

The Two Sides of Effective Adverse Action Management

Notices and Processes: A Double Compliance Challenge

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Table of Contents

Executive Summary	3
Adverse Actions Present a Unique Risk Exposure in Underwriting	3
New Business Underwriting	4
Underwriting Review during the New Business Period	4
Mid-Term Events Triggering Underwriting Review	4
Renewal Review	4
Premium Payment Issues	4
The Cost of Failure Can Be Substantial	5
The First Challenge: Compliant Notices	6
The Second Challenge: Compliant Notice Delivery	7
Compliance is Difficult to Achieve	9
Non-Pay Transactions: A Snapshot of Forms Development Challenges	10
Notice Language Requirement Changes Are Ever Present	11
Regulatory Activity Continues to Modify the Process	12
Key Elements of an Ideal Solution	13

Executive Summary

Property & casualty insurers often underestimate the double challenge of effective adverse action notice management. In today's dynamic regulatory environment, adverse action requirements change continually, affecting either *the specific content of a notice*, or *the manner in which it is delivered*. The compliance risk is considerable, and demands constant vigilance.

Insurers that fail to acknowledge this risk and apply sufficient resources to mitigating it can face significant consequences:

- increased loss exposure
- inefficient cancellation or non-renewal processes that can involve multiple attempts at addressing the same risk
- the likelihood of increased insured/applicant complaints
- greater DOI oversight and investigation into the insurer's internal processes

This paper explores:

- the risks that adverse actions pose to the underwriting process
- the consequences of failure
- the challenges to achieving regulatory compliance
- the key elements of an ideal solution

Adverse Actions Present a Unique Risk Exposure in Underwriting

Insurers today dedicate considerable resources to identifying and managing all types of risk exposures. Of those many exposures, compliance risks rank among the highest. Within the sphere of compliance risks, adverse actions and operational activities within the underwriting function deserve special attention.

As part of an organization-wide risk-management process, underwriting managers must consider their degree of success in managing adverse action notification. These managers face unique risk exposures from noncompliant notices used in all facets of the operations they control.

Insurers are exposed to this compliance risk on a daily basis. Medium sized insurers, defined as those with \$500 million to \$1 billion in annual premiums written, commonly issue between 2,000 - 3,500 notices annually. Using an average of 2,750 notices, this means that underwriting staff is making critical compliance decisions on 53 transactions each week. The key underwriting processes where these risks reside, the areas of common compliance exposure are summarized in the following paragraphs.

New Business Underwriting

When reviewing new business submissions for acceptability, underwriters may make a determination to reject a piece of new business. At that point, Policy Declination requirements are triggered. In those instances insurers must meet written notice of declination requirements in 14 different states, which have a variety of differences in the details of the notice that is produced and processed.

Underwriting Review during the New Business Period

Once a policy is issued, additional underwriting information may be obtained which reveals new information deeming the risk to be unacceptable. If this occurs in the permitted underwriting period, usually 30 or 60 days, the insurer is in a position to discontinue coverage and to issue a New Business Cancellation. All states require a legal notice of cancellation in this situation, but a great deal of variation exists from state to state in the reasons that are prohibited from use to cancel a policy during the new business underwriting period.

Mid-Term Events Triggering Underwriting Review

Some events, such as losses, updated inspection reports, or public record information, may reveal significant deterioration in the risk being insured. Canceling the policy mid-term may be the prudent business decision, but the regulatory constraints on mid-term cancellation are extensive, highly detailed, and they vary extensively from state to state.

Renewal Review

When engaging in a review of renewal questionnaires, loss reports, and updated public records, underwriters may determine that the risk should not continue to be insured, setting the stage for Nonrenewal, or a determination that it should be continued only with higher premium or reduced coverage, resulting in Conditional Renewal requirements. Each of these types of actions requires written notice across the board, but the specific conditions that trigger Conditional Renewal notifications range from any premium increase, 10% or greater, 25% or greater, or more than 30% depending on the state and type of insurance involved. Other triggers also complicate the picture. Sometimes a reduction in coverage; or a change in limits, deductible or self-insured retention may introduce a notification requirement.

Premium Payment Issues

While often a billing function rather than a direct responsibility of underwriting, policy cancellation for Non-Payment of Premium is an additional type of highly regulated transaction.

These notices may be noncompliant for several reasons, they may:

- fail to include required language
- use an incorrect type size

- provide unacceptable reasons for the notice
- notify insureds with an insufficient number of days' notice

Insurers' underwriting systems must feature adverse action development workflows in order to be effective and compliant. Such workflows must meet exacting specifications to ensure that notices account for all required regulatory requirements. Table 1: *Adverse Action Type Requirements* illustrates key examples of such requirements and the notices they affect.

Table 1. Adverse Action Type Requirements						
Regulatory Requirements	Cancel	Non-renew	Non-pay	Policy Change	New Business	Declination
Type size/Font Minimums	X	X	X	X	X	X
Financial Responsibility	X	X	X		X	X
Warnings	X	X	X		X	X
Replacement Insurance Information	X	X	X		X	X
Appeals to DOI	X	X	X		X	X
Appeals to Assigned Risk Plans	X	X	X		X	
Permitted Reasons on Notice	X		X			
Right to Tail Coverage	X	X	X		X	
Premium Refunds	X				X	
Loss Information	X	X				

The Cost of Failure Can Be Substantial

It is imperative that insurers have in place thorough procedures to not only maintain compliant notices, but also properly issue them to applicants and insureds. Faulty documents and processes can affect an insurer in the following direct and costly ways:

- rescission of notices, forcing the payment of claims under policies previously believed to have been canceled
- significant and costly DOI market conduct fines
- costs related to administrative hearings conducted to determine the validity of notices
- court actions by insureds
- adverse publicity, potentially driving away desirable risks

The First Challenge: Compliant Notices

In an intensive regulatory environment, all notices must always be accurate. Looking at the key enforcement criticisms of adverse action notices, we can see that many of the most common pitfalls concern very minor errors or inaccuracies:

<p>5 Enforcement Criticisms of Adverse Action Notices to Watch</p> <ol style="list-style-type: none"> <i>1. Premium increase percentage not specified on Conditional Renewal</i> <i>2. Contact information not provided for and notice of availability of coverage in residual market plan not provided.</i> <i>3. Specific reason for action not provided.</i> <i>4. Right to review by Commissioner not provided.</i> <i>5. Loss information not provided</i>

¹Figure 1. Key Enforcement Criticisms of Adverse Action Notices

To get a clearer picture of the intensive regulatory enforcement insurers currently face regarding adverse action notices, consider the details of market conduct activity outlined in Table 2: *Market Conduct Activity Examples—Adverse Action Notices.*

Table 2. Market Conduct Activity Examples—Adverse Action Notices	
Citation Reference	Summary of Criticism
Maryland: §27-614	Respondent, in a Consent Order executed on {date}, represented that effective {date}, it implemented forms promulgated by the Commissioner in Insurance Regulation COMAR 31.08.03.07 and 31.08.03.08. The forms implemented by Respondent did not comply with those regulations in that they failed to include language requiring insertion of the percentage increase. Between {date} and {date}, Respondent sent 1,017 notices of premium increase that failed to include such language. ~{4/09}
Maryland: §27-602	The Companies, in certain instances, failed to advise policyholders of the current address of the Maryland Joint Insurance Association (JIA). In other instances, the Companies failed to place a check mark in the appropriate box indicating the notice of possible right to replace insurance. ~{3/07}

¹ Source: ComplianceWare Market Conduct Database

Table 2. Market Conduct Activity Examples—Adverse Action Notices

<p>Pennsylvania: Title 40 §991.2008</p>	<p>Any applicant for a policy who is refused such policy by an insurer shall be given a written Notice of Refusal to Write by the insurer. Such notice shall state the specific reason or reasons of the insurer for refusal to write a policy for the applicant. Within 30 days of the receipt of such reasons, the applicant may request in writing to the Insurance Commissioner that he review the action of the insurer in refusing to write a policy for the applicant. The Company failed to issue a Notice of Refusal to Write that would inform the applicant of a) the specific reason or reasons for the refusal and b) the applicant’s right of review by the Insurance Commissioner. ~{4/08}</p>
<p>Pennsylvania: Title 40 §3403</p>	<p>A nonrenewal notice shall state that at the insured’s request, the insurer shall provide loss information to the insured covering at least three years or the period of time during which the insurer has provided coverage to the insured, whichever is less. The... files noted contained a nonrenewal notice which did not provide the required information. {4/09}</p>
<p>Washington: WAC 284-30-570</p>	<p>Five thousand four hundred eighty five (5,485) notices contained wording which stated that State Law requires the insured to submit a written request within 90 days for additional information about the Companies’ actions. There is no such law in Washington. The applicable regulation requires that the notice contain enough information so that the insured does not have to do any follow-up to understand the reason for the Company’s decision. This language is erroneous and is in violation because it implies that there is additional information to help the insured understand the Company’s actions, or that the information on the notice may not be the only reasons for the Companies’ actions.</p>

The Second Challenge: Compliant Notice Delivery

Developing compliant notices is only part of the complex challenge confronting insurers. The other component involves the actual processing systems for these notices.

These systems must incorporate state- and line of business-specific requirements encompassing such factors as:

- timeframes
- mail types
- permitted reasons
- risk circumstances
- number of copies

As the key enforcement criticisms of adverse action processing indicate, attention to many details is the lynchpin of a compliant system:

<p>3 Enforcement Criticisms of Adverse Action Processing to Watch</p> <p><i>1. Notices did not explicitly state that the insured was at-fault or negligent.</i></p> <p><i>2. The insurer failed to issue notice at least 45 days before the date of the proposed action.</i></p> <p><i>3. The insurer cancelled coverage for reasons other than those permitted.</i></p>

²Figure 2. Key Enforcement Criticisms of Adverse Action Processing

Similar to the Department of Insurance market conduct activity concerning the actual text of notices, Table 3: *Market Conduct Activity Examples—Adverse Action Processing* demonstrates that the Departments have a keen interest in ensuring the integrity of the processing systems. Failure to comply can quickly result in DOI actions and consumer complaints.

Table 3. Market Conduct Activity Examples - Adverse Action Processing	
Citation Reference	Summary of Criticism
Maryland: §27-614	Respondent, between December 2008 and June 2009, sent 160 Premium Increase notices to policyholders whose vehicles were involved in accidents. Those notices did not explicitly state that the insured was at-fault or negligent, in violation of the requirements of § 27-614(c)(5)(iii)(1)(C) of the Insurance Article and COMAR 31.08.03.09B(1)(c). There were 32 policies that cancelled on the effective date. There were 128 policies for which the increased premium was paid. Respondent, as a result of the Administration’s investigation, paid restitution to the 128 policyholders, including interest, in the amount of \$90,315. ~{10/09}
Maryland: §27-602	The Company failed to issue notice at least forty-five (45) days before the date of the proposed action. ~{4/07}
Pennsylvania: Title 40 §3402	Canceling in midterm a policy of insurance covering commercial property and casualty risks is prohibited for any reason other than those enumerated under this section. The 5 files noted were cancelled for other than permitted reasons. ~{3/09}

² Source: ComplianceWare Market Conduct Database

Compliance is Difficult to Achieve

While mission-critical, compliance in adverse action processing is difficult to achieve. Adverse action management is a complex undertaking, requiring diligent attention to several unique, and difficult, levels. Not only does each jurisdiction regulate its own notices, but requirements also vary by line of business, action type, and circumstance.



On a countrywide basis, 24 individual lines of insurance can present different language and/or forms processing requirements in each state. Adding to the complexity, 72 variations of circumstances exist across the states that dictate certain adverse action requirements.

Looking more closely at the number of sources that can dictate the specific language and process requirements for adverse action notices, we can even better appreciate the magnitude of the regulatory monitoring task. In addition to the state legislatures, there are multiple state agencies that can enact new requirements. Those agencies include:

- insurance departments
- workers' compensation commissions
- motor vehicle divisions
- assigned risk plans such as AIPSO, JUA's, and FAIR Plans

With so many sources of new and revised regulatory requirements to contend with, insurer-developed and maintained systems are highly likely to miss key regulatory changes and updates. The level of regulatory activity requiring analysis and implementation is daunting for insurers' underwriting and technology staff. Plus, an in-house system that lacks a user-friendly interface frequently carries a high cost for an insurer.

Operating under such conditions, an insurer may find itself with a risk-prone adverse action operation.

Non-Pay Transactions: A Snapshot of Forms Development Challenges

Reviewing Connecticut's regulatory requirements for the basic non-payment cancellation adverse action across standard lines of business, we can see the varied components inherent in the creation of compliant notices—and the immensity of the compliance challenge.

Insurers writing in Connecticut must submit eight different notices in order to comply with *just the property & casualty non-payment regulatory requirements* associated with:

- reasons appearing on the form
- financial responsibility warning
- continuation of coverage option
- excess premium refund
- appeal to Auto Assigned Risk Plan Governing Committee
- claims-made policy notices for extension of coverage/offering of tail coverage
- cancellation rescission notice for auto assigned risk policies (AIPSO)
- amount due notice for AIPSO policies
- rescission reversal notice for AIPSO policies

Connecticut's regulatory requirements are a good example of the number of notices typically required in other states. Multiplied to cover all jurisdictions, the nonpayment adverse action *alone* could result in upwards of 400 individual notices.

That staggering number does not take into account other adverse actions, including:

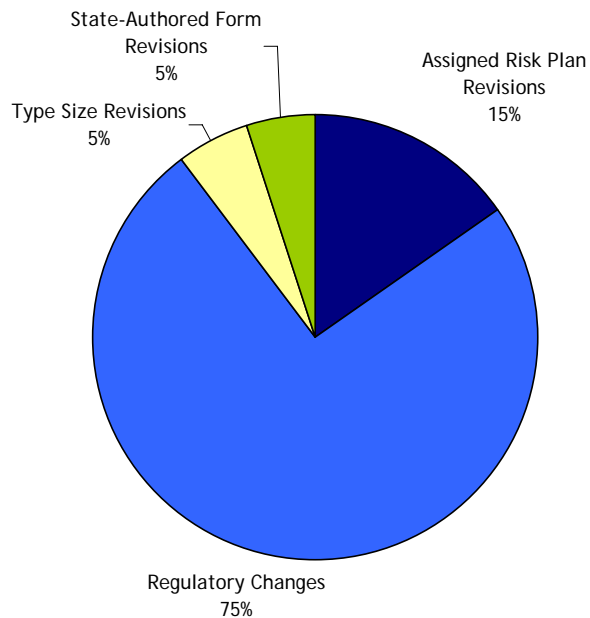
- mid-term cancellation
- non-renewal
- premium increase
- declination
- conditional renewal
- reinstatement
- other policy changes

Clearly, the universe of possible notices that insurers are required to maintain is overwhelming when all states, lines of business, and action types are taken into account.

Notice Language Requirement Changes Are Ever Present

The extensive level of ongoing regulatory activity monitoring presents its own special set of challenges. For example, in 2009, notice language revisions were required in multiple jurisdictions, as shown in Table 4: *Notice Language Revision by Jurisdiction*.

Table 4. Notice Language Revision by Jurisdiction	
Jurisdiction	Required Form Revisions
Kentucky	Address change for FAIR Plan
Louisiana	Address changes to involuntary market entities
Maryland	Address change for the DOI's office
Maryland	Statutory change in premium increase notification
Massachusetts	Right of Appeal regulatory text revision
Michigan	Address change for the Basic Property Insurance Association
New Jersey	Right of Appeal regulatory text revision
New Jersey	Workers' Compensation Rating & Inspection Bureau revised their forms
Pennsylvania	Physical address change for one of the DOI's offices
Rhode Island	Font size changes



The varied drivers of notice language changes consistently present challenges from year to year: The graph at left depicts reasons for forms revisions for the most recent two years.

Regulatory Activity Continues to Modify the Process

Apart from physical changes to notices, many states have taken either legislative or regulatory steps last recently to modify the adverse action process. Missing one or more of these key processing updates could result in insurers being found non-compliant—even if their forms were compliant. Table 5: *Processing Changes* outlines some primary examples of these processing updates.

Table 5. Processing Changes	
Jurisdiction	Required Adverse Action Processing Changes
Illinois	Insurers directed to modify their processing systems, as they are no longer required to provide adverse action notification if an applicant or insured does not receive the best rate, tier, company, coverage, etc. so long as the rate, tier, company, coverage, etc., offered is the same or better from what would be offered to an applicant or insured who had a neutral score.
Louisiana	Established a new declination prohibition this year in directing that no insurer shall refuse to issue an automobile insurance policy providing collision or comprehensive coverage on a newly purchased motor vehicle, at the time of purchase of the automobile from a duly licensed motor vehicle dealer, to one of the insurer's existing automobile policyholders who is an otherwise qualified purchaser, based solely upon a named tropical storm or hurricane in the Gulf of Mexico.
Maryland	Established standard reasons for midterm cancellation of personal, homeowner, commercial or motor vehicle liability insurance, with additional and specific reasons for motor vehicle liability and homeowners policy cancellations.
Maryland	Established that the transfer of commercial and workers' compensation policies between admitted insurers within the same insurance holding company system is considered a renewal, not a non-renewal, if the policyholder's premium does not increase and the policyholder does not experience a reduction in coverage.
Maine	Established prohibitions on insurers refusing to issue, refusing to renew, or canceling a homeowners policy unless the insurer bases that action solely on factors other than the presence of the family child care business; establishes limits on an insurer's discretion to decline to issue coverage and to cancel coverage at will within the first 90 days of a policy.

While simply snapshots of the adverse action regulatory activity in 2009, these state actions demonstrate the ongoing level of commitment required to monitor legislative and regulatory activity.

Key Elements of an Ideal Solution

A compliant and sustainable adverse action notice processing system allows insurers to the benefit of significantly reduced risk to negative financial impacts and adverse brand impact.

In make decisions about how best to establish and maintain a system, insurers should first evaluate the investment necessary to establish and maintain a system using internal resources. The table below illustrates how these costs may be estimated:

Development and Maintenance of Adverse Actions Forms Library				Resource Cost Per Hour	
				States Maintained in Forms Library	Cost
				51	\$45.00
				30	
Description	Per Jurisdiction Costs		All States Library Costs		
	Time (hours)	Cost	Time (hours)	Cost	
Research requirements for one state necessary to develop forms	80	\$3,600.00	4,080	\$183,600.00	
Development of initial forms library	40	\$1,800.00	2,040	\$91,800.00	
Monitoring of regulatory changes for impact on library on annual basis	520	\$15,600.00	520	\$15,600.00	
Cost of updating forms annually (assumes 12 updates per year on average)	40	\$1,800.00	480	\$21,600.00	
Total Annual Research Time and Costs	680	\$22,800.00	7,120	\$312,600.00	

Table 6. Estimating the costs of establishing and maintaining an Adverse Action Forms library

Whether using internal resources or considering an external provider, insurers should look for solutions that provide the following:

- a system of receiving timely information about regulatory change information and an efficient means of identifying the impact on adverse action notices
- a process for quickly updating adverse action notices and processes based on regulatory changes
- verification of filing requirements with each state insurance department
- an end-user interface that allows processes to quickly and easily
- integration with company data that is required to appear on notices
- embedded rules for mail types, permitted reasons, timeframes, and special circumstances for each line of business
- embedded functionality that support compliance with evidence of mail delivery to insureds and other parties on the notice

Insurers will be able to successfully master the monitoring, analysis, and implementation of regulatory change when the key elements are present in the overall solution.

