

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

TEXT OF REGULATION

WORKERS' COMPENSATION DEDUCTIBLE POLICIES

July __, 2018

REG-2017-00018

Add to Title 10 of the California Code of Regulations:

Article 9.8. Workers' Compensation Deductible Policies.

Adopt Section 2509.80. Definitions.

As used in this article:

(a) "Workers' Compensation Deductible Policy" means a policy, or any combination of one or more policies, endorsements or ancillary agreements, in which an insured has agreed with the insurer to be responsible to the insurer for any portion of any workers' compensation claim and, in some cases, the associated loss adjustment expense.

(b) "Workers' Compensation High Deductible Policy" means a Workers' Compensation Deductible Policy in which the portion of any workers' compensation claim and, if applicable, the associated loss adjustment expense, for which the insured agrees to be responsible to the insurer equals or exceeds one hundred thousand dollars (\$100,000.00).

(c) "Insurer" means an insurer admitted in California for the class of workmen's compensation insurance as defined in Insurance Code section 109, and includes the State Compensation Insurance Fund.

(d) "Financial Statements" means the annual statements and quarterly filings required by Insurance Code section 900.

(e) "California Workers' Compensation Claim" means a claim for benefits subject to Chapter 3 of Part 1 of Division 4 of the Labor Code, commencing with Section 3600.

(f) "Open Workers' Compensation Claim" means a California Workers' Compensation Claim under a Workers' Compensation Deductible Policy for which there is any potential future liability.

(g) "Deductible Paid Loss" means the amount of loss paid by the insurer on each workers' compensation claim under a Workers' Compensation Deductible Policy, limited to a maximum value of the policy deductible.

(h) “California Deductible Paid Loss” means the amount of loss paid by the insurer on each California Workers’ Compensation Claim under a Workers’ Compensation Deductible Policy, limited to a maximum value of the policy deductible.

(i) “Allocated Loss Adjustment Expense” or “ALAE” means the cost of adjusting workers’ compensation insurance claims that can be assigned specifically to an individual claim.

(j) “Deductible Incurred Loss” means the estimated final cost of each Open Workers’ Compensation Claim, limited to a maximum value of the policy deductible, which pursuant to the terms of the policy may or may not include ALAE, under the Workers’ Compensation Deductible Policy in question.

(k) “Aggregate Deductible Incurred Loss” means the estimated final cost, which pursuant to the terms of each policy may or may not include ALAE, of all Open Workers’ Compensation Claims, and includes actuarially determined provisions for (1) incurred but not reported claims and (2) a bulk reserve for any shortfall in individual claim cost estimates. In the case of a policy whose terms specify that ALAE is included within the deductible, “Aggregate Deductible Incurred Loss” also includes a reserve for ALAE. “Aggregate Deductible Incurred Loss” includes the deductible portion of all claims that exceed the policy deductible, as well as the full value of all claims within the deductible.

(l) “Deductible Loss Reserves” means the Aggregate Deductible Incurred Loss less any Deductible Paid Loss. (m) “California Deductible Reserves” means Deductible Loss Reserves for California Workers’ Compensation Claims.

(n) “Deductible Ultimate Receivables” means any amounts of Deductible Paid Loss for which the employer has not fully reimbursed the insurer, plus any Deductible Loss Reserves, for the Workers’ Compensation Deductible Policy in question.

(o) “California Deductible Ultimate Receivables” means any amounts of California Deductible Paid Loss for which the employer has not fully reimbursed the insurer, plus any California Deductible Reserves, for the Workers’ Compensation Deductible Policy in question.

(p) “Qualified United States Financial Institution” means a member of the Federal Reserve System that maintains a public debt rating of at least an A.M. Best Company rating of A-; a Standard & Poor’s rating of A-; a Moody’s Investors Service rating of A3; or a Fitch Ratings rating of A-.

(q) “Other-Line Coverage” means any and all insurance other than workers’ compensation insurance, which the insured under a Worker’s Compensation Deductible Policy procures from the Insurer that issues that Workers’ Compensation Deductible Policy.

(r) “Other-Line Deductible Plan” means any and all policies of insurance providing Other-Line Coverage under which policy any amount of a claim other than a workers’ compensation claim is to be paid first by the Insurer, who is then to be reimbursed by the insured.

(r) “Open Other-Line Claim” means a claim under an Other-Line Deductible Plan for which there is any potential future liability.

(s) “Other-Line Deductible Paid Loss” means the amount of loss paid by the insurer on each claim under an Other-Line Deductible Plan, limited to a maximum value of the policy deductible.

(t) “Other-Line Aggregate Deductible Incurred Loss” means the estimated final cost, which pursuant to the terms of each policy may or may not include ALAE, of all Open Other-Line Claims, and includes actuarially determined provisions for (1) incurred but not reported claims and (2) a bulk reserve for any shortfall in individual claim cost estimates. In the case of a policy whose terms specify that ALAE is included within the deductible, “Other-Line Aggregate Deductible Incurred Loss” also includes a reserve for ALAE. “Other-Line Aggregate Deductible Incurred Loss” includes the deductible portion of all claims that exceed the policy deductible, as well as the full value of all claims within the deductible.

(u) “Other-Line Deductible Loss Reserves” means the Other-Line Aggregate Deductible Incurred Loss less any Other-Line Deductible Paid Loss.

(v) “Other-Line Deductible Plan Ultimate Receivables” means any amounts of Other-Line Deductible Paid Loss for which the employer has not fully reimbursed the insurer, plus any Other-Line Deductible Loss Reserves, for the Other-Line Deductible Plan in question.

(w) “Multiline Deductible Loss Reserves” means the sum of the Deductible Loss Reserves and the Other-Line Deductible Loss Reserves.

(x) “Multiline Deductible Ultimate Receivables” means the sum of the Deductible Ultimate Receivables and the Other-Line Deductible Plan Ultimate Receivables.

(y) “Surety” means the insurer issuing a surety bond.

NOTE: Authority cited: Section 11736.5, Insurance Code. Reference: Section 11736.5, Insurance Code.

Adopt Section 2509.81. Collateral, Accounting and Credit Risk Requirements.

(a) In order to secure the deductible amount of any Workers’ Compensation Deductible Policy, an insurer may collateralize the California Deductible Ultimate Receivables according to the collateral and security requirements specified in subdivision (b)(1) of this Section 2509.81. Another option that may be available to the Insurer is to collateralize the Multiline Deductible Ultimate Receivables according to the collateral and security requirements specified in subdivision (b)(2) of this section.

However, if an Insurer issues a Workers’ Compensation High Deductible Policy that insures against a potential California Worker’s Compensation Claim, the Insurer shall, for as long as

there remain any California Deductible Ultimate Receivables under the policy, comply with the provisions of either subdivision (a)(1) or subdivision (a)(2), below:

(1) The Insurer shall, for each Workers' Compensation High Deductible Policy that insures against a potential California Worker's Compensation Claim, report as a loss on its Financial Statements:

(A) any portion of the California Deductible Ultimate Receivables that is not collateralized according to the collateral and security requirements specified in subdivision (b)(1) of this section, or

(B) in the event that the Insurer elects to comply with the requirements of this section by using the optional multistate, multiline alternative approach specified in subdivision (b)(2) of this section, any portion of the Multiline Deductible Ultimate Receivables that is not collateralized according to the collateral and security requirements specified in such subdivision (b)(2); or

(2) The Insurer shall satisfy the credit risk requirements set forth in subdivision (c) of this section.

(b) Permissible Forms of Collateral or Security.

(1) California-dedicated workers'-compensation-only resources. In order to satisfy the collateral and security requirements of this subdivision (b)(1) with respect to any Workers' Compensation Deductible Policy, an insurer must ensure that the employer dedicates and sets aside funds for the exclusive purpose of collateralizing the California Deductible Ultimate Receivables under that policy, in one or a combination of the following forms, in an aggregate amount equal to the California Deductible Ultimate Receivables under the policy:

(A) Assets held by the insurer, as one or a combination of the following:

1. Cash or other lawful money of the United States.

2. Any of the investments described in Article 3 of Part 2 of Division 1 of the Insurance Code, commencing with Section 1170.

(B) All or a separate and distinct portion, not to be used or relied on for any purpose other than to collateralize California Deductible Ultimate Receivables under the Workers' Compensation Deductible Policy in question, of the total amount of the credit available to the insurer under a clean, unconditional, irrevocable, evergreen letter of credit issued by a Qualified United States Financial Institution.

(C) Assets, in one or more of the forms specified in subdivisions (b)(1)(A)1. or (b)(1)(A)2. of this section, which the insurer requires by contract with the employer to be held by the employer in a fiduciary account for the benefit of the insurer, in a Qualified

United States Financial Institution. In this case the insurer shall require by contract with the employer that:

1. The fiduciary account assets shall be held for the benefit of the insurer, its assigns, and successors in interest;
2. The fiduciary account shall be subject to examination by the commissioner;
3. The fiduciary account shall remain open for as long as there are California Deductible Ultimate Receivables under the policy; and
4. That the commissioner or an attorney in this state is designated as the insurer's true and lawful agent upon whom may be served any lawful process in any action, suit or proceeding instituted in regard to the fiduciary account.

(D) A surety bond naming the Insurer as the obligee, provided that:

1. No more than twenty percent (20%) of the California Deductible Ultimate Receivables under the Workers' Compensation Deductible Policy in question are collateralized by means of surety bond;
2. The Surety maintains a company rating of at least an A.M. Best Company rating of A-; a Standard & Poor's rating of A-; a Moody's Investors Service rating of A3; or a Fitch Ratings rating of A-.
3. The Surety is not affiliated with the Insurer issuing the Workers' Compensation Deductible Policy in question; and
4. The surety bond instrument contains, in substance, the following provisions:
 - a. The Surety, and the insured under the Workers' Compensation Deductible Policy in question, shall be jointly and severally bound to the Insurer to pay the Insurer, on demand by the Insurer, the full amount stated on the bond.
 - b. The Surety shall, within a period of no more than ten (10) working days after receiving a written demand for payment by the Insurer, pay the full amount specified by the Insurer in the demand, up to the full amount stated on the bond.
 - c. The Surety's obligation to pay the Insurer the funds specified in the Insurer's written demand, up to the full amount of the bond, shall be unconditional, unqualified and not contingent upon any accounting for the disposition of the bond proceeds by the Insurer after they have been paid

by the Surety, or upon the Surety's obtaining a property interest or other security or indemnification, or upon any other circumstance which absent this provision might allow the Surety to avoid timely paying the demand.

d. The Surety shall, to the fullest extent permissible by applicable law, waive any right to contest its obligation to pay the full amount of any written demand under the surety bond, up to the full amount stated on the bond, and any right to reimbursement for, restitution of or recovery of funds paid to the Insurer under the bond.

e. The surety bond shall be automatically renewable, and the Surety shall not cancel the bond except upon ninety (90) days' written notice to the Insurer.

f. If the Surety cancels or non-renews the bond and the Insurer has not, at least thirty (30) days from the effective date of the cancellation or nonrenewal, received from the insured under the Workers' Compensation Deductible Policy in question replacement security that is satisfactory to the Insurer, then the Surety will, upon demand by the Insurer, pay to the Insurer any amounts not previously paid to the Insurer, up to the full amount of the bond.

(2) Optional multistate, multiline alternative approach. In order to satisfy the collateral and security requirements of this subdivision (b)(2) with respect to any Workers' Compensation Deductible Policy that includes coverage for California Workers' Compensation Claims, an insurer must ensure that the employer dedicates and sets aside funds for the exclusive purpose of collateralizing the Multiline Deductible Ultimate Receivables, in one or a combination of the following forms, in an aggregate amount equal to the Multiline Deductible Ultimate Receivables:

(A) Assets held by the insurer, as one or a combination of the following:

1. Cash or other lawful money of the United States.

2. Any of the investments described in Article 3 of Part 2 of Division 1 of the Insurance Code, commencing with Section 1170.

(B) A clean, unconditional, irrevocable, evergreen letter of credit that is issued by a Qualified United States Financial Institution and is not to be used or relied on for any purpose other than to collateralize the Multiline Deductible Ultimate Receivables.

(C) Assets as described in, and satisfying the requirements set forth in, subdivision (b)(1)(C) of this section.

(D) A surety bond naming the Insurer as the obligee and which satisfies the requirements set forth in subdivision (b)(1)(D) of this section.

(c) Credit Risk Requirements.

In order to satisfy the credit risk requirements of this subdivision (c):

(1) The Insurer must maintain at least an A.M. Best Company rating of A, a Standard and Poor's rating of A+ or A, a Moody's Investors Service rating of A1 or A2, or a Fitch Ratings rating of A+ or A, or be a member of a holding company group that maintains such a rating; and

(2)(A) The Insurer must maintain a sum of paid-in capital as defined in Insurance Code section 36, plus surplus as defined in Insurance Code section 700.02, of at least five hundred million dollars (\$500,000,000), or

(B)1. The Insurer must have entered into an intercompany pooling agreement with its affiliated insurers in the holding company group to which the Insurer belongs, which agreement requires that the loss experience of all the members of the holding company group be 100% pooled, and

2. The holding company group to which the Insurer belongs must maintain a sum of paid-in capital as defined in Insurance Code section 36, plus surplus as defined in Insurance Code section 700.02, of at least five hundred million dollars (\$500,000,000).

NOTE: Authority cited: Section 11736.5, Insurance Code. Reference: Section 11736.5, Insurance Code.

Adopt Section 2509.82. Optional Form of Letter of Credit.

The following form may be, but is not required to be, used for a letter of credit, to ensure compliance with the requirements of subdivisions (b)(1)(B) and (b)(2)(B) of Section 2509.81 of this article:

LETTER OF CREDIT FOR WORKERS' COMPENSATION DEDUCTIBLE POLICY

BANK: _____

ADDRESS: _____

Letter of Credit No. _____

Issue Date: _____

To Beneficiary: Admitted Insurer: _____

We have established this clean, irrevocable, and unconditional Letter of Credit in your favor as beneficiary for drawings up to an aggregate of U.S. \$ _____, effective immediately. This Letter of Credit is for the account of _____. This Letter of Credit is issued, presentable and payable at our office at _____

and expires with our close of business on _____. Except when the amount is increased, this Letter of Credit cannot be modified or revoked without your written consent.

We will promptly honor your sight draft(s) drawn on us, indicating our Credit Number _____, for all or any part of this Letter of Credit, upon presentation at our office at the address given above, or such other office as we may advise, on or before the expiration date hereof or any automatically extended date. Other than your sight draft, no other document need be presented.

This Letter of Credit expires on _____, but shall automatically extend without amendment for a period of one year from the expiration date, or any future expiration date, unless at least sixty (60) days prior to any expiration date the named insurer at the above address, notified by registered or certified mail, return receipt requested, or by overnight courier, signature upon delivery required, that we elect not to renew.

Our obligation under this Letter of Credit is unconditional and is not dependent upon our ability to perfect a lien, or obtain a security interest or any other form of reimbursement.

This Letter of Credit is subject to and shall be governed by and construed in accordance with the laws of the State of California (excluding the choice of law provisions), and the Uniform Customs and Practice for Documentary credits, International Chamber of Commerce, Publication No. 500, or any successor publication, except where that publication is in conflict with California law. Notwithstanding Article 17 of said publication, if this Letter of Credit expired during an interruption of your business or our business, caused by Acts of God, riot, civil commotion, insurrection, war, terrorism, or any other cause beyond control, we hereby specifically agree to pay as provided herein if this Letter of Credit is drawn against within 30 days after the resumption of business.

BANK _____

AUTHORIZED SIGNATURE

NOTE: Authority cited: Section 11736.5, Insurance Code. Reference: Section 11736.5, Insurance Code.