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Issue Brief

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Kansas and Texas Enact Self-Audit Privilege

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Executive Summary

Self-audit privilege laws adopted in Kansas and Texas this year will promote the conduct of internal audits by insurance companies, providing greater protections to insurance consumers in the process. Without the privilege, insurance companies interested in using proactive self-evaluative audits are limited by the reality that the audits may be used against them even if problems identified in the audit have been corrected. The self-audit privilege is a consumer protection tool that encourages good market practices.

With enactment of the Kansas and Texas laws, eight jurisdictions now provide the self-audit privilege. The other six are: the District of Columbia, Illinois, Michigan, New Jersey, North Dakota and Oregon. While not identical, each of the laws has many similarities. Generally, for the privilege to apply:

1. A company must audit its practices and correct identified problems within a reasonable time.

2. If the company fails to correct the problem within a reasonable time, the privilege will not apply.

3. Audits may not be used to hide illegal or improper activity.

4. Lastly, the insurance regulator may obtain audit documents to ensure that the company is following through on its findings. (Illinois does not grant administrative access to self-evaluative audits, the regulator must go to court to gain access.)

5. Failure to correct problems may result in regulatory sanctions.

Summary of Kansas Enactment

Originally introduced as HB 2357, the Kansas law states that an insurance compliance self-evaluative audit document is privileged information and will not be discoverable or admissible as evidence in legal action in any civil, criminal or administrative proceeding assuming corrective action is taken in the course of the self-audit.

Accordingly, the audit and corrective action would also not be subject to discovery or admissible as evidence in any civil, criminal or administrative proceeding. Such documents could be voluntarily submitted to the insurance commissioner as confidential documents in the course of an examination without waiving the privilege. Any provision of current law or amendments thereto permitting the insurance commissioner to make confidential documents public or to grant the National Association of Insurance Commissioners (NAIC) access to confidential documents shall not apply to insurance compliance self-evaluative audit documents voluntarily submitted by an insurance company. Any self-evaluative audit voluntarily submitted to and in the possession of the insurance commissioner shall remain the property of the insurance company and shall not be subject to any disclosure or

production under the Kansas open records act. The self-audit privilege shall not apply if, after an in camera review consistent with the code of civil procedure, a court or administrative tribunal determines, for example, the self-evaluative audit document shows evidence of noncompliance with applicable laws or regulations or if the privilege is asserted for a fraudulent purpose.

The Kansas House approved HB 2357 by a vote of 81-40 on February 25. The bill was amended by the Senate Finance Committee and unanimously adopted by the Senate on March 25. Following a conference committee to reconcile House and Senate versions, the full Legislature adopted the bill on April 1. Governor Kathleen Sebelius, who formerly served as Insurance Commissioner, signed the bill on April 15. It became effective on July 1.

Summary of Texas Enactment

The Texas self-audit privilege provision was one of many topics addressed in SB 14, a wide-ranging enactment which includes creation of a new section of law establishing specific regulatory protocols for market conduct examinations. Subchapter F (Sec. 751.251 b and c) states that an insurer may not be compelled to disclose a self-audit document or waive any statutory or common law privilege. An insurer may, however, voluntarily disclose a self-evaluative audit document to the commissioner in response to any market conduct action or examination.

The Texas law differs from the Kansas act in that the commissioner **may** share a self-evaluative audit document obtained by or disclosed to the commissioner with other state, federal, and international regulatory agencies and law enforcement authorities if the recipient agrees to and has the legal authority to maintain the confidentiality and privileged status of the self-evaluative audit document.

The Texas Senate unanimously approved (31-0) SB 14 on April 21. On May 27, the Senate refused to concur with House amendments and requested a conference committee. The House granted request for conference on May 28 and on May 29, the Senate adopted the Conference Committee Report again by a vote of 31-0. The House adopted the report by a non-record vote. The bill was signed by Governor Rick Perry and becomes effective September 1, 2006.

Why It's Important

Insurance companies have become increasingly aware of the need to conduct self-evaluative analysis audits to determine their compliance with laws and regulations in states where they do business. The self-evaluative process has evolved in part as a reaction to insurance regulators who have become more aggressive in pursuing market conduct examinations. There is also recognition among insurers of the need to develop best practices as a way of creating greater value for customers in a competitive marketplace. As a result, insurers are seeking assurances that if they conduct voluntary self audits, any reports produced in connection with these audits are treated as privileged information. Without the privilege, insurance companies fear such reports may be used against them in administrative procedures or become public under open records laws and be used to pursue class actions suits.

NAMIC Position

There has not been strong support among state regulators or legislators to embrace a self-evaluative privilege for insurance companies even though nearly all states have adopted a similar privilege for medical peer reviews and more than half the states have enacted protections for environmental self-audits.

The National Conference of Insurance Legislators (NCOIL) adopted a model act regarding insurance compliance self-evaluative audit documents in 1998, upon which many of the eight current jurisdictions offering the privilege based their laws. In 2004, NCOIL adopted a model act regarding Market Conduct Surveillance that NAMIC and other organizations have not endorsed for the following reasons:

- The model does not place reasonable limitations on the data collection authority granted to regulators;
- The model does not establish reasonable limits on market conduct examination fees;
- The model needs clarification authorizing only targeted exams for cause, not general purpose exams;
- The model does not include sufficiently strong self-evaluative privilege language; and

- The model does not assure that the due process rights of insurers are being examined.

NAMIC has encouraged NCOIL to re-open debate on the model in an effort to gain consensus for a proposal that protects consumers, streamlines regulatory authority and provides needed reforms to insurers subject to market conduct exams.

NAMIC believes the interests of insurance consumers are enhanced by an insurance company's voluntary monitoring and reviewing of state insurance laws. We also believe the public ultimately benefits from incentives that identify and remedy compliance problems. Legal protection for self-evaluative reports will encourage voluntary compliance and will improve insurance market conduct quality. NAMIC is hopeful that enactment in 2005 of the self-evaluative privilege in Kansas and Texas, as well as a strong attempt to enact the privilege in Missouri, will encourage additional states to adopt the privilege in 2006 and move the country as a whole closer to common-sense market conduct surveillance.