

8-28-1989

# Implementation of Proposition 103, August 28, 1989

Senate Committee on Insurance, Claims and Corporations

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## Recommended Citation

Senate Committee on Insurance, Claims and Corporations, "Implementation of Proposition 103, August 28, 1989" (1989). *California Senate*. Paper 94.

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CALIFORNIA LEGISLATURE  
SENATE INSURANCE, CLAIMS AND  
CORPORATIONS COMMITTEE  
SENATOR ALAN ROBBINS, CHAIR

## IMPLEMENTATION OF PROPOSITION 103



August 28, 1989  
Los Angeles

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SENATE INSURANCE, CLAIMS AND CORPORATIONS COMMITTEE

SENATOR ALAN ROBBINS, CHAIRMAN

IMPLEMENTATION OF PROPOSITION 103



August 28, 1989  
Los Angeles

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CHAIRMAN ALAN ROBBINS: Please take your seats. If I could ask the Department representatives, absent the Commissioner who isn't here, to please come forward. We have two chairs in the center area.

As a matter of introduction, the Senate Insurance Committee has the responsibility, on behalf of the Senate, to supervise the Department in its implementation of Proposition 103.

We come to today's hearing at a time when there is great concern on the part of the public that the rate reductions that they thought they voted for in November of last year are not going to occur. We come at a time when the implementation of Proposition 103 has gone slower than many of us would like to have seen, and at a time when the authors of Proposition 103 have raised what I consider to be legitimate questions -- questions that deserve responses with respect to what is going on in the process.

They have questioned the fact that the Commissioner is proceeding with a series of individual hearings without developing formal guidelines in advance, setting forth the formulas to be used so that consumer groups have the opportunity to criticize them. They have raised the question that Proposition 103 prohibits private meetings between the Insurance Commissioner and insurance companies to discuss rate regulation; yet, a private meeting occurred between the Commissioner and officials of State Farm Insurance. They have the right to ask the legitimate question: What was discussed?

The Insurance Commissioner has indicated she's going to guarantee insurance companies an 11.2 rate of return, to guarantee them the same rate of return they have received historically. To be candid, that is not my reading of Proposition 103, nor my reading of the Supreme Court in ruling that insurance companies are entitled to a fair rate of return.

These are all issues that need to be answered and discussed. Over a month ago, I spoke with the Commissioner; informed her that we felt that it was critical that there be a hearing on the process that was being followed, and in consideration of her very busy schedule, that I would schedule just one hearing -- would not require her to appear at a series of hearings -- and would allow her the courtesy of picking the date when the hearing would occur. Roxani picked this morning as the date and time for the hearing to occur. The Senate has arranged its schedule around it. In what is a very busy time for us at the end of the legislative session, we have arranged the Senate schedule to not have Senate business going on this morning to allow this hearing to take place.

I was extremely disappointed late Friday afternoon to receive your phone call that the Commissioner might have back problems that would preclude her from being able to testify at this hearing, and less happy when you informed me about 15 minutes ago that the Commissioner indeed could not physically come to the hearing this morning, and that you could not reach her by phone because she was at her doctor's.

The Commissioner has an absolute and unequivocal responsibility to answer the questions that have been asked. I have a responsibility, as the Chair of this committee, to make sure that the

Commissioner answers the questions.

I have given you four alternate dates within the next two weeks on which we will again be prepared to rearrange our schedule to schedule a hearing for the Commissioner. This coming Friday, September 1; Tuesday, September 4 (note: should be September 5); or Friday, September 8; and if need be, I am prepared to work on Monday, Labor Day, September 4. It is absolutely imperative that the Commissioner, within the next few hours, respond as to which date and time she will appear. If she does not, it is my intention to request of the Senate Rules Committee that a subpoena be issued at a time of our choosing, and the Commissioner will be ordered to appear.

It is a step we do not take customarily with members of the administration. We normally provide the courtesy of requesting their appearance and allowing them to arrange a date and time. We've done that one time, we're prepared to do it a second time; I will not do it a third time. There will be a subpoena.

If you have any comment on it that you'd like to make about the Commissioner's nonpresence, you may do so; otherwise, we will start in with the substance of the hearing.

MS. CHARLENE MATHIAS: I would like to correct one thing, Senator Robbins. I didn't tell you that she "might" have back problems. I told you that she had injured her back and that there was a possibility that she would not be here today. I would like to correct the record on that point.

CHAIRMAN ROBBINS: I'm sure your statement is correct in that regard. I'm sorry that the Commissioner should have injured her back, though I will tell you, that there are many people, myself amongst them, who have had back injuries, who have serious back problems, and I have to tell you, there are times I've shown up for legislative hearings with my back in a brace. There are times when it's been necessary to arrange a chair, and I told you that we'd set up whatever kind of seating she needed, take whatever types of breaks she would need in order to physically accommodate her.

You have the four dates, and I presume that by mid-day today you will be able to get back a response from her, if she would care to select one of the four dates.

MS. MATHIAS: We'll try to do that, Senator.

CHAIRMAN ROBBINS: Let's proceed. The format I would like to follow today is that on each of the questions that's addressed, we would like to have a two-minute time limit on responses. That's because of my basic philosophy that if you can't make a point in two minutes, probably is too complex to try to make. And while questions may be directed against -- pardon me -- directed to either the Proposition 103 group or to the Commissioner's office, if there's a comment after the response, either side will be given the opportunity to do that.

I think probably the best place to start, in terms of questions, is in terms of basic procedure. The Commissioner is following the procedure of doing it on a company-by-company basis, rather than as requested by the consumer organizations: adopting a set of written guidelines setting forth the formula, setting forth the criteria for exemptions so that with a set of written guidelines the public, the consumer organizations, and the Legislature would have the opportunity to evaluate any exemption granted or any rate reduction ordered against those criteria established by the Commissioner.

Does the Commissioner intend to establish a set of written criteria prior to making rate rulings, and if not, why not?

MS. MATHIAS: Mr. Chairman, may I take time apart from those two minutes to introduce myself and the members of the staff that I have here this morning?

CHAIRMAN ROBBINS: You certainly may. Just because the Chair is not pleased at the absence of the Commissioner does not mean we should dispense with the normal civility of identifying everyone who's present. Let me first introduce to my left Jim Cathcart, consultant to this committee; Maureen Brooks, secretary to the committee; and Senator Joe Montoya, a member of the committee.

MS. MATHIAS: I'm Charlene Mathias, Assistant Insurance Commissioner, representing Roxani Gillespie today. I have several members of the staff with me that have been intimately involved with the carrying out the programs with Prop. 103. On my left is Norris Clark, Chief of our Financial Analysis Division; and beginning on my right, Milo Pearson, the head of our new Rating Division; Reid McClaran, who heads our Legal Rate Enforcement Bureau; and Jim Miller, who is in charge of our Consumer Services Division.

Now to answer your question about the guidelines. Yes, the Insurance Commissioner intends eventually to issue guidelines. She expects to use these first few hearings to help develop the standards and the guidelines that will be eventually adopted. Her feeling is that to go cold into something that we are really innovating in and learning about is a misdirected effort. The interveners will have every opportunity in these hearings to have input into the kind of standards they think should be looked at, the kind of issues that will be looked at, and they will help us through the process on looking at these companies who are really among the most profitable and the most efficient companies that we have called to hearing. Through that process, they will be helping us to develop guidelines which will eventually be adopted.

CHAIRMAN ROBBINS: Comment, Mr. Collis, Mr. Rosenfield?

MR. CONWAY COLLIS: May I just ask a follow-up question on that? If these guidelines and standards are going to evolve, and they have not yet been set, first, how did the Commissioner's office determine that over 180 companies in California ought to be exempt from the mandatory 20 percent rollback? How is that determination made without a hearing at all if the guidelines had not yet been established?

And second, how does that jive with the Commissioner's position in the pre-trial conference on the Allstate application for an exemption that only issues raised by the Department of Insurance could be raised at that hearing, and that any other issues that consumer groups attempted to raise in the course of that hearing could not be considered at this time, but rather had to be referred to the so-called "slow track" that the Department has created for a number of companies?

MS. MATHIAS: With respect to the first part of your question, the Commissioner did adopt one standard that I'm sure you're very aware of, and that was the 11.2 standard that we are going to be -- did use in the rate review process and that we will be using in the hearing as a threshold standard for our prosecutorial purposes in the hearings. I don't know how well this has explained how we expect

the hearing process to go. But we have, in the Department, created two legal bureaus which are entirely separate. One reports to the chief counsel and one reports to the chief deputy so that we keep this segregated ability in the Department to carry out our two roles. One is as a so-called prosecutor in these hearings, and the other one will be acting as the administrative law judge.

So to carry out our rate review and set a standard, yes, we have set the one numerical standard of 11.2. To arrive at that, we worked with SRI International, which is a well-respected organization that helps and advises on policy matters; brought that organization in to review various alternatives with us because we thought that an objective, numerical standard was the only way that we could carry out the rate review and the beginning of the hearing process in a really efficient, timely way.

After reviewing these standards and alternatives with SRI, we determined that 11.2, with its 15-year history in the industry, was appropriate. We looked at, as the court suggested and told us to do, similar institutions with similar risks. One of those was the banking industry, which had I believe an 11 percent rate of return; and the other is diversified financial institutions which, over the 15-year period, have shown a 12.4 rate of return.

So we felt that the 11.2 was -- is that right? 11.2? -- was right in the ballpark. The court also told us that there has to be a rate of return which will keep capital in an industry, and we thought with an 11 -- a 15-year span there that that figure demonstrated that it was sufficient to keep capital in the industry.

CHAIRMAN ROBBINS: Does your definition of using diversified financial institutions include the savings and loan industry, which has suffered in the last calendar year alone a loss of over \$2½ billion?

MS. MATHIAS: I don't believe that it does. I can't tell you that for certain, Senator, but I think that it includes companies like American Express that are truly diversified, that have insurance and other types of -- well, you know as well as I all the things that American Express is into: money orders, all kinds of things. I think it -- it's my understanding that it includes really diversified financial institutions.

MR. COLLIS: Mr. Chairman?

CHAIRMAN ROBBINS: Just one second, I want to follow this point up. If you use, for establishing your percentage return, the portions of the financial industry that have been successful -- the banks and the diversified financial companies -- and you take out the savings and loans and you leave them out of the equation, you get an artificially high percentage rate of return. You're not taking an overall financial industry. What you're doing is you're using the financial industry and excluding the savings and loans. An 11.2 percent of return as a guaranteed return to insurance companies is a higher rate of return than the PUC allows to utilities in the State of California. How can you justify leaving out the savings and loans, if that's what you're going to use?

MS. MATHIAS: I don't know. I can't tell you how -- that we consider the savings and loans, but I don't know that -- you know, the savings and loans have had so many -- I'm not sure they're valid, is what I guess I'm trying to drive at. There's been, as you know, so many failures. I mean, why would we want to pattern the standard that the court gave us after an industry that has been, number one,

rampant with fraud, if you want to say that -- from what the regulators tell us, one-third of the failures have been greatly contributed to by fraud, and that is having trouble -- it requires a bailout. I'm not sure that that's valid, but if there is a point to be made, Senator, our hearings will give that opportunity to the interveners to make the point and tell us where we're wrong.

CHAIRMAN ROBBINS: Well, but we're here today. Which of your experts that you have with you can tell me why you would use the financial industry but leave out the savings and loans...

MS. MATHIAS: Well, let me pool them...

CHAIRMAN ROBBINS: ...rather than using an overall rate of return for the entire industry, which would put you, if you use an overall rate of return -- I'll save someone the mathematics -- it would put you just under 9 percent? It would put you at about an 8.75 rate of return which, if that is defined as your fair rate of return, obviously would result in substantially lower insurance rates for consumers.

MS. MATHIAS: Let me pool them and see if anyone has any insight on that. The answer that I'm hearing here is just what I made: Why would we want to use a rate of return that's indicative of failing institutions? I don't think at this moment that we have any better answer for you, Senator. The interveners are welcome to make that point to us at the hearing.

MR. COLLIS: Mr. Chairman, mightn't I ask one followed question? I think that the problem here is that when you say 11.2 percent, 11.2 percent of what? In the Allstate hearing itself, for example, where we have gone in and looked at the Allstate filing as we had for the other -- the largest companies in California, and found that not one of those companies had proven that they were entitled to any reduction from the polled 20 percent across-the-board rollback. And yet, in Allstate, the Department has gone in, and based on your 11.2 percent standard, asked for a relatively minor level of rollback. In fact, in Allstate, although you have required some rollback, you have essentially exempted Allstate from the bulk of the 20 percent rollback.

My point is that in determining that there were 180 companies that were entirely exempt from the mandatory rollback, you've used an artificial 11.2 percent standard without, according to our analysis, fully taking into account all aspects of the investment income of the companies, without scrutinizing what expenses those companies, including Allstate, were passing on to California consumers, and without properly scrutinizing what money was being poured into the companies' reserve accounts.

And if you allow those things to go on in an unscrutinized way, the fact that you come up with an 11.2 percent rate of return is irrelevant, because it's 11.2 percent of what? In other words, you're not adequately looking at either the expense side of the ledger, or the income side of the ledger, and you've got to do that; and without allowing consumer groups to come in and challenge those kinds of assumptions, you have exempted virtually all of the companies in California from any rollback whatsoever. I think that's the nature of consumer concern. Would you respond to that?

MS. MATHIAS: I'm not exactly sure what your question is, but I...

MR. COLLIS: 11.2 percent of what?

MS. MATHIAS: Well, it's 11.2 percent rate of return on equity, but I don't think that's what



you're driving at. We may be able, among some of the experts here, to amplify a little bit more on that. But I think the real answer to your question is that you and other interveners will certainly have an opportunity to bring this in, into the hearing, and make the case that this is not an appropriate standard.

MR. COLLIS: And my question to you is how do we have an opportunity to make that case at all with regard to those companies that the Department has exempted from any rollback without a hearing whatsoever? There's not going to be a hearing for the companies that you've exempted. In addition, you've taken the position in Allstate that interveners cannot raise any issues that have not already been raised by the Department. So where is the real opportunity for consumers to intervene in that process?

MS. MATHIAS: Reid, do you have any insight on the last point there?

MR. REID McCLARAN: Yeah. With regard to the last point, Mr. Collis, I was at the pre-hearing conference that you're referring to, and it's not correct that the Department has taken the position that the consumers can raise no issues other than those which we have raised ourselves. Quite to the contrary, we argued to the administrative law judge that significantly more than the issues that we raised were involved in the hearings, and that in fact the insurer still maintains, or has the burden to justify their entire application to show that they are entitled to the rates for which they have applied. Obviously, that includes every aspect of their filing and every aspect of their rates.

Additionally, my recollection of that pre-hearing conference was that in most cases, your petitions for hearing requested hearings on members of groups other than those which we called to hearing. For instance, you requested -- well, I don't recall any specifics, but say with Allstate you may have requested hearings in Allstate for companies other than the Allstate company that we called in. If not Allstate, that was certainly the case of some of the others. We noticed a hearing which specifically called specific companies to hearing. To include other companies after the notice was issued would have given the companies excellent grounds for a continuation, and is a request that I'm sure would be (inaudible).

MR. COLLIS: You're referring to different lines of insurance?

MR. McCLARAN: No, I'm referring to different companies. You, as I recall, requested hearings by group. We called hearings by company. And to the extent that we called a company but not other companies of a group and you called the group, the notice was not sufficient to provide due process to other members of the group for which a notice was not issued, and that's the undue broadening that the regulations say cannot occur in one of these hearings. That's why it has to be a separate hearing. Those companies haven't been noticed.

CHAIRMAN ROBBINS: Let me suggest what I'd like to do procedurally here today. First of all, let me say, you know, Conway, that I think you have done an excellent job in terms of if it wasn't for the fact that you and the Attorney General had requested what the Commissioner referred to as almost 200 rate hearings, that there would not be hearings coming up on those almost 200 cases.

But what I would like to do in terms of procedure here today is to move from subject to subject,

giving each side -- giving the Commissioner's office two minutes to comment on a particular item, giving Voter Revolt two minutes to comment on a particular item, as the authors of Proposition 103, and then move on to -- from item to item, rather than having -- for you to make a comment rather than a question. I don't want the Commissioner to feel hesitant about having a recovery on her back condition for fear that she would have to face her ultimate hell on earth and be grilled by the authors of Proposition 103 directly.

MS. MATHIAS: Senator, I think the Commissioner has made herself very available to the public and to everyone else for almost nonstop for the last number of weeks, so.

CHAIRMAN ROBBINS: I think the Commissioner has done a fairly good job of making herself available in hearings and in forums where she is in charge, where she asks the questions, and where she determines which questions are to be answered. The reason why it is absolutely critical that the Commissioner come before this committee is that what's needed is for the Commissioner to be present to respond to questions in a forum where she doesn't get to pick and choose which questions she's going to answer.

I think some of the questions that have been raised on procedure are very serious questions. I think that some of the subjects we need to get into about whether or not there've been private meetings between her and insurance company executives on rate applications are critical questions and questions that the Commissioner, only the Commissioner, can answer directly. And that is the reason why it is necessary for her to come before this committee. Not that people haven't seen her face, but because we haven't seen the answers to the hard questions. The easy questions have been answered along the way and there've been an abundance of press releases talking about the millions of dollars in rate reductions that are being considered or granted.

But what's needed is to talk about such things as -- and that's the next subject I'd like to move to -- that the Commissioner has issued a statement -- I've not had a chance to discuss it with her personally, so I just have her formal statement to go on -- that three of the largest insurance companies in California -- State Farm Insurance, Farmers Insurance, and Automobile Club of Southern California -- are effectively exempted from the current round of rate regulation hearings based upon the applications they submitted, based upon their own definition of reserve accounts of how much money to set aside in reserves, which ultimately if not needed in reserves goes into company profits, and that there is a substantial additional list of companies in addition to those three that are also exempted.

Considering the fact that we have repeatedly offered your Department unlimited authorization for staff, at our hearings on December 14 of last year, January 23 of this year, February 1st of this year, we offered the Department whatever legislative assistance was needed in obtaining additional staff. Since the Department has the authorization to get as much staff as needed, why isn't the Department going to be able to deal with all of the rate cases, and why the exemptions of these three large companies and the other companies that have been exempted from the rate hearings?

MS. MATHIAS: Senator, as you know, the Supreme Court radically rewrote Proposition 103, and the entire -- well, before that. Even though the stay was lifted last December, the court made it

quite clear that it was -- really had the whole Proposition under review. For that purpose and reason, we could not actually get our appropriation and start our staffing until the court review was final and the ruling was final.

We have made a lot of preparations before that time. I'm prepared to tell you about many of the changes that we've made in the Department and some of the programs that we began to implement over the year, but we could not actually begin to significantly hire staff and buy equipment until very recently. That's just part of the question.

I don't think the Commissioner has precluded any further hearings. I think what she has done is to name the companies where she thinks there are the greatest possibilities for rollbacks to go after first.

CHAIRMAN ROBBINS: Which translated means when will there be a hearing on State Farm Insurance, which insures approximately 15 percent of the drivers in the State of California, and which is the largest insurance company in the United States, and which company has -- I will spare you the list -- but has violated several Department rules, including right after Proposition 103 passed requiring all new applicants who had perfect driving records to go into their substandard company designed for drivers with poor driving records. When will there be a hearing on State Farm?

MS. MATHIAS: I can't tell you that, Senator. All I'm saying is that she has not precluded calling other hearings. We're going to be beginning our hearings on the companies that she has listed on September 6th with Allstate. Beyond that, I can't tell you.

CHAIRMAN ROBBINS: Will there be a hearing on State Farm in 1989?

MS. MATHIAS: I can't tell you that.

CHAIRMAN ROBBINS: Will there be a hearing on State Farm by 1990?

MS. MATHIAS: I can't tell you that.

CHAIRMAN ROBBINS: Will there be a hearing on State Farm this century?

MS. MATHIAS: I wouldn't preclude the ultimate possibility that that might happen.

CHAIRMAN ROBBINS: I'm certainly encouraged by the aggressive attitude of the Department to wade right in and get the task done.

MS. MATHIAS: Well, I would like to remind you that the Department did take enforcement action against State Farm earlier on their unfairly discriminatory rating practices. The company did comply with our enforcement action and rescinded their action.

CHAIRMAN ROBBINS: The Department only took that action after it was pointed out to the Department by this committee that that was going on.

MS. MATHIAS: I think the Department was aware of it before you pointed it out, Senator, but we're not going to resolve that here. But I would like to correct the record.

CHAIRMAN ROBBINS: Comment? You've been uncharacteristically quiet so far today, Harvey.

MR. HARVEY ROSENFELD: Well, I'm stunned by the arrogance of the Insurance Commissioner who seems desperate to avoid public scrutiny, whether it be in the hearings and the process by which she has determined that so many companies would be exempted from the rollback,

and also from her obligation as a public official to come before this committee and before the public for the first time and explain herself. That is the source of my silence. I find it staggering that the Commissioner seems intent upon avoiding that public scrutiny that is so urgently needed here.

Let me talk a couple of -- say a couple of things about the points that the Deputy Commissioner just made.

First of all, the Supreme Court -- one of the big problems the Commissioner has created is her distortion, deliberate distortion of the Proposition and what the Supreme Court said about 103. We just heard it mentioned here again the court rewrote Prop. 103. In fact, the court upheld Prop. 103, including the rollback. It's an outrageous misrepresentation to suggest that the court is somehow responsible for the fact the Department of Insurance waited seven months before lifting a finger to implement all of the provisions of 103, most of which were in effect throughout that period of time. And it didn't take a lawyer to know from the court's decision, allowing most of 103 to go into effect, that there was really no hope, as the Commissioner apparently had, that all of 103 would be thrown out. And that the Commissioner should have been, and the Department should have been, moving forward to begin implementing the rollback hearings no matter what the ultimate disposition of the challenge was.

Second, and this gets back to the issue of those three companies. The people of California are not going to accept the statement that you cannot say whether there will be a hearing on State Farm in the next three years. I don't think that -- you can't possibly mean that in the arrogance in which it's coming across.

MS. MATHIAS: Mr. Rosenfield...

MR. ROSENFELD: Wait a second, I'm not finished. It is only because the Commissioner has not allowed us to challenge the phony formula she has come up with that permits the Commissioner to say that State Farm is not required to reduce its rates by 20 percent as Proposition 103 requires. If we were given the chance to argue with the Department and the Commissioner about the ridiculous way in which it has come up with these formulas, without taking into account all the factors that should be considered when determining a company's profitability, then that is why we are stuck in the position of having no hearing and no rollback for State Farm.

MS. MATHIAS: Number one, it is not true that the Department has not done anything to implement Prop. 103. We began before Prop. 103 was even passed on the ballot. The Commissioner asked the staff of the Department a year ago, when all the Propositions were on the ballot, to start looking at them, start estimating the kind of budget and staffing that we would need to implement any of these Propositions. So we began our plans months and months ago, and we would like to tell you about some of the programs we're doing, some of the consumer shopping guide service, some of the technological things that we're doing in the Department to try to make it possible to implement Proposition 103 aggressively for the people of California, to make us more efficient to enable us to handle the workflow better, to absorb more staff. But I don't know whether we'll have an opportunity to do that or not today. But it's absolutely untrue that she has done nothing and -- it's just not true.

CHAIRMAN ROBBINS: I would not be one to say that the Commissioner and the Department

have done nothing. They have certainly taken steps. The question is: Have the steps been sufficiently aggressive to implement the will of the people?

If you can't commit as to when you're going to have a hearing on State Farm and the other companies, what are the reasons that are precluding you from having that hearing? Is it a lack of staff? Can it be dealt with by more staff?

MS. MATHIAS: Senator, this is truly a question that you're going to have to ask the Commissioner. I am -- to answer...

CHAIRMAN ROBBINS: I know that! That's exactly why it was insisted upon the Commissioner be present and we let her pick the date. She doesn't come here, she sends you, and every time we ask a hard question, you have to ask the Commissioner.

MS. MATHIAS: Let me explain what we were talking about a minute ago. I can't tell you when we would have those hearings because I simply don't know. They have not been scheduled. And all I'm trying to convey is it is not precluded. We're not precluded from having a hearing simply because they haven't been scheduled at this time.

Now, as far as the staff goes, I think you are aware that we have had a budget increase of about 263 people that we will be able to hire as a result of that appropriation.

CHAIRMAN ROBBINS: And that budget increase was approved by the Budget Subcommittee I chair?

MS. MATHIAS: Yes.

CHAIRMAN ROBBINS: And we have told the Commissioner if that isn't enough staff let us know, we'll approve more.

MS. MATHIAS: Senator, I think you are aware of the fact that it takes time to train, number one, to start the testing process, to train, to hire, and we began that a long time ago. But we couldn't actually hire people until the budget was implemented.

We are doing continuing testing, continuous testing. We've hired over 90 people to get started on this. We are moving as fast as we can. The people in the Department have worked tirelessly, believe me, to implement this Proposition, and these gentlemen here are talented, experienced people that have really almost totally given up their personal lives for the last three or four months. We think we've accomplished a lot. We think that we're trying to do this as aggressively as possible. The Commissioner is totally committed to trying to implement this Proposition, and we would like to have that really known to the people of the state.

CHAIRMAN ROBBINS: You've hired 90 additional staff people?

MS. MATHIAS: Yes.

CHAIRMAN ROBBINS: You have authorization for 263 additional.

MS. MATHIAS: Yes. And we are continuously testing and trying to absorb these people. A number of these people, you know, from the rating groups and so on, are -- you can't hire -- or it's better to hire experienced people to do this, and we are trying to do that, and we will soon be bringing on some other people that can fill in the gaps.

CHAIRMAN ROBBINS: It's been five months since the Supreme Court ruled. It's been nine

months since you knew you were going to have to implement...

MS. MATHIAS: Yes, and we did some early testings, Senator, but we could not hire the people until we got the budget actually implemented. The funds weren't there.

CHAIRMAN ROBBINS: No, no. Wait a second. Jim, if I could have the transcript from our February 1st hearing?

This was when the Commissioner was present before the committee. "I have many times offered whatever help you need to get us additional staff in the legislative budget process. We're available to help." (That's the Chairman.) Commissioner Gillespie: "That's not a problem, Senator, and you know that's not a problem. We've always gotten staff we needed. We have doubled the Department of Insurance budget. Everyone has been right on board. It has not been an issue."

Under our legislative budget procedures, as we offered on the 1st of February, the Commissioner does not have to wait until the new budget year. The Commissioner was invited to and given the opportunity to request a budget augmentation to get the staff on board without waiting for the June 30th deadline. There is no conceivable justification as to why the Department hasn't hired not 90 people but all 263 people that have been authorized, and no reason why they didn't start that process in March, April, and May rather than apparently waiting until July 1st.

MS. MATHIAS: It's my understanding that we did start it earlier, Senator, and maybe, Milo, can you tell us what's gone on in your particular division, which I think is probably of most interest.

MR. MILO PEARSON: Senator, we created the Rate Regulation -- or the Commissioner did -- Rate Regulation Division in December/January. And that was going to be the primary vehicle to deal with prior approval coming in November of this year.

When the Supreme Court came down with its decision on May 3rd, we had to refocus a lot of internal work and individuals to dealing with the rate exemption rollbacks, of which we received approximately, as you know, 4,000 on June 3rd -- or by June 3rd.

We chose to take a two-pronged attack of this problem, if you will, and to address the rate rollback exemption problem with existing experienced staff, because we knew that we weren't going to be able to do the kind of review that we needed to do for those 450 companies and those 4,000 lines within a 60-day period of time, as outlined in Prop. 103. Yet, we have continued to do hiring of new people for November prior approval when it comes around. So we've basically got two programs working concurrently right now.

Now, with the rate exemption, a portion of it, that's a finite number, and we deal with it and regardless of the outcome, that's it. But come prior approval in November, of course, that's ongoing and we'll continue forever, as far as we're concerned.

So we feel as though we're pretty much right on time in terms of our staffing levels. We've taken our time a little bit, because we were interested because of the complexity of rate reviews, to hire more senior people initially, which we've done, and we will have three separate bureaus that will deal specifically and solely with the prior approval issue. And it's taken us some time to find bureau chiefs, people at the bureau chief level, and the senior insurance rate analyst level with the kind of experience that we're looking for.

We currently now have a list of 60 to 80 people that have gone through the interview process, that have gone through our oral examinations that are now on our list that we will be prepared to hire during the month of September, and those people will receive some fairly extensive training over the next month or two in order to get ready for November.

So we, as I've said, feel pretty good about prior approval, and we've already basically gone through most of our process on the rate exemptions themselves.

MS. MATHIAS: Do you want to address it as from the aspect of the hearing...

CHAIRMAN ROBBINS: Well, let me follow up. Wouldn't you be in a better position if you -- there are 173 vacant positions, correct?

MR. PEARSON: That's correct.

CHAIRMAN ROBBINS: Okay. Wouldn't you be in a better position in getting through these applications if those positions were filled?

MR. PEARSON: The rate exemption applications or the prior approval?

CHAIRMAN ROBBINS: Both sets.

MR. PEARSON: Well, no. We didn't think so. The people that we needed for the rate exemption applications really are a little bit different than I think we need for prior approval, which is much more of a rate analysis of a company's request for an increase, or whatever.

The rate exemption applications, we were looking for somebody that -- or people that not only understood how an insurance company rated their products but also with a little bit of a financial background so they could understand things such as rate of return, etc., etc., etc. And we did not think that we would be able to hire quickly enough at that time to deal with the rate exemption issue, but we did know that we had some good people internally that we could redirect, or rechannel. And those are the resources we used for the rate exemption filings. Then once the rate exemption filings have been settled, they'll go back to their normal assigned task.

CHAIRMAN ROBBINS: So you don't intend to fill the 173 vacant positions?

MR. PEARSON: Absolutely, and we're currently doing that now. But those 173 people are for the prior approval function which begins in November of this year. And we're also dealing with now, you know, changes that we're receiving from insurance companies between now and November.

CHAIRMAN ROBBINS: So when State Farm comes in for their -- so you're going to require State Farm to go through a prior approval process before November 8th?

MR. PEARSON: No. Maybe we're not talking about the same thing, Senator. The exemptions in June that we received primarily was the companies, or the industry's response to justify the fact that they didn't feel that they needed to roll back their rates, as outlined in Prop. 103. Prior approval is really a separate ongoing issue.

CHAIRMAN ROBBINS: Have you ever met an insurance company that agreed that it should roll back its rates?

MR. PEARSON: No.

CHAIRMAN ROBBINS: I don't think you will.

MR. PEARSON: Well, we treated them -- we have treated them as separate issues and have

directed our staffing efforts as such as well.

MR. COLLIS: Mr. Chairman? I wonder if you might ask the follow-up question to the Department. What exactly is the legal justification for a delay in State Farm? Just to review this for a second, the language of Prop. 103 says there will be an "immediate rollback" of 20 percent beyond the 1987 rates. Interveners have gone in and looked at State Farm and found that they hadn't proven they were entitled to any exemption from the full 20 percent rollback, and in response to that, your statement today has been that you wouldn't, and I quote, "preclude a hearing this century on State Farm." What exactly is the legal justification for a delay in the State Farm hearing?

MS. MATHIAS: Reid, do you want to...?

MR. McCLARAN: Well, that question included a number of different questions, but first of all, I would comment that while Prop. 103 did say that companies would immediately roll their rates back, the Supreme Court said that companies would immediately roll their rates back unless they filed with us an application for some other rate level, and in State Farm's case, of course, they did exactly that, as did virtually every insurance company operating in California.

The Supreme Court said that what we would have is a use and file system. They specifically said that, and that's exactly what State Farm and all of these other companies did. The Supreme Court also said, however, that if eventually the Department were to order rollbacks, and the Supreme Court said if any rollbacks, that the companies would be ordered to make them retroactively, refunds, including interest.

And with regard -- I don't recall the Assistant Commissioner saying that, as you quoted, that we would have a hearing some time this century. I think that that was a combination of a number of comments that you attributed to her.

CHAIRMAN ROBBINS: Okay. Are you prepared to then tell us, if it's not going to be within the century, by when will there be a hearing on State Farm's rates?

MR. McCLARAN: Well, as you know, Senator, State Farm Fire & Casualty, a State Farm company which is also very large -- not as large as the Mutual -- is scheduled for hearing, I believe, some time during September. So a specific answer to your question would be that we have a State Farm hearing coming up. I believe, however, you are...

CHAIRMAN ROBBINS: Great. But State Farm Fire & Casualty deals with the substandard risk. State Farm Mutual is the company that has all of the drivers that would qualify for the good driver discount.

MR. McCLARAN: And is much larger than the Fire & Casualty company, that's correct.

CHAIRMAN ROBBINS: Yes. When are you going to be hearing on State Farm Mutual?

MR. McCLARAN: I can't add anything to what Assistant Commissioner Mathias has already said.

MS. MATHIAS: There is no hearing date set for it, Senator, and beyond that, we can't tell you.

MR. ROSENFELD: Mr. Chairman? I neglected to say this before. We have prepared a summary of 22 defects, errors, omissions, and indications of bias in the Commissioner's actions. I have submitted it to the committee. I'd like it to be on the record. And I would ask, in the interest



of actually getting to the bottom of this sordid situation, that the committee ask the representatives of the Department to forward these charges to the Commissioner, and perhaps the Department and the Commissioner could respond to them at the next hearing, since I believe that they encompass all of the various problems we have detected and become very concerned about over the last 6 to 8 weeks. And if we could get a written response before the hearing, so that we then would proceed to the next hearing, with the Commissioner hopefully, in some sense of what they have in mind.

CHAIRMAN ROBBINS: Okay. I presume they have a copy of it. I have not had a chance to review it because I just received it myself. Obviously to the extent that -- when we have the next hearing, to the extent that the Commissioner's able to bring written material in advance that is helpful to everyone in the process, but I will review your material, and to the extent that there are particular questions that I feel need to be responded to in advance I will make that request of the Department.

MR. ROSENFELD: I have one other question.

CHAIRMAN ROBBINS: Sometimes your questions do get a bit on the aggressive side. If we could get the Department as aggressive in pursuing the insurance companies, as Voter Revolt is in questioning the Department, then perhaps we could get this rate process resolved.

MR. ROSENFELD: Could I raise one other question? The Assistant Commissioner said that the Department had divided itself up into two -- essentially two forces: an advocacy force -- a prosecutorial force, and the judges, which is exactly how a lot of administrative agencies run, the Public Utilities Commission being one example. When the Commissioner arrives at these decisions in advance of hearings, is she acting as a judge or as an advocate? And then if she's acting as an advocate in arriving at these decisions before the hearings, who's going to make the final decision after those hearings?

MS. MATHIAS: Reid, why don't you -- since it's your area, you can expound on it.

MR. McCLARAN: Well, this is actually a good question Mr. Rosenfield has raised.

MR. ROSENFELD: Thank you.

MR. McCLARAN: You're welcome. Has raised one of the difficult areas of acting as an administrator. The fact is that -- and the Commissioner has full authority for running the Department of Insurance and for directing its activities, and additionally, as imposed by Prop. 103, the responsibility to make final decisions with regard to these rate cases. What the Commissioner has done is delegate those tasks, as the Assistant Commissioner has suggested, to separate units within the Department. The Administrative Law Bureau, which contains the Department's administrative law judges, is totally separate and apart from my unit, which is the prosecutorial unit of attorneys.

The Commissioner has made no decisions. The Commissioner will make the decision based upon the record as she is required to do by Proposition 103. The Commissioner, however, did need to direct the Department employees, the staff, in reaching its determinations as to which companies would be called to hearing.

The 11.2 percent, as all other aspects of the Department's notices of hearing against these

companies, is not a final order. It is simply the Department's opening position and what we are charging the companies with. As you know, a number of consumer groups, including, I understand, Ralph Nader has said that the rate of return should be considerably higher than 11.2 and has said 13, 14, or 15 percent. We have taken a very low approach. We understand that the companies will come in with a higher, and in some cases perhaps a much higher number, and it will be up to initially the administrative law judges, who are independent of us, to reach a determination, and ultimately to the Commissioner, to review those decisions, and based upon a review of the record to reach a final determination.

CHAIRMAN ROBBINS: Let me just ask one or two more questions on the State Farm situation, then I'll want to move on to some of the other aspects.

The Commissioner scheduled a hearing on State Farm's 9.6 percent rate increase in March. That was held in San Francisco. I requested to be an intervener and was allowed to intervene and participate in that hearing. Am I correct that since no action has been taken on State Farm Mutual, since no hearings have been scheduled on State Farm Mutual, that State Farm is still collecting that 9.6 rate increase?

MR. PEARSON: As far as I know, Senator, yes, that's true.

CHAIRMAN ROBBINS: Okay. In March the Department held a hearing on whether or not that rate increase was a rate increase that was permissible, reasonable. The findings, to the best of my knowledge, the Department has yet to release findings from that hearing. Has something been released that I'm not aware of?

MS. MATHIAS: Not that I know of. It's my understanding that that has all been folded in. Is that correct?

MR. McCLARAN: My understanding is that the Commissioner determined that that investigatory hearing into that rate increase was rendered moot by the issuance of the Supreme Court's decision in the Cal Farm case.

CHAIRMAN ROBBINS: So it's now been folded in to the rate hearing on State Farm which hasn't been scheduled. Is that -- I mean, I don't want to put words in anyone's mouth.

MS. MATHIAS: I was asking a question, Senator. I was not making a statement at that point in time. I was asking Mr. McClaran if he had any insight into that. That hearing, as you know, was held under prior law under our Bulletin 88-6 that was under law that was enacted before Proposition 103. It was an investigatory hearing held under procedures, under prior law, not under Proposition 103. We were challenged on those procedures and taken to court. The court ruled in our favor, and that's as much as I can tell you right now.

CHAIRMAN ROBBINS: Okay. Well, we'll treat your comment as a question. Would you say her question is -- the answer to her question has been folded in to the rate hearing on State Farm Mutual? What is the answer to her question? Has it been folded in?

MR. McCLARAN: Well, if the -- as Mr. Pearson says, if the 9.6 percent increase is still in effect, and I have no reason to think that it's not, then those rates were considered in the Department's review of State Farm's final rate of return.

Now, with regard to State Farm Fire & Casualty, which also took that 9.6 or 9.8 percent increase in January, that obviously is a part of the hearing that will take place in September. With regard to the Mutual, I assume that that increase was reflected in the final rate of return that the Department's calculation showed did not come anywhere near 11.2 percent. It was much lower than that, even with that increase.

CHAIRMAN ROBBINS: But am I correct that then there was -- that when that exemption, which is -- essentially the exemption therefore froze the 9.6 increase, correct?

MR. McCLARAN: Well, State Farm Mutual...

CHAIRMAN ROBBINS: It left it in place.

MR. McCLARAN: ...has not been exempted, but unless a hearing is held with regard to State Farm Mutual, then yes, they will presumably retain that increase, but that is an if. There has been no exemption of State Farm Mutual, as you know.

CHAIRMAN ROBBINS: But there was no public hearing in conjunction with the decision to take no action and to allow them to continue to collect it.

MR. McCLARAN: Well, the Department hasn't determined not to take action with regard to State Farm Mutual. As we've said, I can't tell you whether a hearing will be set or not, or if so when, but I can tell you that we have not decided that we will not hold a hearing with regard to State Farm Mutual, as I believe Ms. Mathias told you as well.

CHAIRMAN ROBBINS: I have to be honest, one could come to the conclusion that the Department is not being very clear on the question of whether it's going to do anything, or if it's going to do anything when it's going to do it; or when it will decide to tell us that it is or is not going to do what it may or may not do if it is or is not going to do something.

MR. McCLARAN: I appreciate that, Senator. Maybe I can put it -- I don't think we're going to satisfy you with this, but perhaps I can put it this way. State Farm Mutual has not been exempted from the rate rollback. The Department, as far as I know -- I can just tell you what I know -- I do not know that any date has been set for a hearing on State Farm Mutual, and I do not know if a date will be set. I don't know.

CHAIRMAN ROBBINS: Well, you're not alone on the list of people in the Department who fall into that category.

MR. COLLIS: Mr. Chairman, the Commissioner announced that because the Attorney General and myself on behalf of the Intervention Team had filed for a hearing against State Farm, and it filed to intervene in that hearing, she announced that although she did not believe that they ought to be subject to any of the mandatory rollback, there nevertheless would be a hearing; and she created what she called a "slow-track process" which she said could take as much as ten years to be heard, and that was repeated today. So the Commissioner has said that there will be a hearing on all aspects of State Farm. Was her statement correct or was it not?

MR. McCLARAN: I don't recall her making that exact statement. However, I will tell you this, that I do know that both you and the Attorney General have requested a hearing with regard to State Farm Mutual, and that the Commissioner will have to act on that petition. I do not believe that she's

acted on it yet because I don't think that State Farm Mutual has yet filed with us their required response to either of those petitions. Once the petitions -- or the answers are in, presumably the Commissioner will rule, and if she determines to hold a hearing, then the date would be set, presumably.

CHAIRMAN ROBBINS: You don't believe she has, Reid? Wouldn't it be an accurate statement she hasn't?

MR. McCLARAN: Well, as far as I know, she has not. But let me say this, that the regulations governing these petitions require that a company for whom a petition of hearing has been filed with us file a response with us; and certainly, it would be inappropriate for the Commissioner to rule on a petition before the required answer from the respondent or the insurer is received.

CHAIRMAN ROBBINS: It didn't stop the Commissioner from putting some of these companies on the "slow-track process" before she had given the consumer groups an opportunity to appear on the subject.

MR. McCLARAN: Well, those are all companies for whom responses should be filed, and the responses will be due within a couple of weeks, finally depending on whether they're out of state or not. At that point, I assume the Commissioner will rule on each of the petitions.

CHAIRMAN ROBBINS: Okay, we're moving slowly through this, and I realize it's difficult on the staff members who are here without the captain of the ship to tell us where this ship is going. Why don't we -- we've been going for a little bit over an hour. Why don't we take -- give everybody a five-minute recess. We will then resume and finish our hearing by 11 a.m.

(BREAK)

CHAIRMAN ROBBINS: We will continue to try to cover as much ground as we can. During the recess, Mr. Collis called my attention to Section 1861.05(C) of Proposition 103 -- he appears to have memorized every section of it -- which provides that "the Commissioner shall notify the public of any application by insurer for a rate change. The application shall be deemed approved 60 days after public notice unless" -- and then it goes down three -- "the proposed rate adjustment exceeds 7 percent of the then applicable rate for personalized, or 15 percent for commercialized, in which case the Commissioner must hold a hearing upon a timely request."

Since the 7 percent standard would apply against the Prop. 103 amount, which is the rollback amount, obviously the State Farm rates substantially exceed that. The Supreme Court has not invalidated this section. Would the Department disagree with the apparent legal requirement that the Commissioner is, presuming we would qualify the request as timely, required to hold a hearing, that it's not a discretionary matter, that it is required to hold a hearing under Prop. 103?

MR. McCLARAN: Senator, as I think I said in the first session, the Department agrees with that analysis. However, prior to receiving the answers to these petitions, it would be premature for the Commissioner to actually rule that that analysis is correct.

In the answers that we've received thus far, I have seen at least some companies that are arguing that they haven't increased their rates at all. They haven't increased their rates 7 percent and they haven't increased them 15 percent. They are using their existing rates. It's not an increase.

Now, the Department disagrees with that and agrees with Mr. Collis' interpretation of that session, but until the answers are received -- the Commissioner of course has to consider the answers to the petitions in conjunction with her determination as to whether there should be a hearing -- she won't make that determination. That is my belief. I think that's correct.

CHAIRMAN ROBBINS: Why? I mean, the law says the Commissioner must hold a hearing, if requested. You acknowledged that a request has been made...

MR. McCLARAN: Mm hmm, and it was timely.

CHAIRMAN ROBBINS: The law doesn't say that you have to ask State Farm's permission first. That'd be standard Department practice, but it's not what the law says.

MR. McCLARAN: Well, Senator, the companies -- as I say, the ones that I have reviewed, and I've seen only a few of these answers, are arguing that -- they have a factual argument with that. They say that there is no increase and therefore it falls under 1865 -- or 1861.05(A), or I guess (C)(1) -- anyway, under 7 or 15 percent increase. As I say, I disagree with their view and I agree with both your position and that of Mr. Collis. The Commissioner will rule on the petitions when the answers are received.

MR. COLLIS: But how tough could it possibly be to figure out that people's premiums have been increased? There's obviously been an increase. I mean, it's there in black and white. What argument can the companies possibly give against that? Beyond that, since you have agreed with my position, why put State Farm Mutual and the two other major companies on the so-called slow-track that the Commissioner has said, and it's been repeated today, may take as much as ten years to be heard? Why not have a hearing on those companies?

MR. McCLARAN: Senator, would you like me to respond directly to Mr. Collis? I'd be happy to.

CHAIRMAN ROBBINS: Sure. But I'd like as much as possible for the rest of our time to...

MR. McCLARAN: Or I'd be happy not to, if you prefer.

CHAIRMAN ROBBINS: I think it would expedite things in this particular case to respond.

MR. COLLIS: I apologize for losing my temper, Mr. Chairman.

CHAIRMAN ROBBINS: I didn't know you had one.

MR. McCLARAN: Frankly, I'm sorry, Conway, but I've lost the train of the question. Could you restate it?

CHAIRMAN ROBBINS: Let me move it along into another area because I want to try to get into as many of these areas as we can in the time that we have this morning.

By announcing essentially an 11.2 percent guaranteed rate of return for the insurance companies, you create a situation where a company that has been highly inefficient, that has overpaid its executives, that has spent excessive amounts of money on entertainment, advertising, promotion, political contributions would be rewarded for their inefficiency by being allowed to charge a higher rate for the same insurance policy as a company that has been highly efficient. How do you justify that?

MS. MATHIAS: I don't think that's going to be the eventual outcome of these hearings, Senator.

I think that, as I've explained before, one of the reasons that the Commissioner selected these initial companies to go to hearing is because they are efficient companies. She will be looking at those companies in order to set guidelines and standards which should set high standards for the other companies.

The 11.2 figure, I think we've tried to explain to you, is simply a threshold tool. It's not necessarily a figure that is guaranteed to these companies. It's a threshold tool for the Department, and Mr. McClaran has explained that all the issues will be raised at these hearings. The interveners can come in and advise us that they think another standard is appropriate. The insurers will come in and give their best case for the standard that they think is appropriate, and the Commissioner ultimately will review all the record and make her decision. It is her intent to have these guidelines reward efficient companies.

And I would like to correct you, as far as I know she has said that political contributions won't be part of the record.

Maybe somebody else would like to amplify on that. Is there any other comments?

CHAIRMAN ROBBINS: They don't seem to be rushing to jump in. So political contributions will not be allowed -- considered allowable expenses?

MS. MATHIAS: That's my understanding.

CHAIRMAN ROBBINS: So do I take what you've just said to indicate that the Department is moving in the direction of requiring the companies that have been inefficient and overpriced to reduce their premium levels to that of the level that's going to be allowed for the companies that have been efficient?

MS. MATHIAS: I think her intent is through the guidelines that will be issued to move in that direction -- that will be issued in the future -- through the evolutionary process of these hearings.

CHAIRMAN ROBBINS: But these are...

MS. MATHIAS: Are you asking me for the purpose of this hearing, each individual hearing that's coming up?

CHAIRMAN ROBBINS: Well, has the basic policy decision been made, and if so, what is it?

MS. MATHIAS: I'm not sure I understand your question. On rewarding efficient insurers or not rewarding inefficiency?

CHAIRMAN ROBBINS: Okay. The Commissioner is going to start out by looking at the efficient companies first. That's the Department policy, right?

MS. MATHIAS: That is -- yes, the Commissioner has expressed that.

CHAIRMAN ROBBINS: The Commissioner is moving toward allowing those companies 11.2 percent rate of return.

MS. MATHIAS: She has used -- indicated to the staff, as Mr. McClaran said, that that is the bench mark the staff can use for rate review purposes and for the prosecutorial role of the Department.

CHAIRMAN ROBBINS: So we would call it a tentative rate of return?

MS. MATHIAS: I think that's appropriate.

CHAIRMAN ROBBINS: Okay. Now, she has then delayed hearings on the inefficient companies, the companies that have been, by comparison, relatively overpriced in terms of rate of return.

MS. MATHIAS: I don't know that's an exact equivocal statement, but I can tell you that she has tried to take the companies first that she considers the most profitable, the most inefficient, the companies that have the greatest possibilities for rollbacks, and intends to use those companies to generate the greatest possibilities for the rollbacks, and to develop guidelines and standards that will then be applied to other companies at future hearings.

CHAIRMAN ROBBINS: Okay. So she's going to start with the inefficient companies.

MS. MATHIAS: No. I think I just said...

CHAIRMAN ROBBINS: She's going to start with whoever strikes her whim on a given day?

MS. MATHIAS: The most profitable and efficient companies is what she has indicated, where the greatest possibility for rollbacks now are.

CHAIRMAN ROBBINS: Okay. That's what I thought when we started this. So she's going to start with the most profitable and most efficient companies.

MS. MATHIAS: That's what she's indicated.

CHAIRMAN ROBBINS. Okay. And is working -- allowing those companies a tentative 11.2 percent rate of return.

MS. MATHIAS: The 11.2 is the threshold that she has given the staff to use in the prosecutorial role.

CHAIRMAN ROBBINS: Okay.

MR. ROSENFELD: Mr. Chairman?

CHAIRMAN ROBBINS: Let me pursue this for just a second.

MR. NORRIS CLARK: One of the points is the -- I think what the Commissioner has said is the inefficient writers -- just as a broad brush definition -- have not exhibited in their filings an 11.2 percent rate of return. They have rates of return negative or substantially and substantially below 11.2. In order to come up with guidelines in the future as to what expense levels should be appropriate, we would like to review the efficient writers in their expense levels in what they justify in the hearing process in order to then look at expenses of the inefficient.

Right now the inefficient writers do not have an 11.2 percent rate of return. So to schedule a hearing on them would be simply on their expenses in trying to determine if they're charging too much, passing on too much of their other than loss costs.

It explains it, but let's say a company that's scheduled for a hearing, 20th Century. They have underwriting expenses approximately 10 percent. That doesn't necessarily mean that every company that writes automobile insurance in California can operate at a 10 percent underwriting expense ratio. And in the process of evaluating the initial rollback applications, the Department did not arbitrarily level expenses and say anybody that had a 15 percent underwriting expense should have been 10 percent and lop off 5 percent off of the premium immediately. That's a process and the guidelines will be developed in the course of the initial rate hearing.

CHAIRMAN ROBBINS: But you're going to develop the guidelines. Instead of issuing written guidelines prior to the rulings, what you're going to do is develop the guidelines after you go -- as you go along. So that when you finish the hearings, after you've authorized the insurance companies to charge a set of rates, then you will issue a set of guidelines. Is that a fair statement of what you're telling me?

MR. CLARK: I don't believe the companies that were initially not scheduled for hearing might not in the future on this slow-track process be required to justify their expenses and pay refunds at some point in time.

CHAIRMAN ROBBINS: What is the Department policy? In other words, once the Department determines that for an individual who falls into a given category -- certain driving record, certain number of years of experience, criteria set forth -- that for that individual, that the first company you hear, which is a very efficient company, is authorized to charge that individual for a given category of insurance \$596. Then when you get around to the slow-track at an undefined time, which I've already been told the Department won't commit will be in 1989, the Department won't commit to hold the hearing in 1990, I'm told that the Department probably will commit to hold it this century, that when you hold that hearing you're going to have before you a company that says no, based on the way we've operated in the past, we can't sell that policy for \$596 because instead of spending 10 percent on administration we spend 26 percent on administration, and we pay our executive officials large, six-figure salaries, because when you're an inefficient company it's hard to get qualified help so you have to pay them more. What's the Department policy going to be? Are you going to allow that other company that comes in that's been less efficient to receive a higher premium for the identical policy? Or are you going to hold them to the standard of saying we allowed these other three companies \$596 in premiums, we're going to require you to make your company more efficient and sell the identical policy for the same amount that we've authorized 20th Century to sell it for?

MR. CLARK: Presumably it could go either way. I mean, the company...

CHAIRMAN ROBBINS: That I figured out.

MR. CLARK: The company is going to have the burden to justify their expense levels in any rate filing on a prospective basis.

MR. ROSENFELD: Mr. Chairman?

CHAIRMAN ROBBINS: Harvey?

MR. ROSENFELD: I have two points. One is that we're now -- the Department has created a new concept in law. It's called the evolving guideline. The problem is, what about the 184 companies that received the exemption under the unevolved guideline and are not going to have hearings? When do we get to, if ever, put the evolved guideline upon them?

The second question I have is that the Commissioner is acting like a prosecutor, apparently. Here we have these insurance companies that have committed grand larceny, but the Insurance Commissioner is charging them with jaywalking, and we the victims can come in and protest that but the Commissioner, who is the prosecutor, also happens to be the judge. So I don't think the process



that's laid out works. I don't see how lawfully -- where is the legality in that process?

CHAIRMAN ROBBINS: We'll deal with that as a comment and rhetorical question. If the Department has a comment, please feel free. If someone in the Department has a comment, please feel free to take a mike and make it.

MR. McCLARAN: I can respond, at the risk of using up some more of our shrinking amount of time.

CHAIRMAN ROBBINS: With brevity.

MR. McCLARAN: I'll attempt. The Commissioner is, as Mr. Rosenfield no doubt knows, is in charge of the Department of Insurance and is responsible for directing the activities of the Department of Insurance. As such, the Commissioner directs me and directs the attorneys who represent the Department in these rate hearings, and she has given us the standards, our internal standards, with which we will look at these companies for our own purposes, as opposed to whatever purposes the interveners may want to request hearings.

The Commissioner is also, under Prop. 103, as I said earlier, responsible for making the final decisions in these rate cases. It is a difficult situation in that she does have two roles. However, the Department has endeavored to keep the two roles as separate as we possibly can in order to maintain the due process that the insurers and other participants in these proceedings are entitled to.

CHAIRMAN ROBBINS: Let me move on to a subject that the Department doesn't like to discuss, particularly in Los Angeles, territorial rating. The Department's had a series of hearings on the question of how to deal in particular with the question of territorial rating. Proposition 103 provides for a series of rating factors to be the primary factors: driving record, experience, number of miles driven, and territorial rating is not on that list as one of the primary factors. The Department has had a series of hearings that began with "Good morning, San Diego, Good morning, Los Angeles, Good morning, Fresno", and the gist of what the Commissioner had to say was that if it was implemented without having territorial rating that rates would go up in 55 of the 58 counties.

What is the Department going to do on the subject? What has the Department concluded after the series of hearings that were held?

MR. McCLARAN: The Department has concluded that it will write its regulations, which will be issued within the next couple of weeks, and that's really all I can say. We do not have those regulations prepared yet and I'm really not able to say what will be contained in them.

CHAIRMAN ROBBINS: But the Department will issue them within two weeks.

MR. McCLARAN: That is the Department's intent, yes.

MR. COLLIS: These regulations are emergency regulations or draft regulations what's going to be issued?

MR. McCLARAN: The Department anticipates within approximately two weeks, give or take, issuing its regulations with regard to the driver rating methodology and good driver discount policies.

MR. COLLIS: Well, are these draft regulations that will be subject to hearings? Because if not, upon what data and information is the Department going to base those regulations?

MR. McCLARAN: Well, I think you're assuming that there are going to be factors contained in

the regulations which require data. I think you'll have to wait and see what the regulations say.

CHAIRMAN ROBBINS: Okay. That gives us a timetable. We have a date that we can look forward to.

MR. McCLARAN: That's an approximate timetable, Senator, but it should be pretty close, yes.

CHAIRMAN ROBBINS: I've come to understand through all these hearings that all of the timetables we're given are approximate timetables.

Let me ask in terms of the process, Proposition 103 prohibits private meetings relating to rate regulation applications with insurance companies. There was a report of a private meeting that took place early on in the process with State Farm officials. What is the Department policy in terms of private meetings with insurance companies on rate applications? Is the prohibition in Prop. 103 being conformed to? Are meetings taking place? What is the Department policy?

MR. McCLARAN: The area of ex parte communications in these rate hearings is a difficult one, as Mr. Rosenfield I think has pointed out, or at least for the same reasons that he's pointed out, and that is because of the Commissioner's dual role. The Commissioner is a decision maker. The Commissioner is also -- or the Department is also a party in these hearings.

I understand the Department's process to be -- or the Department's position with regard to ex parte communications to be that the Commissioner, the administrative law judge, anyone else involved in the decision-making aspect of the Department's responsibilities does not have any ex parte communications with insurers, interveners, or any other parties to the actions.

The Department's role, which my staff is responsible for of being a party, of being one of the participants in these hearings, however, is a little bit different. And it's my feeling that my attorneys can deal with other parties -- could deal with Mr. Collis, for instance, could also deal with the insurers, Consumers Union, whoever has intervened in the process -- the same as any other party.

In other words, we are a party in the proceeding distinct from the Commissioner, the administrative law judge, and whatever other Department people may be involved in that chain of decision making. Those people are kept isolated from it. We, though, as a party, do feel that it's appropriate for us to speak with any of the other parties, but not with the judge.

CHAIRMAN ROBBINS: Therefore, the Commissioner does not engage in private meetings with the insurance companies on the subject of rate regulations.

MR. McCLARAN: I have no idea. I've told you what I understand the Department's position to be. That's really all I can say.

CHAIRMAN ROBBINS: Is the Department's position that since the Commissioner is the ultimate judge that the Commissioner will not engage in private meetings with insurance companies?

MR. McCLARAN: Well, the Commissioner may engage in meetings with whoever she wants, but with regard to matters specifically before her in a rate hearing, I think that she would not do that. Certainly she could meet with them for other purposes though, I would think.

CHAIRMAN ROBBINS: Mr. Collis?

MR. COLLIS: Has the Department retained either Price Waterhouse or SRI to advise them with regard to the adjudicatory proceedings on the rollbacks now before it?

MR. McCLARAN: Senator, again, I'd be happy to respond.

CHAIRMAN ROBBINS: I think it would move along quicker if you either phrase what you've to say by commenting on what the Department has said, or phrase it as your opinion on it, which...

MR. COLLIS: I apologize. Mr. Chairman, I think there's considerable consumer concern that Price Waterhouse and Stanford Research Institute have both been retained by the Department to advise them on the rollbacks, the adjudicatory proceedings on one hand, and the rate regulation on the other. There are a range of consumer allegations that both of those companies have considerable insurance industry clients.

If that's the case, the Department would be in the position of not only breaching the prohibitions against ex parte contact, but going so far as to have the very same consulting firms that are representing insurers actually advising the Insurance Commissioner as to how to resolve the issues resolving those insurers.

That issue has been particularly raised because we filed a Public Records Request with the Department to ask about other clients of those two consultants, and the Department wrote back saying that any information they had in their possession that spoke to this issue was subject to the attorney-client privilege and thus not disclosable. I wonder if there might be some comment on that from the Department.

CHAIRMAN ROBBINS: Well, let me -- essentially what Mr. Collis is saying is that there's the appearance that you've hired the fox to go check out the chickens. And to put it in quick summary, with respect to your consultants, in particular Price Waterhouse and SRI, do they do work for insurance companies as clients, and if so, what is the annual dollar amount that they receive in fees from insurance companies?

MR. McCLARAN: Well, Senator, I don't know by whom Price Waterhouse is employed other than by the Department, but I can tell you that Price Waterhouse's efforts on behalf of the Department, to my knowledge, have been entirely in setting up the Department's systems for the review of these rate applications. They've done a massive computer office automation feasibility report for the Department that you may be familiar with, and has also developed a tracking system in other various systems type of work for us. I am not aware that they have been involved in any decisions with regard to any specific companies or really any other substantive decisions at all, to my knowledge.

CHAIRMAN ROBBINS: But in terms of setting up the systems, if there's a large volume of fees that they receive each year from insurance companies, might they be hesitant to set up a system that would be as tough on the insurance companies as some of us might like?

MR. McCLARAN: Well, maybe I didn't make myself clear. They've figured out what kind of computers we need on our desk, and they've set up a system whereby we can keep track of our files. I mean, that's the sort of thing they've done for us.

CHAIRMAN ROBBINS: Then let's talk about SRI.

MR. McCLARAN: Same question, I assume?

CHAIRMAN ROBBINS: Same question. Are you aware of -- do you know what their annual fee

volume from insurance companies is?

MR. McCLARAN: Again, I don't. I'm not -- I wasn't the one that hired either of these outfits.

CHAIRMAN ROBBINS: And I presume no one else here was the one who hired them?

MR. McCLARAN: I think that's correct.

CHAIRMAN ROBBINS: I presumed as much.

MR. McCLARAN: And so I don't know. Again, SRI, while they weren't doing just systems work as Price Waterhouse was, basically was employed as a consultant who helped the Department to formulate its own processes for these matters. But in direct answer to your question, I don't know. We could certainly find out.

CHAIRMAN ROBBINS: Okay. Does anyone else know anything about how they were hired or what their annual dollar volume of fees from insurance companies are?

It makes it a little bit hard to sift through facts without having them all there, but let me try another area.

The consumer corporation that was provided in Prop. 103 was eliminated by the Supreme Court because you cannot legally create a corporate entity in an initiative. That has left the consumer groups to try to fend for themselves, and Voter Revolt and Consumers Union and some of the other groups have stepped in without having the funding mechanism provided under the Proposition. That makes their task a little more difficult.

It has been their position, and I tend to agree with them, that insurance companies have not been as forthcoming in providing them useful data as they should be; and in fact, in most cases have provided them very little data or no data. The Department has basically said yes, they should provide the data. The question is: What is the Department doing to enforce getting the consumer organizations the data and information they need from the insurance companies?

MR. McCLARAN: Mr. Collis' group requested, I guess along with Voter Revolt, requested some information based on an actuarial study done by a Mr. Van Slyke. We received that and immediately forwarded it on to the companies that had participated in -- this was with regard to the rating methodology hearings -- we forwarded it on. We heard at the hearings, however, that Mr. Collis and others felt that insufficient information had been provided.

We followed up at the end of that week, which is the week before last, with a further order to the insurers involved that they provide the information, and the response time for that, as I recall, they have another few days, and I don't know what kind of response the consumers have received.

CHAIRMAN ROBBINS: Well, let's see. Harvey, Conway, the Department doesn't know what kind of response -- they want to help you -- they don't know what kind of response you've received. Tell them.

MR. COLLIS: Mr. Chairman, first of all, without that information, which is the only information on the public record at all with regard to rating factors and the weights for those factors, is the information requested by Voter Revolt and the Intervention Team and all of the consumer groups in the state, and the analysis of that information, what little there was, that was prepared by the statistician that we employed, the major conclusion was that it's not possible to go

forward without more information from the companies.

In light of that, I wonder how in the world the Department can issue regulations in the next two weeks without that further information having been provided and analyzed.

A further question, though, along that line, is that we have not received a copy of the further order to the companies that we'd like to so that we can see what it contains.

CHAIRMAN ROBBINS: Okay. The question was that the -- the statement part of it was that they were not aware of what information you've received. Have you received the information you need? If not, what information haven't you received, specifically?

MR. COLLINS: No, we haven't received the information that we need, and all the information that we have received has also been received by the Department. The Department order to the companies was to provide the information to us with a copy to the Department, so the Department has received everything beyond that.

In my testimony during the hearings of two weeks ago, we provided not only summaries of that information but also the analysis of it by the statistician that we hired. So the Department knows what information has been received and the analysis that's been done of it.

Again, first of all, it showed that we just need more information before the Department can go forward with any kinds of emergency regulations. And it also shows, Mr. Chairman, and I think this will be important to you, that the Department went around the state talking about the impact of territory, and yet, the information that we had, which is the only information on the public record, showed that in fact -- or suggested that in fact territory has far less importance than the factors that 103 requires be used -- driver safety record, miles driven, and years of experience.

CHAIRMAN ROBBINS: Okay. Why don't you provide, so there's no question about what's needed, provide the Department with a current -- in writing -- with a current update of what you need, what's missing of those companies that have not responded at all, and those companies that have partly responded that additional information is needed on.

MR. COLLIS: Sure. Mr. Chairman, is it possible that -- Mr. McClaran has indicated that there has been a further -- did I understand that correctly, that the Department has ordered further documents and data from the companies?

MR. McCLARAN: Yes. As I told you, I think a week ago Friday the Department has asked the same companies to, if they haven't already done so, provide whatever information they've got to you. I've been back in my office only for I think one day since then and I may have copies of responses and I may not. I don't know.

MR. COLLIS: If we could also have a copy of the Department's order.

MR. McCLARAN: I thought you had one, and we'll be happy to provide it.

CHAIRMAN ROBBINS: Okay, they'll get you a copy of the order, you'll get them a written communication of what you still need. Hopefully, that intercourse will result in further clarification.

I think this is a good point to start moving toward summarization of where we are this morning, because I did promise everyone by 11 a.m. we would have everybody out of here.

I think what I'd like to do is give the Department two minutes to summarize where they feel we

are today and what we've covered. I have to be candid, I don't think we've been able to have the same kind of definitive responses, though I think everybody who's been here from the Department has worked very hard to assist, the same kind of definitive responses that we could have had if the Commissioner was present. And then two minutes for the people who gave us Prop. 103 to summarize, and if we're running right on schedule, that will allow the Chair exactly two minutes to get everyone out of here at the stroke of eleven.

MS. MATHIAS: Well, Senator, when this hearing was called you asked us to report to the committee on what we had been doing to implement Proposition 103. We feel that we have worked diligently and very hard for the people of this state to implement Proposition 103. We've issued emergency regulations in time to guide insurers in making their June rate filings; the regulation that provided for public notice of rate changes; and set up procedures for rate hearings, which include procedures for intervention and payment of witness and advocacy fees to those persons making meaningful contributions on behalf of consumers.

Another thing that the Commissioner has done is to hire an intervener coordinator who has had extensive experience with public input into the governmental process, and she has charged this person with the vigorous intervener program for the Department.

We have completed our review of rates for all insurers on all lines of insurance subject to Proposition 103. We have called or given notice of intent to call to hearing 47 companies whose rates were not approved. We've developed regulations on rating methodology -- proposed regulations, that is -- and have held extensive hearings up and down the state to gain the widest possible public exposure and public comment before submitting our soon-to-be-finished final product to the Office of Administrative Law.

We've done all this in less than four months while still carrying out the obligations and responsibilities of the Department in trying to gear up administratively for an ongoing law which, in the court's words, have "made numerous and fundamental changes to our insurance law in California," and we feel that the Department has a record that we are proud of, both in terms of effort and in terms of results thus far.

It's an evolutionary process. We've talked about that this morning. We expect to refine these procedures and to learn as we go along and to continue to try to improve what we're doing here.

CHAIRMAN ROBBINS: Two minutes, Prop. 103 people.

MR. ROSENFELD: Mr. Chairman, I would thank you for the opportunity that we had hoped we would have to have the Insurance Commissioner explain some of the strange and mysterious actions that she's taken in the last month or so. I think in fairness to the representatives of the Department they too are unaware or unsure or unclear about what the Commissioner is doing in some of these areas.

This hearing has raised more important questions than it's answered, that's clear. I think we know a couple of things. Number one, it makes no sense not to have a series of hearings to set up the ground rules before you start willy-nilly granting exemptions to companies from the rollback required by 103.

Number two, there should be hearings on every company that has requested an exemption, and consumers should be allowed to challenge each of those companies, particularly State Farm. People should not have to wait for ten years to have a hearing on State Farm's exemption, particularly because under the law and under Prop. 103 their 9.6 percent rate increase this year demands a hearing.

I just would conclude by saying that it's shocking that the Commissioner did not show up today. It is imperative that the voters of California have a chance to hear her side of the story. Why is it that officials of this administration do not like to come out in front of the public and explain themselves?

CHAIRMAN ROBBINS: Let me say in conclusion for today that it is extremely unfortunate that when this hearing was scheduled on the date and time selected by the Commissioner that she was unable to attend. I have given the Commissioner four dates to select from -- September 1, 4, 5, and 8 -- one of those dates even being Labor Day when obviously the Commissioner has no hearings scheduled. I would hope -- I will insist that the Commissioner select one of these dates, or if not, I will have no alternative but to go to the presiding officer of the Senate and proceed to have a date selected for her.

The questions are serious ones that are pending: Is the 11.2 percent rate of return higher than it should be? Should we reward inefficient companies by giving them the same rate of return even though it means you were authorizing them to charge a substantially higher premium for the identical insurance policy? Where are we at with territorial rating? What are the policies that are being followed with respect to private meetings between the Insurance Commissioner and insurance companies? All of these questions need to be answered.

We have two groups of people that have not been the best of friends. The Prop. 103 people did not consult the Commissioner's office and the Department when they drafted their Proposition. It was passed by the voters, it became law. There has been something short of a totally joint effort in its implementation between those who authored it and those who are charged with administering it.

This committee has the responsibility to make sure that the questions are answered. All I can do for today is to give my promise to those who authored and voted for Proposition 103 that the Commissioner will, at a date within the next two weeks, appear before our committee and will answer the questions, and I'm confident that when she does that there will be greater clarity.

I certainly thank the staff members from the Department who've come. I think they've tried, to the best of their ability, to answer their questions with candor, and I think they have shed some light on the issue.

We know now what the issues are. Hopefully, before too many days go past, we will know what the answers are to those questions.

I thank everyone for participating in today's hearing.

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