

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
300 Capitol Mall, 17th Floor
Sacramento, CA 95814**

NOTICE OF PROPOSED RULEMAKING AND NOTICE OF PUBLIC HEARING

SPECIAL INVESTIGATIVE UNITS

July 19, 2019

REG-2018-00023

SUBJECT OF PROPOSED RULEMAKING

The Commissioner proposes to adopt amendments to Title 10, California Code of Regulations (“CCR”), Chapter 5, Subchapter 9, Article 2, sections 2698.30 and 2698.33-2698.41 after considering comments from the public. The proposed regulations clarify requirements of an insurer’s unit or division responsible for investigating possible fraudulent claims by insureds or persons making claims for services or repairs against policies held by insureds, as authorized by the provisions of Insurance Code section 1875.24.

PUBLIC HEARING

The Commissioner will hold a public hearing to provide all interested persons an opportunity to present statements or arguments, orally or in writing, concerning the proposed regulation as follows:

Date: September 5, 2019

Time: 10:00 a.m. If it is necessary for the hearing to exceed two hours, there will likely be a one-hour break from 12:00 noon to 1:00 p.m.

**Location: California Department of Insurance
300 Capitol Mall, 13th Floor, Room 13025
Sacramento, California**

ACCESS TO HEARING ROOMS

The facilities to be used for the public hearing are accessible to persons with mobility impairments. Persons with sight or hearing impairments are requested to notify the contact person(s) for the hearing to make special arrangements, if necessary.

PRESENTATION OF WRITTEN COMMENTS; CONTACT PERSONS

All persons are invited to submit written comments on the proposed regulation during the public comment period. The public comment period will end at **5:00 p.m. on September 5, 2019**. Please direct all written comments to the following contact person:

Summer Volkmer
Attorney III
California Department of Insurance
45 Fremont Street, 21st Floor
San Francisco, CA 94105
Telephone: (415) 538-4169
Summer.Volkmer@insurance.ca.gov

Questions regarding procedure, comments, or the substance of the proposed action should be addressed to the above contact person. In the event the contact person is unavailable, inquiries regarding the proposed action may be directed to the following alternate contact person:

Damon Diederich
Attorney III
California Department of Insurance
300 Capitol Mall, 11th Floor
Sacramento, CA 95814
Telephone: (916) 492-3567
Damon.Diederich@insurance.ca.gov

DEADLINE FOR WRITTEN COMMENTS

All written materials must be received by the Insurance Commissioner, addressed to the contact person at the address listed above, no later than **5:00 p.m. on September 5, 2019**. Any written materials received after that time may not be considered.

COMMENTS TRANSMITTED BY E-MAIL OR FACSIMILE

The Commissioner will accept written comments transmitted by email, provided they are sent to the following two email addresses: Summer.Volkmer@insurance.ca.gov and Damon.Diederich@insurance.ca.gov. The Commissioner will also accept written comments transmitted by facsimile, provided they are directed to the attention of Summer Volkmer and sent to the following facsimile number: (415) 904-5490. However, email comments are preferred.

Comments sent to other e-mail addresses or facsimile numbers will not be accepted. Comments sent by e-mail or facsimile are subject to the deadline set forth above for written comments.

AUTHORITY AND REFERENCE

The Commissioner proposes to adopt amendments to add Article 2, containing Sections 2698.30 and 2698.33-2698.41, to Title 10, Chapter 5, and Subchapter 9 of the California Code of Regulations pursuant to the rulemaking authority vested in him by subdivision (c) of section 1875.24 of the Insurance Code.

The proposed adoption will implement, interpret, and make specific the provisions of Insurance Code sections 730, 1872.4, 1874.2, 1874.6, 1875.24, 1875.4, 1877.3, 1877.5, 1879.5, and 1879.6.

INFORMATIVE DIGEST/ POLICY STATEMENT OVERVIEW

SUMMARY OF EXISTING LAW

The Legislature enacted Insurance Code section 1875.20 requiring insurers admitted to conduct business in California to provide for the operation of a unit or division to investigate possible fraudulent claims. The Commissioner promulgated regulations to implement that requirement in 2005. The current regulations provide definitions and procedures for detecting, investigating, and referring suspected insurance fraud, establishes training requirements, specifies the information insurers are required to report to the Department, and provides guidelines regarding the Commissioner's examinations of an insurer's unit.

POLICY STATEMENT OVERVIEW

Every insurer admitted to do business in this state is required to maintain a unit or division to investigate possible fraudulent claims. It has become apparent that additional clarification and guidance is necessary to ensure that fraud is being adequately investigated by insurers. Additionally, the regulations need to be amended to address changing practices in insurers' fraud investigations. The most frequently occurring problems include inadequate fraud referrals being made to the Department, insurers missing investigative steps, not all cases of suspected insurance fraud being investigated or reported, and the lack of information necessary to for the Department to determine the adequacy of insurers Special Investigative Units (SIUs).

The regulations require procedures for detecting and investigating insurance fraud, but the regulations have been interpreted differently by insurers and lacks information necessary for the Department to conduct meaningful compliance audits. Additional clarification would assist insurers in fraud investigations as well as the Department with its ability to monitor compliance.

The Department receives a high quantity of referrals from insurers that are either incomplete or sent prematurely without the insurer having completed the necessary investigation. Many referrals omit entire sections or key data fields that are essential to the Department's intake process. The volume of referrals received that are incomplete results in a significant waste of Department resources. Additionally, when a referral is sent prematurely the Department receives referrals that should not have been referred in the first place, resulting in additional wasted resources.

The Department has found a higher rate of noncompliance with insurers who contract out its fraud investigation functions. Additionally, the Department has found that oftentimes the insurer is not appropriately monitoring its contractors, and when there are multiple levels of subcontracting the Department is unable to identify which contractor is responsible for what function. The lack of insurer oversight of its contractors and subcontractors is troubling and the Department cannot properly monitor compliance when SIU duties and functions are difficult to understand due to multiple layers of contracting.

The information requested in these regulations assists the Department in determining whether an SIU is adequately staffed pursuant to section 2698.32. The existing regulations are not specific enough for the Department to gather information necessary to determine compliance. The Department has identified additional information that would assist its evaluation in that respect, but cannot mandate insurers to report that information because it is not addressed in the regulations.

Anticipated benefits from the proposed regulatory action include the following:
The regulations will facilitate the detection of insurance fraud in this state, by increasing the overall effectiveness of insurer fraud investigations. The regulations will result in more, higher-quality insurer fraud referrals to the Department, and reduce the number of low-quality referrals, which will lead to efficiencies in fraud investigations for state and local governments. These efficiencies are expected to reduce the incidence of fraud, thus promoting an insurance market better able to serve consumers.

EFFECT OF PROPOSED ACTION

The proposed action will clarify procedures and requirements which will result in more consistent standards by which insurers are to conduct and report its fraud investigations. The proposed action will also update the regulations to align it with current practice and technology, increase the overall effectiveness of insurer investigations, and provide the Department with additional tools to monitor compliance. The proposed changes will result in better fraud investigations by the insurer, higher quality referrals to the Department, and clearer compliance guidelines.

NOT MANDATED BY FEDERAL LAW OR REGULATIONS

These regulations are not mandated by federal law. There are no existing federal regulations or statutes comparable to these proposed special investigative unit regulations as no federal statutes or regulations require insurers to provide for the continuous operation of a unit or division to investigate possible fraudulent claims.

CONSISTENCY OR COMPATIBILITY WITH EXISTING STATE REGULATIONS

The Department conducted an evaluation of existing law, including a review of its existing regulations, and determined that the proposed regulation is not inconsistent or incompatible with any existing state regulations.

OTHER STATUTORY REQUIREMENTS

The Department evaluated whether there were other requirements prescribed by statute applicable to these regulations by reviewing statutes and regulations relating to this issue, and determined that there were no such requirements.

LOCAL MANDATE

The Department has determined that the proposed regulation will not impose a mandate on a local agency or school district that requires reimbursement pursuant to Government Code section 17500 *et seq.*

FISCAL IMPACT

The Department has determined that the proposed regulation will not impose a cost to any local agency or school district that requires reimbursement under Government Code section 17500 *et seq.*, nor will it result in other nondiscretionary costs or savings to local agencies. There will be no cost or savings in federal funding to the state. The regulation is expected to increase annual costs on the State Compensation Insurance Fund by \$27,500 and increase Department of Insurance costs by \$2.7 million in the first year, and \$1.7 million annually thereafter.

HOUSING COSTS

The proposed regulations will have no significant effect on housing costs.

SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The Department has made an initial determination that the adoption of the proposed regulations may have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states. The types of businesses that will be affected are insurers. In order to comply with the proposed regulations, insurers will have to make reasonable efforts to investigate suspected insurance fraud, make referrals of suspected insurance fraud to the Department according to specifications set forth in the regulations, provide required training to the insurers' SIU personnel, and provide additional information on the annual reports which insurers are presently required to file with the Department. The Department has considered proposed alternatives that would lessen any adverse economic impact on business and invites you to submit proposals. Submissions may include the following considerations:

1. The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to businesses.
2. Consolidation or simplification of compliance and reporting requirements for businesses.
3. The use of performance standards rather than prescriptive standards.
4. Exemption or partial exemption from the regulatory requirements for businesses.

STATEMENT OF RESULTS OF THE ECONOMIC IMPACT ASSESSMENT

The Department is required to assess any impact the proposed adoption may have on the following: the creation or elimination of jobs within the State of California (Government Code § 11346.3(b)(1)(A)); the creation of new businesses or the elimination of existing businesses within the State of California (Government Code § 11346.3(b)(1)(B)); and the expansion of businesses currently doing business within the State of California (Government Code § 11346.3(b)(1)(C)).

Below is a summary of the results of the Economic Impact Assessment pursuant to Government Code sections 11346.3(b)(1)(A) through (D).

A. The proposed regulation is anticipated to result in the creation of 19.4 jobs. As a result, the proposed regulations will likely have a minimal effect, a net gain of 2.4 jobs, on overall employment within the State of California. The regulation is expected to affect less than one ten-thousandth of a percent of the total nonfarm employment in California (i.e., $2.4 / 17,566,770 = 0.00001\%$).

B. The proposed regulation is anticipated to result in the elimination of 17.4 jobs. As a result, the proposed regulations will likely have a minimal effect, a net gain of 2.4 jobs, on overall employment within the State of California. The regulation is expected to affect less than one ten-thousandth of a percent of the total nonfarm employment in California (i.e., $2.4 / 17,566,770 = 0.00001\%$).

C. Insurers are very large financial companies often operating in multiple states. Given that the average cost impact to an insurer is estimated to be \$27,800 (\$6.4 million / 230 firms), and the average insurer has an estimated benefit of \$19,100 (\$4.4 million / 230 firms), it is not expected that the proposed regulation will have a significant impact on the creation of new businesses in California.

D. Insurers are very large financial companies often operating in multiple states. Given that the average cost impact to an insurer is estimated to be \$27,800 (\$6.4 million / 230 firms), and the average insurer has an estimated benefit of \$19,100 (\$4.4 million / 230 firms), it is not expected that the proposed regulation will have a significant impact on the elimination of existing businesses in California.

E. Insurers are very large financial companies often operating in multiple states. Given that the average cost impact to an insurer is estimated to be \$27,800 (\$6.4 million / 230 firms), and the average insurer has an estimated benefit of \$19,100 (\$4.4 million / 230 firms), it is not anticipated that the proposed regulation will have an impact on the ability of businesses in California to expand. Additionally, the estimated net loss to total economic output of \$12.2 million suggests that the regulation will have a very small impact on the California economy as a whole.

F. The proposed regulation will benefit the health and welfare of California's consumers and businesses. Streamlining the investigative process, eliminating incomplete SIU referrals, and recovering additional restitution payments will lead to a more efficient insurance market that can better serve consumers.

POTENTIAL COST IMPACTS ON REPRESENTATIVE PRIVATE PERSON OR BUSINESS

Except for insurance companies, the Department is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action. The cost known to the Department that a representative insurer could incur to comply with the proposed regulation is approximately \$27,800 on average.

BUSINESS REPORT

The Department finds that it is necessary for the health, safety or welfare of the people of the state that the regulation apply to businesses.

IMPACT ON SMALL BUSINESS

The proposed regulation will have a minimal adverse direct impact on insurers as discussed in the foregoing analysis, but by law they are not considered small businesses (Government Code section 11342.610(b)(2)).

ALTERNATIVES STATEMENT

The Department must determine that no reasonable alternative considered by the Department or that has otherwise been identified and brought to the attention of the Department would be more effective in carrying out the purpose for which this action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law.

AVAILABILITY STATEMENTS

The Department will make the express terms of the proposed adoption available to the public for inspection and copying on request to the contact person listed above and on its public website.

The Department has prepared an Initial Statement of Reasons that describes the reasons for the proposed adoption. The Initial Statement of Reasons will be made available for inspection and copying on request to the contact person listed above and on the Department's public website.

The file for this proceeding, which includes a copy of the proposed text of regulation, the Initial Statement of Reasons, the information upon which the proposed action is based, and any supplemental information, including reports, documentation, and other materials related to the proposed action that is contained in the rulemaking file, is available by appointment for inspection and copying at 300 Capitol Mall, 16th Floor, Sacramento, California 95814, between the hours of 9:00 a.m. and 4:00 p.m., Monday through Friday. Please direct appointment requests to the contact person listed above.

MODIFIED TEXT

If the Department adopts a regulation that differs from the one that has originally been made available but is sufficiently related to the original proposed adoption, the full text of the amended regulation, with the changes clearly indicated, will be made available to the public for at least 15 days prior to the date the Department adopts the amended regulation. Interested persons should request a copy of the amended regulation from the contact person listed above.

AUTOMATIC MAILING

A copy of this Notice (including the Informative Digest, which contains the general substance of the proposed adoption) will be sent to all persons who have previously filed a request with the Department to receive notice of proposed rulemakings.

FINAL STATEMENT OF REASONS

Upon request, the Final Statement of Reasons will be made available for inspection and copying once it has been prepared pursuant to Government Code section 11346.9(a). Requests for the Final Statement of Reasons should be directed to the contact person listed above.

INTERNET ACCESS

Documents concerning proposed regulation, including the proposed text of regulation and Initial Statement of Reasons, and are available on the Department's website at the following link: <https://legaldocs.insurance.ca.gov/publicdocs/RegulationList>.