



January 8, 2009

Ms. Nancy Hom  
Staff Counsel III  
California Department of Insurance  
45 Fremont Street, 24<sup>th</sup> Floor  
San Francisco, CA 94105

**Re: Comments regarding CDI motion to Repeal REG-2008-00033: Disability Income Insurance Benefit Reduction Regulations, Article 2.2**

Dear Ms. Hom:

① This letter is submitted on behalf of the Association of California Life and Health Insurance Companies (ACLHIC), and the American Council of Life Insurers (ACLI), whose members write the majority of disability income insurance in the United States and California. We appreciate the opportunity to comment on the Department's decision to repeal its regulations governing DII benefit reductions (or "offsets"): Title 10, Chapter 5, Subchapter 2, Article 2.2; Sections 2232.45.1, 2232.45.2, 2232.45.3, 2232.45.4 and 2232.45.5.

We support the Department's decision to repeal these regulations, as we did not believe the commissioner had the authority to promulgate these rules under Insurance Code section 790.03 and 790.10. For example, only through an administrative hearing process is the Commissioner allowed to consider additional changes to 790.03 (which outlines specific prohibited acts). Additionally, in many areas of the regulation, we believe the Office of Administrative Law/Administrative Procedure Act standards of Authority, Clarity and Consistency were not met.

For your convenience, our detailed objections to the original and amended regulations are attached (letters dated July 10, 2007, and April 23, 2008). Again, thank you for the opportunity to provide these comments. Please feel free to contact us if you need any additional information.

Sincerely yours,

Ted M. Angelo  
Legislative and Regulatory Counsel  
ACLHIC

John Mangan  
Regional Vice President, Pacific Region  
ACLI



July 10, 2007

Ms. Nancy Hom  
Staff Counsel III  
California Department of Insurance  
45 Fremont Street, 24<sup>th</sup> Floor  
San Francisco, CA 94105

**Re: COMMENTS on Disability Income Insurance Benefit Reduction Regulations  
(Public Hearing 7/10)**

**Dear Ms. Hom:**

This letter is submitted on behalf of the American Council of Life Insurers and the Association of California Life and Health Insurance Companies, whose members write the majority of disability income insurance in the United States and California. We appreciate the opportunity to comment on the above-captioned proposals.

Generally, we do not believe the commissioner has the authority to promulgate these rules under Insurance Code section 790.03 and 790.10.

**Comments to Proposed Regulation 2232.45.1 and 2232.45.2 (Retirement Benefits)**

**Benefit Reductions Based on Estimated Retirement Awards.** The language of proposed regulation 2232.45.2 is overbroad and inconsistent with the California Department of Insurance (the Department) explanation of intent as presented in the Summary of Existing Law; Effect of Proposed Action, section 2232.45.2, entitled "Benefit Reductions Shall Not be Based on Involuntary Retirement".

The Department indicates its intent is to prohibit disability income policy provisions that force employee retirement by reducing or eliminating benefits through the use of estimated retirement benefit offsets. However, the actual language of the regulation appears to prohibit estimating any amount of benefits the insured might receive under a program for retirement, even if the employee can apply and receive the retirement benefits while working. For example, normal retirement age benefits under Social Security. A disability claimant who is at or past normal retirement age may be eligible to receive SSA retirement benefits (and for some reason, not apply for it) regardless of whether they are retired or working. In this circumstance, estimating a benefit under the SSA's retirement program would not result in a "forced retirement" as described by the Department because the person may continue to work and apply and receive the SSA retirement benefit. Thus, the current proposed regulation is overbroad and would prevent offsetting an estimated retirement benefit that does not force retirement of the insured.

In addition, this proposed regulation is unnecessary and, in part, without legal authority. As the comments to the regulation note, there are already legal restrictions imposed by the Age Discrimination in Employment Act (ADEA) upon the right to estimate retirement benefits when entitlement to those retirement benefits is based entirely on age.

However, the proposed regulations do not merely reiterate what was held by the Court in the *Kalvinskas* case, they expand that holding without legal authority. Subsections (a), (d) and (e) of this proposed regulation deal with retirement benefits that an insured is eligible for based on his or her age. Accordingly, the ADEA already regulates the problems these subsections are intended to address.

In contrast, in subsections (b) and (c), the proposed regulations purport to impose restrictions with respect to offsets for disability retirement benefits. While those terms are undefined, most such plans allow benefits not based on age, but based on meeting a test of disability. The ADEA is not applicable to these situations because there is no age-based classification involved.

The Commissioner cites no legal authority for expanding the effect of the ADEA to these situations. When a carrier finds that an insured is eligible for benefits from a retirement plan to replace income lost due to a disability, a carrier should have the right to use an estimated offset for those benefits if: (a) the insured chooses not to apply for or pursue those disability retirement benefits, (b) the policy notifies the insured of his or her obligation to pursue those benefits, and (c) the carrier has a reasonable means of estimating the amount payable.

The Commissioner must acknowledge that an insured has a duty to mitigate his or her damages. When an insured is eligible for a retirement benefit because of disability, but for whatever reason chooses not to apply for or diligently pursue those benefits, an insurer should have the right to estimate those benefits. There is no legal authority that prohibits estimating an offset for disability retirement benefits. Failing to recognize the strong public policy requiring a party to a contract to mitigate their damages would unnecessarily result in increased costs for California employers and employees seeking group disability income insurance.

This provision is not really necessary at all, given that existing federal law (ADEA and the Older Worker's Benefit Protection Act, as interpreted in the 9th Circuit by *Kalvinskas*) already addresses the issue. Still, we would not find the provision objectionable if it were consistent with the court's holding in *Kalvinskas*. At a minimum, the provision should be modified by striking "voluntary" from line 2, and by removing Social Security and PERS from the list of benefits affected. The Department's stated basis for this provision is to enforce *Kalvinskas*; but the proposed regulation goes farther in two respects.

First, *Kalvinskas* interprets a provision in the Older Worker's Benefit Protection Act which regulates offsets with employer-sponsored pension plans only. It does not purport to regulate offsets against Social Security normal retirement age benefits or other public sector programs. Most LTD plans do in fact terminate benefits for most employees at normal retirement age. There is no good reason why a plan should not be able to provide for continued payment of benefits subject to offset for estimated Social Security normal retirement age benefits or PERS benefits payable at normal retirement age, when it is permissible to terminate benefits entirely at normal retirement age. Moreover, there are means by which the amount of these benefits can be estimated with a high degree of confidence.

Second, *Kalvinskas* only addressed the issue of whether an *estimated* offset for employer-sponsored retirement benefits itself constituted forced retirement, in cases where the employee had to retire in order to receive the estimated retirement benefit.

Finally, if an individual is eligible for disability benefits under a public or private retirement plan, an insurer should have the right to estimate those disability benefits for which they are eligible and offset disability benefits by that amount. There should be a distinction between benefits a retirement plan pays for retirement versus what it pays for disability. Any loss of time benefit paid out for the disability from another plan should be deductible from the group disability plan to avoid double recovery for that loss.

#### **Comments to Proposed Regulation 2232.45.3 (Workers' Compensation - Temporary)**

This proposed regulation is unnecessary and overly broad. The apparent purpose of this regulation is to prohibit group disability insurers from offsetting estimated amounts of workers' compensation benefits when those benefits are being disputed. In those cases where workers' compensation is disputed, industry practice is to pay disability benefits without any offset and pursue recovery of any potential overpayment through the lien process. Thus, the regulation is unnecessary.

Furthermore, the regulation is overly broad because it is not limited just to the circumstance where the insured has diligently pursued workers' compensation benefits and the claim for workers' compensation benefits is pending. It would also prohibit an insurer from offsetting workers' compensation benefits in those situations where the insured fails to provide adequate notice of an accident that would give rise to a claim or fails to cooperate with the workers' compensation carrier's claim requirements. The duty of good faith runs both ways in an insurance contract and the insured has a duty to mitigate his or her damages. If an insured chooses to not pursue a claim for workers' compensation for which he or she is eligible and would be entitled had the insured diligently pursued that claim, the disability insurance carrier should not bear the burden. Instead, in that circumstance, sound public policy supports allowing the insurance company to reduce the insured's claim by that amount. There is no legal authority for the Commissioner to prohibit parties from agreeing to recognize that public policy.

The language of proposed regulation 2232.45.3 is incomplete and will result in double recovery for the dishonest or uncooperative claimant. The proposed regulation misinterprets *Silberg v. California Life Insurance Co.* The issue in that case was not that the insurer estimated workers' compensation benefits, but that the insurer did not have a good faith basis for doing so, given that the claimant's eligibility for workers' compensation was being contested. Where there is a good faith basis for believing a claimant is eligible for workers' compensation benefits and for estimating the amount of benefit due, a carrier should have the ability to offset. Asserting a lien is inefficient as it increases costs.

To avoid this result, we suggest that a workable solution would allow for estimated offsets where: (1) the claimant has failed to pursue this benefit with reasonable diligence; (2) the carrier has a reasonable good faith belief that the claimant is entitled to such benefit and a reasonable means of estimating the amount payable; or (3) the carrier has a good faith belief that the claimant has received or is receiving temporary workers' compensation benefits, and (4) the claimant fails to provide information reasonably requested by the carrier in relation to application for, or receipt of, workers' compensation benefits. Without the requested change, the honest and diligent insured will be penalized in comparison to the dishonest and uncooperative claimant. In addition, the effect of the overpaid claims will harm the plan, the plan sponsor and current and future participants in the form of higher premium rates. We would be willing to discuss this issue further with the Department.

### Comments to Proposed Regulation 2532.45.4 (Workers' Compensation – Permanent)

This proposed regulation would prohibit a group insurance policy from including an offset for permanent workers' compensation benefits. The cited authority does not provide a valid basis for the proposed regulation. Furthermore, the regulation would also encourage structuring workers compensation payments to avoid any offset.

The comments accompanying the proposed regulation cite to *Russell v. Bankers Life Co.*, (1975) 46 Cal. App. 3d 405. This proposed regulation misinterprets this decision, which did not hold that the offset was contrary to public policy, or inappropriate in all cases. It held only that the policy language in question did not clearly allow for the offset. The Department's stated rationale – that permanent benefits cover the employee's working capacity through retirement age – is in fact the best argument for allowing this offset, as most LTD policies are covering the same risk.

Allowing the offset to the extent that the award is attributable to the period for which benefits are payable under the disability policy is consistent with the Department's stated rationale. Failure to allow this offset results in situations where an LTD benefit, which pays a benefit through normal retirement age, is unable to take into account the workers' compensation award covering the same period of disability.

The *Russell v. Bankers Life Co.* case does not stand for the blanket proposition that permanent workers' compensation benefits cannot be offset under California law. Instead, the Court ruled that the insurer could not offset the workers' compensation settlement at issue for two reasons. First, there was a conflict between the terms of the group policy and the booklet outlining the coverage that had been provided to the insured. Second, the Court found that the particular policy language was ambiguous about whether the phrase "loss of time" was intended to modify the offset for workers' compensation benefits. The holding of the *Russell* case cannot be expanded beyond the particular facts and particular policy language at issue in that case.

The comments also reference Cal. Labor Code 4903.1(a)(3). That statute recognizes that a disability insurer would have a lien against any payments of temporary workers' compensation payments to the extent of disability income insurance benefits received. This is not sufficient legal authority to prohibit any offset for permanent benefits. The fact that the legislature created a remedy for disability insurers but limited the remedy to temporary workers' compensation benefits cannot be reasonably construed as an outright prohibition on an offset for permanent workers' compensation benefits.

Further, the comments do not assert the Commissioner has legal authority to issue this regulation on the grounds that an offset for permanent workers' compensation benefits is an unfair trade practice. Instead, the Commissioner asserts that he has authority to make the definition of unfair trade practices more specific. However, the Insurance Code specifically defines unfair trade practices in Cal. Ins. Code 790.03. Offsetting permanent workers' compensation benefits is not included within those definitions. The only statutorily authorized way for the Commissioner to specify conduct as an unfair trade practice is through an administrative complaint and a hearing as described in Cal. Ins. Code 790.06. The Commissioner cites no such ruling and we are not aware of any. Accordingly, the Commissioner is without authority to issue a regulation applicable to permanent workers' compensation benefits.

Finally, limiting an insurer's right to offset only temporary workers' compensation benefits will result in a windfall to an insured and possible additional litigation. When workers' compensation benefits are disputed, the parties frequently agree to a compromise settlement. If a disability insurer only has the right to offset temporary workers' compensation benefits, the settlement is likely to be structured to recite that the benefits are for permanent benefits or for medical expenses. The intent of such a settlement would be that the disability insurer would be deprived of its right to offset all or a portion of the lump sum the insured received from the workers' compensation carrier. If such a settlement is allowed, the insured would receive windfall disability income insurance benefits without an offset and a payment of what is essentially temporary workers' compensation benefits. To avoid such a result, a disability carrier would be forced to intervene in the workers' compensation matter to protect its interest and litigate in the event that such a settlement is attempted. This could delay workers' compensation payments, place additional burdens on the workers' compensation system, and result in increased costs for the disability insurance carrier that may be passed along to the policyholder and employees in the form of increased rates.

We request that this provision not be adopted.

#### **Comments to Proposed Regulation 2532.45.5 (Work Earnings)**

This proposed regulation appears unnecessary and the cited authority does not support the authority of the Commissioner to issue it. This proposed regulation would require an insurer to have a good faith basis for estimating earnings that would be the subject of an offset. However, an insurer's duty of good faith is already implicit in the insurance relationship. The Commissioner has failed to provide any evidence that violations of this duty occur so frequently as to make this regulation necessary. We request this section be deleted.

#### **Comments to Proposed Regulation 2536.2(b)(4) (Advertisements)**

While we support the premise that the existence and effect of offsets should be made clear in conjunction with description of the amount of benefit payable, we believe the regulation goes too far in requiring advertisements to contain specific illustrative examples. Examples are not necessary to make the effect of offsets clear, and in some cases may be a more confusing way of presenting the information to the consumer. In addition, the proposed regulation would create a burdensome requirement that would be expensive and difficult to satisfy. These additional costs would be ultimately born by California employers and employees. Further, as it is currently drafted, the proposed regulation is ambiguous regarding the scope of its applicability.

The proposed regulation ignores that most group disability insurance is offered by and through employers, who very often will create their own descriptive materials. In fact, employers will create their own descriptive materials if they consider the materials provided by the carrier to be too cumbersome. In our experience, carrier-created materials are most readily accepted by employers when they are clear and brief.

The requirement of disclosing each possible reduction of benefits, the circumstances when each reduction applies and including an example of each of those reductions would impose a significant, impractical burden and transform advertisements from a brief description of the product into a detailed description of claims process, more lengthy than the applicable policy provisions themselves. Because factual claim situations vary by individual, how the offset ultimately applies in any given situation will vary.

Furthermore, the proposed regulation could be interpreted to apply to many different types of advertising. The regulation applies to any advertisements for the policy when a group disability income insurance policy contains a provision which reduces the benefit payable. "Advertisements for the policy" are not defined, which will lead to speculation and conjecture about the types of advertisements to which these requirements would be applicable.

The current advertising regulations divide the types of advertising into three categories: (1) institutional advertisements; (2) invitations to inquire; and (3) invitations to contract. These are defined in 10 CCR 2535(g)-(i). Other existing regulations are drafted with reference to these categories. For example, 10 CCR 2526.2(b)(1) is limited to an advertisement which is an invitation to contract. By not being similarly restricted, the proposed regulation is unclear about its scope and applicability.

Not being clear in the scope and applicability, the regulation creates significant financial and administrative burdens because it applies to all group disability advertising, including invitations to inquire and institutional advertisements. The application of this proposed rule should be narrowed. The Department should consider adding language to the proposed regulation excluding institutional advertisement as defined in Section 2535.3(g) and an invitation to inquire as defined in Section 2535.3(h). If the Department does not change the language of the proposed regulation, then it should restrict application of the proposed regulation to invitations to contract in the same fashion as set out in existing Guideline 2536.2(b)(1). That Guideline states that: (1) an institutional advertisement as defined in Section 2535.3(g) is not subject to the proposed regulation, and (2) an invitation to inquire as defined in Section 2535.3(h), which mentions either the dollar amount of the benefit payable (including when expressed as a percentage of wage or earnings) and/or the period of time during which the benefit is payable, must include a description of each such reduction and the circumstances under which the reduction would apply, including an illustrative example, and appearing with the same prominence as the maximum benefit amount.

The proposed regulation should exclude group disability income insurance issued to employer groups. One of the stated public policy reasons for the change is that the Department sees that *"problems arise when the purchasers of such policies or the persons insured by such policies are unaware at the time the policy is purchased that the insured will not receive the maximum benefit amount stated in the policy marketing material."* We have not seen evidence in the marketplace that employers are unaware of the offsets in the group disability policies. In fact, it appears that employer groups - the vast majority of which are governed by the ERISA - have designed their employee benefits program with offsets as an essential feature. Employers and their insurance agents are sophisticated purchasers who choose to design their plans with certain offsets. Thus, we would request that advertisements directed only at employer policyholders should be exempted.

We do believe it is possible to craft a clear disclosure that would be helpful to the consumer. For example, we believe it would be clear to state that: "The LTD policy pays a benefit of 60% of pre-disability earnings, to a maximum of \$10,000 per month, reduced by Social Security disability or retirement benefits, workers' compensation disability benefits, and other specified offsets." We would be happy to discuss this issue further with the Department.

Thank you for your consideration of these comments. Please feel free to contact us with any questions.

Sincerely yours,



Ted M. Angelo  
Legislative and Regulatory Counsel  
ACLHIC



John Mangan  
Regional Vice President, Pacific Region  
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April 23, 2008

Ms. Nancy Hom  
Senior Staff Counsel  
California Department of Insurance  
45 Fremont Street, 24<sup>th</sup> Floor  
San Francisco, CA 94105

**Re: Amended text to Proposed Disability Income Insurance Benefit Reduction Regulations  
(REG-2006-00009)**

Dear Ms. Hom:

This letter is submitted on behalf of the American Council of Life Insurers and the Association of California Life and Health Insurance Companies, whose members write the majority of disability income insurance in the United States and California. We appreciate the opportunity to comment on the amended text to the above-referenced regulations that propose to govern benefit reductions in Disability Income Insurance products. These comments are intended to supplement many of the concerns outlined in our letter of July 10, 2007.

In many areas of the proposed regulations, we continue to believe the commissioner does not have the authority to promulgate these rules under Insurance Code sections 790.03, 790.06 and 790.10. For example, only through an administrative hearing process is the Commissioner allowed to consider additional changes to 790.03 (which outlines specific prohibited acts). Additionally, in many areas of the proposed text, we believe the Office of Administrative Law/Administrative Procedure Act standards of Authority and Consistency are not met.

**Comments to Proposed Regulation 2232.45.2 (Retirement Benefits)**

The amended language of proposed regulation section 2232.45.2 seems to satisfactorily address the Department's previous concerns regarding the potential for forced retirement. The revisions appear to resolve the concerns we had expressed that the Department was misinterpreting *Kalvinskas*. *Kalvinskas* addresses where benefits have the effect of forcing retirement, and cannot be read as supporting a prohibition on estimating offsets where the insured actually has retired.

However, in subsections (b) and (c), the proposed regulations continue to impose restrictions with respect to offsets for disability retirement benefits. When a carrier finds that an insured is eligible for benefits from a retirement plan to replace income lost due to a disability, a carrier should have the right to use an estimated offset for those benefits if: (a) the insured chooses not to apply for or pursue those disability retirement benefits, (b) the policy notifies the insured of his or her obligation to pursue those benefits, and (c) the carrier has a reasonable means of estimating the amount payable.

The Commissioner must acknowledge that an insured has a duty to mitigate his or her damages. When an insured is eligible for a retirement benefit because of disability, but for whatever reason chooses not to apply for or diligently pursue those benefits, an insurer should have the right to estimate those benefits. There is no legal authority that prohibits estimating an offset for disability retirement benefits. Failing to recognize the strong public policy requiring a party to a contract to mitigate their damages would unnecessarily result in increased costs for California employers and employees seeking group disability income insurance.

#### **Comments to Proposed Regulation 2232.45.3 (Workers' Compensation - Temporary)**

We have no additional concerns with the amended text. However, we continue to believe that this proposed regulation is unnecessary and overly broad. The apparent purpose of this regulation is to prohibit group disability insurers from offsetting estimated amounts of workers' compensation benefits when those benefits are being disputed. In those cases where workers' compensation is disputed, industry practice is to pay disability benefits without any offset and pursue recovery of any potential overpayment through the lien process. Thus, the regulation is unnecessary.

Also, the regulation seems to continue to prohibit an insurer from offsetting workers' compensation benefits in those situations where the insured fails to provide adequate notice of an accident that would give rise to a claim or fails to cooperate with the workers' compensation carrier's claim requirements. The duty of good faith runs both ways in an insurance contract and the insured has a duty to mitigate his or her damages. If an insured chooses to not pursue a claim for workers' compensation for which he or she is eligible and would be entitled had the insured diligently pursued that claim, the disability insurance carrier should not bear the burden. Instead, in that circumstance, sound public policy supports allowing the insurance company to reduce the insured's claim by that amount. There is no legal authority for the Commissioner to prohibit parties from agreeing to recognize that public policy.

#### **Comments to Proposed Regulation 2232.45.4 (Workers' Compensation - Permanent)**

This proposed regulation would continue to prohibit a group insurance policy from including an offset for permanent workers' compensation benefits. The cited authority does not provide a valid basis for the proposed regulation. Furthermore, the regulation would also encourage structuring workers compensation payments to avoid any offset.

The comments accompanying the proposed regulation cite to *Russell v. Bankers Life Co.*, (1975) 46 Cal. App. 3d 405. This proposed regulation misinterprets this decision, which did not hold that the offset was contrary to public policy, or inappropriate in all cases. It held only that the policy language in question did not clearly allow for the offset. The Department's stated rationale – that permanent benefits cover the employee's working capacity through retirement age – is in fact the best argument for allowing this offset, as most LTD policies are covering the same risk.

Allowing the offset to the extent that the award is attributable to the period for which benefits are payable under the disability policy is consistent with the Department's stated rationale. Failure to allow this offset results in situations where an LTD benefit, which pays a benefit through normal retirement age, is unable to take into account the workers' compensation award covering the same period of disability. This is still a problem and will likely make it impossible for insured LTD plans to avoid duplicate payments.

Further, the comments do not assert the Commissioner has legal authority to issue this regulation on the grounds that an offset for permanent workers' compensation benefits is an unfair trade practice. Instead, the Commissioner asserts that he has authority to make the definition of unfair trade practices more specific. However, the Insurance Code specifically defines unfair trade practices in Cal. Ins. Code 790.03. Offsetting permanent workers' compensation benefits is not included within those definitions. Again, the only statutorily authorized way for the Commissioner to specify conduct as an unfair trade practice is through an administrative complaint and a hearing as described in Cal. Ins. Code 790.06.

**Comments to Proposed Regulation 2232.45.5 (Work Earnings)**

This proposed subsection appears unnecessary and the cited authority does not support the authority of the Commissioner to issue it. Again, only through an administrative hearing process is the Commissioner allowed to consider additional changes to 790.03. This proposed regulation would require an insurer to have a good faith basis for estimating earnings that would be the subject of an offset. However, an insurer's duty of good faith is already implicit in the insurance relationship.

**Comments to Proposed Regulation 2536.2(b)(3)&(4) (Advertisements)**

While we support the premise that the existence and effect of offsets should be made clear in conjunction with description of the amount of benefit payable, we believe the regulation continues to go too far in requiring advertisements to contain specific illustrative examples.

While improved, the guidelines are not necessary to make the effect of offsets clear, and in some cases may be a more confusing way of presenting the information to the consumer. A specific requirement that two offsets be illustrated could be very confusing, when most of the time there will only be one offset affecting a disability benefit at any given point.

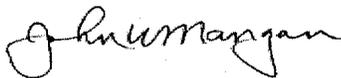
Group disability insurance is offered by and through employers, who very often will create their own descriptive materials. In fact, employers will create their own descriptive materials if they consider the materials provided by the carrier to be too cumbersome. In our experience, carrier-created materials are most readily accepted by employers when they are clear and brief.

Thank you for your consideration of these comments. Please feel free to contact us with any questions.

Sincerely yours,



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