

October 12, 2009

Hon. Edmund G. Brown Jr.  
Attorney General  
1300 I Street, 17<sup>th</sup> Floor  
Sacramento, California 95814

Attention: Ms. Krystal Paris  
Initiative Coordinator

Dear Attorney General Brown:

Pursuant to Elections Code Section 9005, we have reviewed a proposed statutory initiative related to automobile and residential property insurance and insurance brokers (A.G. File No. 09-0029).

### **Background**

***State Regulation of Insurance.*** The state regulates many aspects of California's insurance market. Pursuant to Proposition 103, a statewide initiative enacted by voters in 1988, the Insurance Commissioner is responsible for reviewing and approving rate changes for property and casualty insurance lines—such as automobile, homeowners, and earthquake insurance—before revisions to the rates can take effect. Under this prior approval process, the Insurance Commissioner examines and regulates an insurance company's expected profit to ensure the rates allow for a fair rate of return.

Some specific rate-setting rules apply to automobile insurance. As required under Proposition 103, automobile insurance rates and premiums are determined by the application of specific factors in decreasing order of importance: (1) the insured's driving record, (2) the number of miles driven annually, and (3) the number of years of driving experience. Under current law, the fact that someone did not previously have automobile insurance may not be used as a criterion for determining automobile rates, premiums, or insurability.

***Insurance Premiums and Fees.*** Under current law, an insurance premium is defined as being the amount of money that the insurance company charges to a policyholder to provide coverage for a specified risk. However, the Insurance Commissioner does not consider certain types of fees to constitute premiums. These include penalties imposed

on policyholders for paying an insurance bill from a checking account with insufficient funds, membership dues in an organization that offers insurance, and installment finance charges. State insurance laws and regulations do not set forth any specific limits on how much in fees can be charged to policyholders.

***Insurance Agents and Brokers.*** Certified insurance brokers and agents doing business in California receive a “broker-agent ” license. Under current law, insurance agents engage in insurance transactions on behalf of an insurance company. Insurance brokers work on behalf of the consumer in insurance transactions other than those involving life insurance. The Insurance Commissioner regulated and licensed more than 305,000 agents and brokers in 2008.

Existing state law regulates the collection of fees by brokers in connection with insurance transactions. For example, a broker must disclose the amount of the fee to a consumer and obtain their signed written consent to the payment. In addition, the broker cannot be an agent of the insurer that would provide coverage. The amount of broker fees is not, however, limited by the Insurance Commissioner and information on them is not systematically reported to him. Also, state insurance regulations permit a broker to collect fees both from the consumers they represent as well as to receive commissions from insurance companies as part of an insurance transaction.

***Taxation of Insurers and Brokers.*** Under current law, insurance companies doing business in California pay an insurance premium tax in lieu of a state corporate income tax. The tax is based on the amount of insurance premiums earned in the state each year for automobile insurance as well as for other types of coverage, such as fire and health insurance. The tax is not imposed on certain insurance fees. In 2008, insurance companies paid about \$1.8 billion in premium taxes on the various types of insurance policies in California. In addition, fees paid to brokers are not treated as premiums but instead under state income tax law as income to the broker.

## **Major Provisions**

This measure contains provisions that (1) establish additional statutory provisions relating to setting insurance rates, (2) define insurance fees as premiums subject to regulation, and (3) limit insurance broker fees. We describe these provisions in more detail below.

***Provisions on Insurance Rate-Setting.*** Consistent with existing law relating to automobile insurance, this measure creates an additional statutory provision stating that the absence of prior insurance could not be used as a criterion for determining rates, pre-

miums, or insurability. This measure, however, differs from existing law in that it applies this provision both to automobile and residential property insurance.

Consistent with existing laws governing automobile insurance, this measure creates an additional statutory provision stating that an insurer would not be allowed to take into account a customer's claims experience in determining automobile insurance rates, premiums, or insurability. This measure further states that prior claims experience could not be considered in calculating any insurance discount or surcharge. However, these restrictions on considering claims experience would not apply to discounts given to good drivers, as permitted under Proposition 103.

***Provisions Related to Fees.*** This measure specifies that installment fees or any other amounts paid by a policyholder on a periodic basis constitute payments of premiums. Additionally, the measure specifies that insurance companies cannot charge more than the direct cost, including the printing and mailing cost, of collecting installment payments from their customers.

***Limits Imposed on Broker Fees.*** The measure limits the charging of broker fees in connection with insurance transactions. Specifically, if a broker collects a fee from a customer as part of an insurance transaction, the broker would be prohibited from additionally collecting a commission from the insurer. The measure specifies that broker fees must be fair, reasonable, and not unfairly discriminatory. The Insurance Commissioner would be directed under the measure to adopt rules to enforce this provision, including, but not limited to, rules establishing broker fee limits and broker duties.

## **Fiscal Effect**

The provisions of this measure relating to the regulation of automobile and residential property insurance could result in a change in the total amount of premiums and, therefore, insurance premium taxes collected by the state. Specifically, the provisions of this measure that treat installment fees and any other amount billed to a policyholder as premium could result in an increase in insurance premium tax revenues. On the other hand, insurance agents working on behalf of an insurance company may choose as a result of the changes made by this measure to work on behalf of the consumer as a broker, thus lowering the amount of revenues collected from the insurance premium tax. The net fiscal effect of these changes cannot be determined, but is unlikely to be significant.

**Summary of Fiscal Effects**

This measure would probably have no significant fiscal effect on state and local governments.

Sincerely,

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Mac Taylor  
Legislative Analyst

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Michael C. Genest  
Director of Finance