.

### [\[4\]](#) Insurance 217 1809

#### [217](#) Insurance

[217XIII](#) Contracts and Policies

[217XIII\(G\)](#) Rules of Construction

[217k1809](#) k. Construction or Enforcement

as Written. [Most Cited Cases](#)

If the terms of an insurance policy are clear and unambiguous, then those terms will be enforced.

### [\[5\]](#) Insurance 217 1805

#### [217](#) Insurance

[217XIII](#) Contracts and Policies

[217XIII\(G\)](#) Rules of Construction

[217k1805](#) k. In General. [Most Cited Cases](#)

Insurance contracts, like other contracts, are to be construed according to the sense and meaning of the terms which the parties have used.

761 N.W.2d 916  
277 Neb. 308, 761 N.W.2d 916  
(Cite as: 277 Neb. 308, 761 N.W.2d 916)

**[6] Insurance 217 ↪1822**

217 Insurance  
217XIII Contracts and Policies  
217XIII(G) Rules of Construction  
217k1822 k. Plain, Ordinary or Popular Sense of Language. Most Cited Cases  
If the terms of an insurance policy are clear and unambiguous, they are to be taken and understood in their plain, ordinary, and popular sense.

**[7] Insurance 217 ↪2380(2)**

217 Insurance  
217XVII Coverage--Liability Insurance  
217XVII(B) Coverage for Particular Liabilities  
217k2377 Directors' and Officers' Liabilities  
217k2380 Particular Exclusions  
217k2380(2) k. Regulatory Exclusions. Most Cited Cases

Regulatory exclusion in insolvent insured insurance company's directors, officers and corporate liability (D&O) insurance policy, which stated that policy did not apply to any claims brought by or on behalf of any insurance regulatory agency or supervisory authority, was not in direct conflict with provisions of the Insurers Supervision, Rehabilitation, and Liquidation Act granting liquidator the power to collect all debts and money due and claims belonging to the insurer and the power to exercise and enforce all rights, remedies, and powers of any insured, creditor, shareholder, or member; under the terms of the policy, liquidator could still have a claim against the personal assets of the directors and officers. Neb.Rev.Stat. §§ 44-4821(1)(h, u).

**[8] Insurance 217 ↪2380(2)**

217 Insurance  
217XVII Coverage--Liability Insurance  
217XVII(B) Coverage for Particular Liabilities  
217k2377 Directors' and Officers' Liabilities  
217k2380 Particular Exclusions  
217k2380(2) k. Regulatory Exclusions. Most Cited Cases  
Regulatory exclusion in directors, officers and corporate liability (D&O) insurance policy, which stated

that policy did not apply to any claims brought by or on behalf of any insurance regulatory agency or supervisory authority, was not void as against public policy.

**[9] Contracts 95 ↪108(1)**

95 Contracts  
95I Requisites and Validity  
95I(F) Legality of Object and of Consideration  
95k108 Public Policy in General  
95k108(1) k. In General. Most Cited Cases

It is not the province of courts to emasculate the liberty of contract by enabling parties to escape their contractual obligations on the pretext of public policy unless the preservation of the public welfare imperatively so demands.

**[10] Contracts 95 ↪1**

95 Contracts  
95I Requisites and Validity  
95I(A) Nature and Essentials in General  
95k1 k. Nature and Grounds of Contractual Obligation. Most Cited Cases

Unless the case is one that is free from doubt, the respective parties to a contract bear risks that the conditions under which the contract was entered will change and become less favorable to them over the course of the contract's term.

**\*\*917 Syllabus by the Court**

**\*308 1. Summary Judgment.** Summary judgment is proper when the pleadings and evidence admitted at the hearing disclose no genuine issue as to any material fact or as to the ultimate inferences that may be drawn from those facts and that the moving party is entitled to judgment as a matter of law.

**2. Judgments: Appeal and Error.** When reviewing a question of law, an appellate court reaches a conclusion independent of the lower court's ruling.

**\*\*918 3. Insurance: Contracts.** If the terms of an insurance policy are clear and unambiguous, then those terms will be enforced.

761 N.W.2d 916  
277 Neb. 308, 761 N.W.2d 916  
(Cite as: 277 Neb. 308, 761 N.W.2d 916)

**\*309 4. Insurance: Contracts.** Insurance contracts, like other contracts, are to be construed according to the sense and meaning of the terms which the parties have used. If the terms of the contract are clear and unambiguous, they are to be taken and understood in their plain, ordinary, and popular sense.

**5. Contracts: Public Policy.** It is not the province of courts to emasculate the liberty of contract by enabling parties to escape their contractual obligations on the pretext of public policy unless the preservation of the public welfare imperatively so demands.

**6. Contracts.** Unless the case is one that is free from doubt, the respective parties to a contract bear risks that the conditions under which the contract was entered will change and become less favorable to them over the course of the contract's term.

[Robert L. Nefsky](#), [John H. Binning](#), and [Jane F. Langan](#), of Rembolt Ludtke, L.L.P., Lincoln, and [Mark I. Wallach](#) and [Matthew M. Mendoza](#), of Calfee, Halter & Griswold, L.L.P., Cleveland, OH, for appellant.

[Jerald L. Rauterkus](#), of Erickson & Sederstrom, P.C., Lincoln, and, of Counsel, [Michael P. Comiskey](#) and [Hugh S. Balsam](#), of Locke, Lord, Bissell & Liddell, L.L.P., Chicago, IL, for appellee United National Insurance Company.

[Kevin J. Schneider](#) and [Travis P. O'Gorman](#), of Cline, Williams, Wright, Johnson & Oldfather, L.L.P., Lincoln, and [R. Douglas Rees](#) and [Lauren N. Pierce](#), of Cooper & Scully, P.C., Dallas, TX, for appellee General Agents Insurance Company of America, Inc.

[HEAVICAN](#), C.J., [CONNOLLY](#), [STEPHAN](#), [McCORMACK](#), and MILLER-LERMAN, JJ.

[HEAVICAN](#), C.J.

#### INTRODUCTION

L. Tim Wagner, acting as liquidator, appeals the order of the Lancaster County District Court granting summary judgment to United National Insurance Company (United National) and General Agents Insurance Company of America, Inc. (GAINSCO). The liquidator was acting pursuant to the authority granted him under the Nebraska Insurers Supervision, Rehabilitation, and Liquidation Act,

**\*310** [Neb.Rev.Stat. § 44-4801 et seq.](#) (Reissue 1998) (Liquidation Act), on behalf of the insolvent insurance company, Amwest Surety Insurance Company (Amwest). The district court found that a regulatory exclusion within the United National and GAINSCO insurance policies applied to Amwest and the liquidator, and granted summary judgment to the insurance companies. The liquidator claims the regulatory exclusions contained in the policies do not apply to the liquidator in his statutory capacity and that, in any case, the exclusion is void as against public policy. We find the regulatory exclusion does apply and is not void as against public policy. We therefore affirm.

#### BACKGROUND

Amwest is an insolvent Nebraska insurance company in liquidation pursuant to the Liquidation Act. The Director of Insurance was appointed to serve as liquidator for Amwest under § 44-4818(1). Amwest's headquarters were previously located in Calabasas, California, and it is a wholly owned subsidiary of Amwest Insurance\*\*919 Group, Inc., a Delaware corporation. United National is a Pennsylvania corporation with its place of business in Pennsylvania, but is licensed to sell, and has sold, insurance in the State of Nebraska. GAINSCO is an Oklahoma corporation with its principal place of business located in Texas. GAINSCO is also engaged in the business of insurance and is licensed to sell, and has sold, insurance in Nebraska. GAINSCO has since been dismissed from the action, however, and Wagner has since died and has been replaced by his successor in office, Ann Frohman. (For simplicity, when referring to the actions of the director while serving as liquidator, we will use the term "the liquidator.")

Amwest purchased a "Directors, Officers and Corporate Liability" (D & O) insurance policy from National Union Fire Insurance Company (National Union) of Pittsburgh, Pennsylvania, on September 30, 1999. Amwest also purchased D & O policies from United National and GAINSCO. The United National policy was in excess to the National Union policy, and the GAINSCO policy was in excess to both policies. Each supplemental policy carried a limit of \$5 million.

**\*311** The liquidator filed this action against the insurance companies on January 26, 2006. This action

761 N.W.2d 916  
277 Neb. 308, 761 N.W.2d 916  
(Cite as: 277 Neb. 308, 761 N.W.2d 916)

is closely related to the liquidator's separate lawsuit against the directors and officers of Amwest. The liquidator has alleged that Amwest became insolvent through the wrongful conduct and breach of multiple fiduciary duties of its officers and directors. The liquidator brought the action to request that the district court invalidate the regulatory exclusions contained in both the United National and GAINSCO policies. The United National regulatory exclusion provides:

This Policy does not apply to any Claims brought by or on behalf of, any insurance regulatory agency or supervisory authority including but not limited to any state or local insurance department or Commission, or any state or local Insurance Guaranty or Insolvency Fund (any of the foregoing organizations hereafter referred to as an "Agency"), including any type of legal or equitable action which such Agency has the legal right to bring as receiver, conservator, liquidator or assignee of the insured, its security/unit holders or its creditors, or otherwise; whether such action or proceeding is brought in the name of such Agency or by or on behalf of such Agency in the name of any other entity(ies) or solely in the name of any third entity(ies).

The district court found that the regulatory exclusion applied to the liquidator and was not void as against public policy and granted summary judgment to United National and GAINSCO. The liquidator appeals.

#### ASSIGNMENTS OF ERROR

The liquidator assigns that the district court erred in (1) finding that the regulatory exclusion applied to the liquidator and (2) failing to hold that the regulatory exclusion was void as against public policy.

#### STANDARD OF REVIEW

[1] Summary judgment is proper when the pleadings and evidence admitted at the hearing disclose no genuine issue as to any material fact or as to the ultimate inferences that may be \*312 drawn from those facts and that the moving party is entitled to judgment as a matter of law.<sup>FN1</sup>

<sup>FN1</sup>. *Hughes v. Omaha Pub. Power Dist.*

274 Neb. 13, 735 N.W.2d 793 (2007).

\*\*920 [2] When reviewing a question of law, an appellate court reaches a conclusion independent of the lower court's ruling.<sup>FN2</sup>

<sup>FN2</sup>. *Eggers v. Rittscher*, 247 Neb. 648, 529 N.W.2d 741 (1995).

#### ANALYSIS

#### REGULATORY EXCLUSION APPLIES TO LIQUIDATOR

[3] We first address the argument that the regulatory exclusion in the policy does not apply to the liquidator. Essentially, the liquidator argues that the position of liquidator cannot be considered as an " 'agency, authority, department, fund, or organization' " under the regulatory exclusion.<sup>FN3</sup> United National argues that because the Director of Insurance is the liquidator, the liquidator is a " 'supervisory authority' " under the regulatory exclusion.<sup>FN4</sup> The liquidator claims that the role of liquidator is legally separate from the role of Director of Insurance and that the liquidator is an officer of the court and is under the authority of the court. For that reason, the liquidator claims he cannot be considered as either an " 'agency' " or an " 'authority.' " <sup>FN5</sup> We do not find this argument persuasive.

<sup>FN3</sup>. Brief for appellant at 14.

<sup>FN4</sup>. Brief for appellee United National at 13.

<sup>FN5</sup>. Brief for appellant at 14.

Section 44-4818(1) provides that the Director of Insurance and his or her successors in office shall be appointed as liquidator of an insolvent domestic insurance company. The liquidator is granted statutory authority to act under § 44-4821. The statute states that "[t]he liquidator shall have the power" to (among other things) appoint a special deputy to act for him or her, employ various personnel and experts as necessary, appoint an advisory committee with approval from the court, fix compensation for employees, pay reasonable \*313 compensation, hold hearings, audit books and records, and collect debts and money.

761 N.W.2d 916  
277 Neb. 308, 761 N.W.2d 916  
(Cite as: 277 Neb. 308, 761 N.W.2d 916)

The language of United National's regulatory exclusion specifically precludes

any type of legal or equitable action which such Agency has the legal right to bring as receiver, conservator, *liquidator* or assignee of the insured ... whether such action or proceeding is brought in the name of such Agency or by or on behalf of such Agency in the name of any other entity(ies) or solely in the name of any third entity(ies).

(Emphasis supplied.)

The district court pointed out in its order that while the roles of liquidator and director are not identical, “the Director while serving as Liquidator still carries out regulatory and supervisory functions in an effort to oversee the business of insurance in Nebraska.” The language of the regulatory exclusion clearly applies to the liquidator in this case.

[4][5][6] We have previously held that if the terms of an insurance policy are clear and unambiguous, then those terms will be enforced.<sup>FN6</sup> And insurance contracts, like other contracts, are to be construed according to the sense and meaning of the terms which the parties have used. If the terms of the contract are clear and unambiguous, they are to be taken and understood in their plain, ordinary, and popular sense.<sup>FN7</sup> We find that the plain language of the regulatory exclusion applies to the liquidator.

FN6. See *Fokken v. Steichen*, 274 Neb. 743, 744 N.W.2d 34 (2008).

FN7. *Id.*

**\*\*921 REGULATORY EXCLUSION IS NOT  
VOID AS AGAINST PUBLIC POLICY**

[7][8] We next turn to the liquidator's argument that the district court erred when it failed to invalidate the regulatory exclusion as against public policy. The liquidator argues that because § 44-4821 grants the liquidator the right to enforce all the rights, remedies, and powers of any insured, creditor, or shareholder, the regulatory exclusion is in direct conflict with the provisions of the Liquidation Act. The liquidator also argues \*314 that the regulatory exclusion is against

public policy, because the exclusion blocks the liquidator's ability to carry out his or her statutory duties.

The liquidator cites § 44-4821(1)(h) and (u). Section 44-4821(1)(h) grants the liquidator the power “[t]o collect all debts and money due and claims belonging to the insurer, wherever located...” The power to collect debts was granted for three express purposes: “[t]o institute timely action in other jurisdictions ... [t]o do such other acts as are necessary or expedient to collect, conserve, or protect its assets or property ... and ... [t]o pursue any creditor's remedies available to enforce his or her claims.”<sup>FN8</sup> Section 44-4821(1)(u) grants the liquidator the power “[t]o exercise and enforce all the rights, remedies, and powers of any insured, creditor, shareholder, or member, including any power to avoid any transfer or lien that may be given by the general law...”

FN8. § 44-4821(1)(h)(i) to (iii).

There is no direct conflict between the statutory provisions and the regulatory exclusion. The liquidator argues that the statute grants the liquidator any remedies available to an insured, creditor, shareholder, or member and that the regulatory exclusion strips one of those remedies from the liquidator. The regulatory exclusion does not conflict with the statute, because under the terms of the policy, the liquidator may still have a claim against the personal assets of the directors and officers.

[9][10] We have continuously upheld the freedom to contract.<sup>FN9</sup> We have also stated that “ ‘ [i]t is not the province of courts to emasculate the liberty of contract by enabling parties to escape their contractual obligations on the pretext of public policy unless the preservation of the public welfare imperatively so demands.” ’ ’<sup>FN10</sup> Unless the case is one that is free from \*315 doubt, “[t]he respective parties to a contract bear risks that the conditions under which the contract was entered will change and become less favorable to them over the course of the contract's term.”<sup>FN11</sup>

FN9. *Parkert v. Lindquist*, 269 Neb. 394, 693 N.W.2d 529 (2005); *American Fam. Mut. Ins. Co. v. Hadlev*, 264 Neb. 435, 648 N.W.2d 769 (2002); *Hood v. AAA Motor Club Ins. Assn.*, 259 Neb. 63, 607 N.W.2d 814 (2000); *OB-GYN v. Blue Cross*, 219

761 N.W.2d 916  
277 Neb. 308, 761 N.W.2d 916  
(Cite as: 277 Neb. 308, 761 N.W.2d 916)

Neb. 199, 361 N.W.2d 550 (1985).

FN10. *OB-GYN, supra* note 9, 219 Neb. at 204, 361 N.W.2d at 554, quoting *E.K. Buck Retail Stores v. Harkert*, 157 Neb. 867, 62 N.W.2d 288 (1954).

FN11. *Jeffrey Lake Dev. v. Central Neb. Pub. Power*, 262 Neb. 515, 523, 633 N.W.2d 102, 109 (2001).

The liquidator, as Director of Insurance, approved, or did not disapprove, a significant number of exclusions like the one involved in this case. In his deposition, the liquidator conceded there is no stated public policy addressing regulatory exclusions in Nebraska. And the district court pointed out that in Nebraska, “it is the Director of Insurance’s duty to approve or disapprove insurance policies based on their conformance with public policy and \*\*922 the provisions and intent of the law in Nebraska.”

Although we have said that the sole fact that the Department of Insurance approves a policy is not determinative,<sup>FN12</sup> the liquidator, as director, admitted he was unaware of a clear public policy prohibiting regulatory exclusions. Furthermore, there is no statutory requirement that an insurance company carry D & O coverage. Upholding the regulatory exclusion does not violate any clearly articulated public policy in Nebraska, but voiding the provision would undermine our policy supporting freedom to contract. We therefore find that the regulatory exclusion does not violate public policy, and we find that the liquidator is barred from recovery under the regulatory provision.

FN12. *Rawlings v. Amco Ins. Co.*, 231 Neb. 874, 438 N.W.2d 769 (1989).

#### CONCLUSION

The plain language of the regulatory provision applies to the liquidator, and the regulatory exclusion does not violate a clearly articulated public policy. We therefore affirm the decision of the district court granting summary judgment to United National.

AFFIRMED.

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GERRARD, J., participating on briefs.

WRIGHT, J., not participating.

Neb., 2009.

State ex rel. Wagner v. United Nat. Ins. Co.  
277 Neb. 308, 761 N.W.2d 916

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