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RE: Public Comments to Proposed Rulemaking R21-93 amending R20-6-407

Dear Ms. Kosinski:

On behalf of the Service Contract Industry Council ("SCIC"), I am writing to you to provide the SCIC's comments to the Department of Insurance and Financial Institutions ("Division") on the proposed amendments to Arizona's Proposed Rulemaking R21-93 amending R20-6-407 regarding service contracts. By way of background, the SCIC is a national trade association whose member companies include manufacturers, service contract providers, administrators, and retailers offering service contracts covering motor vehicles, homes and contract holder goods throughout the country. Combined, we estimate our member companies offer over 80% of the service contracts available in the marketplace today.

The SCIC has played a significant role in the development of uniform regulatory standards appropriate for the industry and contract holders, and actively pursues model legislation, lobbies for those standards, and provides industry advice for legislative and regulatory issues. The association was established in 1991 and has worked with lawmakers and regulators around the country as well as the National Association of Insurance Commissioners ("NAIC") in the development of fair and comprehensive regulations governing the service contract industry.

The SCIC appreciates the opportunity to respond to the proposed rulemaking and offers the following comments:

I. Statutory Changes and Proposed Rulemaking:

Two relevant pieces of legislation were passed, and signed by the Governor, in 2021 that form the basis for the proposed rulemaking, Senate Bill 1049 and House Bill 2443, both with effective dates of September 29, 2021. The proposed rules, R21-93 amending R20-6-407 which were published on July 30, 2021, provide guidance on the statutory changes, in addition to providing modifications and clarifications to existing rules.

II. SCIC Comments:

A. Preexisting Conditions

Title 20, Chapter 4, Article 11 §D.12. of the Arizona statutes states: "[s]ervice contracts shall clearly indicate whether preexisting conditions are covered or excluded under the terms of the service contract."

The proposed draft rule states:

> "No service contract form shall be approved unless it: . . . [n]otifies the contract holder that the denial of a claim can be appealed if the contract holder can produce a home inspection report, maintenance records, or other evidence that show the contract holder was not aware, at the time of contracting, of any preexisting condition that would be the basis for the denial of the claim;"

The proposed draft rule goes beyond what the statute authorizes, as amended by Senate Bill 1049 and the subsequent House Bill 2443. The statute requires contract holder notice as to whether preexisting conditions are covered or excluded under the service contract. The proposed rule identifies new considerations that an administrator must consider in adjudicating a claim, such as:

- the availability of a home inspection report,
- the availability of maintenance records, or
- "other evidence" that show the contract holder was not aware, at the time of contracting, of the preexisting condition that is the basis for denial.

A standard adjudication or inspection process objectively assesses the breakdown to determine if there's a valid, covered claim. If a preexisting condition is discovered through this process, that is clear and contractually absolves the provider from covering damage that it should not legally, or contractually, be obligated to pay, and there's no other provision in the contract to the contrary, the claim is denied – that burden currently resides with the provider to establish. The proposed rule seems to enable the contract holder to throw any evidence into the process, which would place heightened burdens and requirements on the provider and could further confuse the process. Consider what happens when there's multiple, competing documents that speak to whether knowledge existed and was readily available prior to the date of contracting? How is a provider to reconcile? In addition, this also introduces the concept of moral hazard and purchasing coverage when a known defect exists, the objective evidence of inspection becomes irrelevant and the purported knowledge of what the contract holder knew, or didn't know, at the time of contracting is the operative fact.

Furthermore, litigation and/or arbitration will ensue to resolve conflicts. Of supreme concern is what constitutes "other evidence"? This is highly subjective and could lead to untenable situations that put the provider and administrator at a significant disadvantage. In addition, the denial of a claim can be "appealed" according to the proposed rule, which adds further misunderstanding to the process. For example, what does an appeal look like? How does that work? Must a provider and/or administrator honor all appeals in this realm? Please keep in mind that it is standard industry practice where a contract holder may also protest or ask for reevaluation of their claim, including securing additional information that may be helpful to fully understand the outcome of their claim decision. The industry has a longstanding practice of honoring this process and the current framework strongly supports a consumer's ability to have their claim reevaluated, so the language on this topic in the proposed draft rule does little to enhance contract holder protections.

In our opinion, and supported by the current statute, the clear exclusion disclosure language in the contract holder's form, leveraging objective criteria and objective loss adjustment processes, is the best way to manage preexisting conditions and we respectfully request the final rule remove all new requirements currently being proposed pertaining to preexisting conditions.

B. <u>Disclosure of Coverage Exclusions</u>

The current rule requires contracts to list in large bold-faced type specific items or components which are excluded from coverage. The proposed draft rule adds "[a]ny item or component not specifically excluded from a covered system, product or appliance is covered."

The proposed rule appears to go too far in affirming coverage for any item or component not specifically excluded, but it fails to consider that other limitations, conditions and exclusions that might exist in the form. It's a considerable switch to require providers to list specific items or components which are excluded from coverage to requiring forms to list "any item or component not specifically excluded" and suggesting that failure to do so could result in a covered claim.

The new requirement will force providers to enumerate every possible item or component that would not be covered, which will add significant length of the form, introduce more confusion for contract holders and require a constant change, and refiling, of forms to accommodate new items or situations that may not exist on prior forms. Consider the area of automobile service contracts, with hundreds of component parts that vary wildly by manufacturer, vehicle model and customization (e.g., limited edition, luxury etc…). How could this possibly be administered? This is a significant change in risk and conflicts with statute 20-1095.06 D.6 which requires "6. Service contracts shall specify the merchandise and services to be provided and any limits, exceptions or exclusions. Exclusions from coverage shall be in bold-

faced type. Service contracts may, but are not required to, cover damage resulting from rust, corrosion or damage caused by a noncovered part or system." Many companies offer both inclusionary and exclusionary coverage allowing consumers a flexible fee structure for the products.

To remove ambiguity and avoid confusion, we recommend reverting to the old language, which appears sufficient and protective of contract holder interests.

C. <u>Required Disclosures</u>

The rule adds new requirements regarding what needs to be stated in the contract:

1. "…in clear and easily understood language the specific circumstances under which a contract holder may engage a subcontractor who is not recommended by the service company without becoming financially responsible under the contract and whether pre-authorization is required prior to engaging a subcontractor who is not recommended by the service company…"

Listing specific circumstances under which the contract holder may engage a subcontractor that is not recommended by the service company will be difficult to administer. It is extremely difficult to contemplate every "specific" circumstance that will govern this situation, which could lead to an endless cycle of form changes and Division filings to contemplate enhancements, emerging loss trends and other patterns that need to be addressed. Administrators have a vested interest in providing timely, competent and safe repairs to contract holders due to covered breakdowns, coupled with extensive requirements dictating how to adjudicate claims and avoid unfair claim practices. This language also appears to prohibit pre-authorization. The ability to authorize a claim provides the consumer with certainty knowing what their financial responsibility will entail. Our recommendation and supported by the statute, is to allow claims professionals and administrators the professional discretion to adjudicate claims in a compliant, safe and timely manner, recognizing that preauthorization to utilize subcontractors is the best way to protect the interests of all stakeholders.

2. "…in clear and easily understood language the service company's financial responsibilities to the contract holder when any of the systems, products or appliances covered by the contract cannot be replaced or repaired…"

It is unclear what is meant by "financial responsibilities to the contract holder when any of the systems, products or appliances covered by the contract cannot be replaced or repaired." Again, this will add additional language to the contract that could also lead to further contract holder confusion. In addition, the commitment under the form/agreement is to repair or replace breakdowns after they occur, ensuring the contract holder is made whole when coverage exists

under a covered claim. There are several ways in which an administrator can perform this legal and contractual obligation, which enables the administrator to work with the contract holder in a way that is in everyone's best interest and aligned with applicable adjudication statutes and requirements. It is our recommendation that this requirement be removed from the final rule and leverage the plain reading of the forms to dictate situations where a repair or replacement is not possible following a covered claim.

> 3. "….the dates of coverage under the service contract including any delay in coverage that differs from the purchase date of the contract which would extend the coverage term of the contract and any terms that govern renewal of the service contract…"

A.R.S. § 20-1095.06 does not require that any coverage be extended or renewed. Again, if the Division requires this language, we respectfully request the addition of language 'If applicable' to be clear. Without modification the proposed rule is redundant as this information already exists in the form and further requirements would add to the length of the form and potentially introduce contract holder confusion. Typically, the term and date that coverage begins is on the declarations page, with renewal terms in a separate section that govern cancellation and/or termination. Requiring this language to be duplicated via a disclosure or elsewhere in the form could lead to confusion, duplication and extend the length of the form. It is our recommendation that this requirement be removed from the final rule, recognizing that these are key, salient terms that are always addressed in the base form and easy to locate.

D. <u>Financial Disclosure Requirements</u>

Current law requires that a service company applicant be solvent but as stated in A.R.S. § 20-1095.03 B "does not require the director to determine the actual financial condition or claims practices of any service company" and "[t]he issuance of a service company permit indicates only that the entity appears to be financially sound and to have satisfactory claims practices and that the director has no credible evidence to the contrary." Additionally, Arizona Senate Bill 1049 removed statutory references to *audited* financial statements and *certified public accountants*.

The proposed draft rule requires a service company to submit a copy of "the service company's most recent financial statement, including an income statement and a balance sheet, verified by a certified public accountant." It also defines "solvent" and requires applicants submit: "a summary of the applicant's financial position."

The proposed draft rule adds new requirements not contemplated in the current statute. Certainly, the Division has a responsibility and mandate to ensure applicants have the financial wherewithal to make good on their obligations and remain solvent, but the proposed rule seems to require specific, discreet methods to satisfy this requirement that may be inconsistent with current industry practices and add additional costs to preparing financial information. In

addition, the current requirements appear vague and difficult to understand. For example, what type of "summary" would be required for the applicant's financial position? We would recommend that the final rule indicate that the applicant must submit its most recent financial statement, including an income statement and a balance sheet, but to present the information in the method and format that they currently prepare in accordance with standard business or accounting practices, which also preserves all other, existing powers delegated to the Division to review the financial competency of the applicant. We further suggest that new, arbitrary documents that may not be currently developed could lead to filing and approval delays and added costs for providers.

E. Disclosure of Disciplinary Actions against Owners

The current rule requires a list of suspensions, revocations or other disciplinary or rehabilitative actions taken against the applicant. The proposed draft rule additionally requires "a list of actions taken against any of the owners, officers, managers, or directors of the applicant in any jurisdiction by a regulatory agency or state attorney general."

This appears to go beyond the statutory requirement and current Arizona law and could inject additional concerns with the stakeholders listed in the proposed draft rule, which go beyond standard NAIC requirements or the biographical affidavits that may previously have been required. This seems to shift the focus from the applicant to a broader subset of individuals, some of which may not be in any sort of leadership or officer-level role. For example, what is contemplated by the term "manager," and how pervasive and expansive is that list desired to be? We respectfully request this provision be removed in the final rule, with focus on current rule requirements and reliance on the existing biographical affidavits.

F. Application Catch-All

The current rule doesn't enable the Division to ask for additional items in the application process. The proposed draft rule also requires applicants submit "any other information the division deems necessary."

While we understand there may be instances where it would be helpful or appropriate for the Division to request information not strictly contemplated, the proposed rule is very broad and will lead to confusion. We certainly do not want to impede the Division's ability to properly regulate the industry and protect contract holders, but the industry would desire more concrete guidance to effectively understand what could reasonably be requested by the Division. Our recommendation would be to remove this catch-all requirement, recognizing the Division has broad authority under separate, existing sections to secure the needed information to perform a full and complete assessment of the applicant in alignment with its statutory mandate.

G. Timeframe to Provide Contract to Holder and to Perform Services

Current law requires a service company to provide a copy of the service contract to the service contract holder within a reasonable period-of-time after the date of purchase. The proposed draft rule defines reasonable period-of-time as "mailed or electronically delivered but not more than two business days after the purchase date of the contract."

Although the obligation to deliver the terms and conditions to the contract holder remains a high priority and the statutory requirement is within a "reasonable" time, two business days will be extremely difficult for the industry in certain circumstances and unduly burdensome. With the high volume of transactions, we respectfully recommend that the definition of "reasonable" and "reasonable period of time" be removed from the final rule, and general practices of reasonableness and protections imposed by unfair trade practices and standard business policies should govern provider and administrator behaviors in delivering contract holder forms. In our estimation, this balances the interests of service companies, regulators, administrators and contract holders and aligns with the statute.

In addition, current law lists "failure to perform the services promised under the service contract within a reasonable time and in a competent or workmanlike manner" as an unfair trade practice.

The proposed draft rule states that a reasonable time is "what an ordinary person would consider 'reasonable' under the totality of the circumstances. This is highly subjective and could lead to a lot of confusion in the marketplace; we respectfully request this language be stricken from the final rule and that the statute stand on its own merit.

H. Cancellation Fees

The proposed rule states:"[n]o service contract form shall be approved unless it…[s]tates that the administrative expenses may not exceed $75 or 10% of the purchase price of the service contract, whichever is less, when providing a pro rata refund upon cancellation of the service contract before the end of the coverage period of the service contract."

The proposed draft rule requires the above statement in all forms. While the industry accepts the ability to collect the cancellation fees to help absorb processing and related costs associated with cancellation of contracts, a provider or administrator may not wish to charge a cancellation fee and this appears to not be an option, as drafted. The language as stated in the rule conflicts with A.R.S. § 20-1095.06.D.9. which requires the disclosure, if applicable, and that the administrative expense may not exceed $75 or 10% of the gross amount paid whichever is less. We recommend the following modification to the final rule to align with the statutory intent to read as follows: "no service contract form shall be approved if it……[s]tates that the administrative expenses exceed $75 or 10% …."

I. List of Subcontractors Under Common Ownership or Control

The proposed draft rule would require an applicant to submit the name and contact information of any administrator used; requiring a "list of subcontractors who are under common ownership or control or are affiliated with the applicant."

We respectfully ask that this requirement be removed. The service contract form will clearly identify the provider and administrator, with relevant contact information, to ensure contract holders know who to contact if they have any questions or concerns, or would like to submit a claim, under the terms and conditions of the contract. Listing all subcontractors would confuse contract holders, adds unneeded steps to the application, and renewal, process that do not serve a purpose that appears aligned with statutory intent. The applicant and the contracting parties with the contract holder retain all responsibility under the law and contract to fulfill its obligations and providers, administrators and other parties may elect to utilize subcontractors if permitted by law. Listing all subcontractors would add confusion for contract holders on who to contact, be cumbersome and unduly burdensome for the industry, and do not appear to advance any statutory or regulatory purpose. We respectfully request this request be removed in the final rule.

J. In the Renewal Form, Changes to the Administrator Information and the "types of items" covered

The proposed draft rule requires in the renewal form that it include "[a]ny changes to the service company's contact person or persons or service contract administrator, or their contact information" and "[a]ny changes to the types of items the service company intends to cover under its service contracts." It is unclear why this information is necessary as the administrator's contact information would always appear in the service contract form. We respectfully request this requirement be removed from the final rule. Further, pertaining to the "types of items" the provider intends to cover, it is unclear what this means and how this would be addressed. Do "items" include categories of products, specific parts, something else, etc…? This could be a daunting task to list and providers would be fearful of inadvertently omitting something that the Division would view as important. The service contract form is the governing document that memorializes the obligations to the contract holder; we respectfully request that this requirement be removed from the final rule.

III. Concluding Thoughts

We appreciate the Division's willingness to allow written comments and to carefully consider the items outlined in this public comment letter. We are very interested in continuing the dialogue with the Division on the proposed revisions to the rules. Based upon the foregoing,

it is our hope that a consensus can be reached that both addresses the Division's concerns as well as avoids the establishment of new requirements that are sometimes broader than what is contemplated in the statute or could be potentially harmful to contract holders and the delivery of benefits under the contract terms and conditions.

Sincerely,

Timothy J. Meenan
Executive Director & General Counsel
Service Contract Industry Council