

**STATE OF CALIFORNIA  
OFFICE OF ADMINISTRATIVE LAW**

In re:	)	
	)	
DEPARTMENT OF INSURANCE	)	DECISION OF DISAPPROVAL OF REGULATORY ACTION
	)	
REGULATORY ACTION:	)	(Gov. Code, sec. 11349.3)
	)	
Title 10, California Code of Regulations	)	OAL File No. 06-1130-01 S
	)	
ADOPT SECTIONS 2698.23, 2698.23.1, 2698.24, 2698.24.1, 2698.25, 2698.25.1, 2698.25.2, 2698.25.3, 2698.26, 2698.27	)	
_____	)	

**SUMMARY OF REGULATORY ACTION**

Section 10127.17 of the Insurance Code creates a Life and Annuity Consumer Protection Fund. Money in the fund is distributed by the Commissioner and exclusively dedicated to protecting consumers of life insurance and annuity products in this state. This regulatory action adopts regulations establishing the Life and Annuity Consumer Protection Program

**DECISION**

On January 12, 2007, the Office of Administrative Law (OAL) disapproved the above referenced regulatory action for the following reasons: failure to comply with the authority, clarity, consistency, necessity and reference standards of Government Code section 11349.1; failure to include a summary and response to all public comments; and the statement of mailing for the 15 day comment period was inadequate.

**DISCUSSION**

The adoption of regulations by the Department of Insurance (“Department”) must satisfy requirements established by the part of the California Administrative Procedure Act (“APA”)

that governs rulemaking by a state agency. Any rule or regulation adopted by a state agency to implement, interpret, or make specific the law enforced or administered by it, or to govern its procedure, is subject to the APA unless a statute expressly exempts the regulation from APA coverage. (Gov. Code, sec. 11346.)

Before any rule or regulation subject to the APA may become effective, the rule or regulation is reviewed by the Office of Administrative Law (“OAL”) for compliance with the procedural requirements of the APA and for compliance with the standards for administrative regulations in Government Code Section 11349.1. Generally, to satisfy the standards a rule or regulation must be legally valid, supported by an adequate record, and easy to understand. In this review OAL is limited to the rulemaking record and may not substitute its judgment for that of the rulemaking agency with regard to the substantive content of the regulation. This review is an independent check on the exercise of rulemaking powers by executive branch agencies intended to improve the quality of rules and regulations that implement, interpret, and make specific statutory law, and to ensure that the public is provided with a meaningful opportunity to comment on rules and regulations before they become effective.

## 1. AUTHORITY

Government Code section 11349.1(a)(2) requires that OAL review all regulations for compliance with the “authority” standard. Government Code section 11349(b) defines “authority” to mean “... the provision of law which permits or obligates the agency to adopt, amend, or repeal a regulation.” Government Code section 11342.1 requires that each regulation “...be within the scope of authority conferred and in accordance with standards prescribed by other provisions of law.”

Insurance Code Section 10127.17, subdivision (a), provides in pertinent part:

“The Life and Annuity Consumer Protection Fund is hereby created as a special account within the Insurance Fund. Each insurer admitted to transact insurance in this state shall pay a fee to be determined by the commissioner, not to exceed one dollar (\$1), for each individual life insurance policy and each individual annuity product that it issues to a resident of this state with a value of fifteen thousand dollars (\$15,000) or more...”

This statutory provision went into effect on January 1, 2005.

New regulation section 2698.24 provides in pertinent part:

- (a) “A \$1.00 fee shall be assessed **annually** on all new individual life insurance policies and individual annuity contracts with an initial and/or intended face amount of \$15,000 or more **beginning January 1, 2005** ....”
- (b) “The total annual assessment shall be based upon data provided by the insurer to the Commissioner. The data shall be submitted to the Commissioner semi-

annually by January 10<sup>th</sup> and July 10<sup>th</sup>, or as determined by the Commissioner. The data shall include at a minimum the following ...” (Emphasis added.)

These new regulatory provisions set the amount of the fee imposed by Insurance Code section 10127.17 retrospectively back to 2005 and 2006. Similarly, these new regulatory provisions retrospectively establish very specific data reporting requirements and specific deadlines for data submission which occurred in 2005 and 2006. No specific authority has been cited for new regulation section 2698.24 that would permit such retroactive application of the regulation.

## 2. CLARITY

The Legislature in establishing OAL, found that regulations, once adopted, were frequently unclear and confusing to the persons who must comply with them. (Gov. Code, sec. 11340(b).) For this reason, OAL is mandated to review each regulation adopted pursuant to the APA to determine whether the regulation complies with the “clarity” standard. (Gov. Code, sec. 11349.1(a)(3).) “Clarity” as defined by Government Code section 11349(c) means “written or displayed so that the meaning of regulations will be easily understood by those persons directly affected by them.”

a. New regulation section 2698.24 provides in subsection (a):

“A \$1.00 fee shall be assessed annually on all new individual life insurance policies and individual annuity contracts with an initial and/or intended face amount of \$15,000 or more beginning January 1, 2005 ....”

A person directly affected by this regulation would not easily understand from the use of the word “annually” whether the fee is a one time fee on new life insurance policies or a recurrent charge for life insurance policies newly issued after the effective date of the regulation.

b. New regulation section 2698.24 provides in subsection (b):

“The total annual assessment shall be based upon data provided by the insurer to the Commissioner. The data shall be submitted to the Commissioner semi-annually by January 10<sup>th</sup> and July 10<sup>th</sup>, **or as determined by the Commissioner** ....”(Emphasis added.)

A person directly affected by this regulation would not easily understand when the data is required to be submitted since the due date could be changed by the Commissioner at any time without notice or public input.

c. New regulation section 2698.25.2 provides in subsection (a):

“The Request for Applications (RFA) shall be distributed annually **or as determined by the Commissioner** to each county district attorney in the state. Applications received after **the date set for submission** shall not be considered for funding ....” (Emphasis added.)

This subsection neither provides a due date for submission of applications for funding nor a time frame from issuance of the RFA within which applications for funding must be submitted. A person directly affected by section 2698.25.2 would not understand from the regulation when funding applications are due.

d. New regulation section 2698.25.2 provides in subsection (b):

“An Application for Grant Funding shall contain all of the information detailed in the RFA including the amount of funding requested. Applications missing any of these required elements shall not be considered for funding. Applications shall include ....

(3) “Executed Board of Supervisors Resolution”....”

A person directly affected by section 2698.25.2 would not understand from the regulation what must be said in the required Board of Supervisors resolution.

e. New regulation section 2698.27 provides in part in subsection (a):

“...The Commissioner shall inform the Grantee in writing if performance by Grantee is not satisfactory and may, at his or her discretion suspend any payment and/or performance under the Agreement. The Commissioner may redistribute those funds to other eligible Grantees. The Grantee shall return any unused funds to the Department within thirty (30) day of the request from the Department.”

Separated by two unrelated subsections concerning availability of records and audits, new regulation section 2698.27 then provides in subsection (d):

“The Commissioner may terminate the Agreement for cause, other than the exercise of prosecutorial discretion, with at least thirty (30) days written notice to Grantee, except, if the Commissioner has evidence of fraud, the Agreement may be terminated immediately....”

A person directly affected by section 2698.27 would not easily understand the distinction, if any, between the suspension and termination process.

f. We also note that section 2698.23.1 in subsection (e) refers to “section 10127.17” without identifying the section as being contained in the Insurance Code and in subsection (k) is missing some quotation marks differentiating a “Program Report” from an “Expenditure Report”.

### 3. CONSISTENCY

OAL is required to review every regulation adopted by a state agency pursuant to the APA to determine whether the regulation complies with the “consistency” standard. “‘Consistency’ means ‘being in harmony with, and not in conflict with or contradictory to, existing statutes, court decisions, or other provisions of law.’” (Gov. Code, sec. 11349(d).)

a. Subdivision (d)(3) of Insurance Code section 10127.17 provides:

“Each district attorney that receives funds pursuant to this section shall submit a final report to the commissioner, that may be made public, as to the success of the case or project conducted. The report shall **provide information and statistics on the number of active investigations, arrests, indictments, and convictions.**” (Emphasis added.)

New regulation section 2698.25.3 provides in subsection (a):

“Each Grantee shall submit a Program Report to the Department no later than thirty (30) days after the end of the first year of the Grant Funding Cycle. The Program Report shall include the following: a narrative description of the funded activities, how those activities have resulted in increased reporting and/or reduced the number and/or severity of life insurance and annuity financial abuse cases in the county; a summary of key cases investigated/prosecuted during the Grant Funding Cycle including pending cases and cases which have reached a verdict; the disposition of those cases, including any restitution paid to the victim and any other relevant information and statistical data ....”

The Program Report required by regulation section 2698.25.3(a) does not include “information and statistics on the number of active investigations, arrests, indictments, and convictions” as required by subdivision (d)(3) of Insurance Code section 10127.17.

b. Subdivision (d)(2) of Insurance Code section 10127.17 provides:

“Each district attorney that receives funds pursuant to this section shall submit a final detailed accounting **at the conclusion or closure of each case or project.** For cases or projects that continue longer than six months, interim accountings shall be submitted every six months, or as otherwise directed by the commissioner ....” (Emphasis added.)

New regulation section 2698.25.3 provides in subsection (b):

“Each Grantee shall submit an Expenditure Report to the Department no later than sixty (60) days after the close of the first year of the Grant Funding Cycle....”

Neither the Initial Statement of Reasons nor the Final Statement of Reasons contains any explanation for the variance. Has the Department found that cases or projects as a matter of course continue longer than 6 months?

#### 4. NECESSITY

Government Code section 11349.1(a)(1) requires that OAL review all regulations for compliance with the “necessity” standard. Government Code section 11349(a) defines “necessity” to mean “. . . the record of the rulemaking proceeding demonstrates by substantial evidence the need for a regulation to effectuate the purpose of the statute, court decision, or other provision of law that the regulation implements, interprets, or makes specific, taking into account the totality of the record. For purpose of this standard, evidence includes, but is not limited to, facts, studies, and expert opinion.”

To further explain the meaning of substantial evidence in the context of the “necessity” standard, subdivision (b) of section 10 of the Title 1 of the California Code of Regulations (CCR) provides:

“In order to meet the ‘necessity’ standard of Government Code section 11349.1, the record of the rulemaking proceeding shall include:

“(1) a statement of the specific propose of each adoption, amendment, or repeal; and

“(2) information explaining why each provision of the adopted regulations is required to carry out the described purpose of the provision. Such information shall include, but is not limited to, facts, studies, or expert opinion. When the explanation is based upon policies, conclusions, speculation, or conjecture, the rulemaking record must include, in addition, supporting facts, studies, expert opinion, or other information. An ‘expert’ within the meaning of this section is a person who possesses special skill or knowledge by reason of study or experience which is relevant to the regulation in question.”

In order to provide the public with an opportunity to review and comment upon an agency’s perceived need for a regulation, the APA requires that the agency describe the need for the regulation in the initial statement of reasons. (Gov. Code, sec. 11346.2(b).) The initial statement of reasons must include a statement of the specific purpose for each adoption, amendment, or repeal, and the rationale for the determination by the agency that each regulation is reasonably necessary to carry out the purpose for which it is proposed or, simply restated, “why” a regulation is needed and “how” this regulation fills that need. (Gov. Code, sec. 11346.2(b)(1).) The initial statement of reasons must be submitted to OAL with the initial notice of the proposed action and made available to the public during the public comment period, along with all the information upon which the proposal is based. (Gov. Code, secs. 11346.2(b) and 11346.5(a)(16) and (b).) In this way the public is informed of the basis of the regulatory action and may comment knowledgeably. The initial statement of reasons and all data and other factual information, studies or reports upon which the agency is relying in the regulatory action must also be included in the rulemaking file. (Gov. Code, sec. 11347.3(b)(2) and (7).)

The Initial Statement of Reasons provided with this regulatory action describes the effect of the proposed regulations but fails to provide substantial evidence of the need for specific provisions contained in sections 2698.24, 2698.24.1, 2698.25, 2698.25.1, 2698.25.2, 2698.25.3, 2698.26 and 2698.27. The Final Statement of Reasons does not augment this information.

**5. THE FINAL STATEMENT OF REASONS DOES NOT CONTAIN A SUMMARY AND RESPONSE TO ALL COMMENTS SUBMITTED DURING THE PUBLIC COMMENT PERIOD.**

Since its inception in 1947, the APA has afforded interested persons the opportunity to participate in quasi-legislative proceedings conducted by state agencies. The APA currently requires that rulemaking agencies provide notice and at least a 45-day comment period prior to adoption of a proposed regulatory action. (Gov. Code, secs. 11346.4 and 11346.5). By requiring the state agency to summarize and respond in the record to comments received during the comment period, the Legislature has clearly indicated its intent that an agency account for all relevant comments received, and provide written evidence of its meaningful consideration of all timely, relevant input. Section 11346.9(a)(3) of the Government Code requires that the adopting agency prepare and submit to OAL a final statement of reasons which shall include a “. . . summary of each objection or recommendation made regarding the specific adoption, amendment, or repeal proposed, together with an explanation of how the proposed action has been changed to accommodate each objection or recommendation, or the reason for making no change.”

The Final Statement of Reasons for this regulatory action does not contain a summary and response to the following recommendation made by the California Advocates for Nursing Home Reform to amend regulation section 2698.25.1 (b):

“(b) Add new criteria to be (4)”

“ A plan to promote communication between the District Attorney’s Office and the Department of Insurance and to develop a procedure for sharing information on criminal prosecution that involve financial elder abuse by licensed insurance agents.”

In addition, the Final Statement of Reasons stated that it accepted another recommendation from the California Advocates for Nursing Home Reforms to add sections 17200, 17500, and 17500.3 of the Business and Professions Code to the definition of “Life insurance and annuity financial abuse” in regulation section 2698.23.1(i). Only the latter two Business and Professions Code sections were added.

**6. INADEQUATE STATEMENT OF MAILING**

Between October 17, 2006 and November 1, 2006, the Department conducted a 15 day availability period for sufficiently related changes made to the original text of the regulations made available to the public. Pursuant to section 44 of title 1 of the California Code of

Regulations, notice of the proposed changes and the text are required to be mailed out to specified categories of persons. Subsection (b) of section 44 provides:

“The rulemaking record shall contain a statement confirming that the agency complied with the requirements of this section and stating the date upon which the notice and text were mailed and the beginning and ending dates for this public availability period.”

The statement of mailing provided with this rulemaking for the October 17, 2006 availability period did not conform to these requirements.

## **7. AUTHORITY AND REFERENCE CITATIONS**

Subsection (a)(2) of Government Code section 11346.2 provides:

“ The agency shall include a notation following the express terms of each California Code of Regulations section, listing the specific statutes or other provisions of law authorizing the adoption of the regulation and listing the specific statutes or other provisions of law being implemented, interpreted, or made specific by that section in the California Code of Regulations.”

Subsection (b) of Government Code section 11349 provides:

“‘Authority’ means the provision of law which permits or obligates the agency to adopt, amend, or repeal a regulation.”

Subsection (e) of Government Code section 11349 provides:

“‘Reference’ means the statute, court decision, or, other provision of law which the agency implements, interprets, or makes specific by adopting, amending, or repealing a regulation.”

New regulation section 2698.24 includes Insurance Code sections 10508.7, 12921.6, and 12995 among its authority citations. These statutory provisions do not provide authority for adopting this regulation. New regulation section 2698.24.1 includes Insurance Code section 12995 in its reference citations. This statutory provision does not appear to be implemented, interpreted, or made specific by regulation section 2698.24.1.

**CONCLUSION**

For the reasons set forth above, OAL has disapproved this regulatory action. If you have any questions, please contact me at (916) 323-6808.

Date: January 18, 2007

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CRAIG S. TARPENNING  
Senior Staff Counsel

for: WILLIAM L. GAUSEWITZ  
Director

Original: Steven Poizner, Insurance Commissioner  
cc: Elena Fishman