

August 19, 1986

SUBJECT: INSURANCE

Circular Letter No. 14 (1986)

August 19, 1986

TO: ALL AUTHORIZED PROPERTY/CASUALTY INSURERS IN NEW YORK STATE ALL INSURANCE  
AGENT & BROKER ORGANIZATIONS IN NEW YORK STATE

RE: INTERPRETATION AND ENFORCEMENT OF NEW STATUTORY PROVISIONS RELATING TO  
CANCELLATION, NONRENEWAL, CONDITIONAL RENEWAL & ALTERNATIVE RENEWAL OF  
COMMERCIAL LINES INSURANCE POLICIES

The Insurance Department is receiving many inquiries from insurers, producers and consumers concerning the recently enacted omnibus legislation (Chapters 220 & 221 of the Laws of 1986). Inquiries have especially focused upon the component of the new law establishing standards in regard to cancellation and nonrenewal of commercial lines insurance policies.

This particular component, repeals former Sections 3426 and 3427, adds a new Section 3426 to the New York Insurance Law and, among other things, introduces new concepts, such as conditional renewal and alternative notice. Its provisions dealing with cancellation (e.g., 3426(c)) and other matters during the policy term are now in force, having taken immediate effect upon the date, June 28, 1986, that this omnibus legislation was signed into law by Governor Cuomo. However, for transition purposes, those provisions (e.g., Section 3426(e)) dealing with nonrenewal, conditional renewal, alternative renewal and other matters relating to policy expiration are effective on and after Wednesday, August 27, 1986.

The purpose of this Circular Letter is to set forth Department interpretations concerning key issues that have been brought to our attention thus far, in an effort to assist affected parties in understanding and implementing these new provisions. This Circular will be refined and reissued in the form of a regulation in due course. Because time is of the essence as systems are being modified to become compatible with the new standards, the Department issues this circular at this time, in order to minimize market disruption and facilitate smooth transition.

Applicability.

While Section 3425 continues to govern personal lines policies, new Section 3426 governs every policy covering commercial risk insurance, professional liability insurance and public entity insurance, as these terms are now defined in Section 107 of the Insurance Law. New Section 3426 - applies, for example, to umbrella, excess layer, certain inland marine, fidelity and surety, and Free Trade Zone policies. However, these provisions do not apply, for example, to workers compensation, reinsurance, or policies written by non-admitted carriers through the excess and surplus lines market.

Cancellation Standards.

The statute proscribes unwarranted mid-term cancellations, providing that no policy in force and effect on or after

June 28, 1986 may b[ILLEGIBLE WORDS] cancelled during its term by the insurer, except with notice and for specified grounds explained in such notice. Moreover, except for voluntary extensions not exceeding ninety (90) days or for seasonal policies, all covered polic[ILLEGIBLE WORDS] upon issuance or renewal must have at least a twelve (12) month term, required policy period. However, an excess layer or umbrella policy may issued so that its expiration date coincides with the underlying primary policy's expiration.

Thus any commercial risk, professional liability or public entity insurance policy in effect on and after June 28, 1986 must remain in full force and effect until its regular expiration date, unless cancelled at the insured's request or unless the policy is sooner terminated by the insurer in strict compliance with the provisions of. Section 3426(c), which in essence provides as follows:

(A) A newly issued policy may be cancelled during the first sixty (60) days for any sound underwriting reason, subject to twenty (20) days advance notice.

(B) After the policy has been in effect for sixty (60) days, it may not be cancelled mid-term except for the one or more of the following reasons, subject to fifteen (15) days advance notice:

\*\*\* non-payment of premium, unless cured within the fifteen (15) day notice or grace period;

\*\*\* the insured or someone acting on its behalf is convicted of a crime arising out of acts that increase the hazards insured against;

\*\*\* fraud or material misrepresentation on the part of the insured is discovered in obtaining the policy or in presenting a claim;

\*\*\* an act, omission or violation of a policy condition on the part of the insured, taking place after policy issuance or renewal, is discovered that substantially and materially increases the hazards insured against;

\*\*\* material physical changes in the property or material changes in the nature and extent of the risk, within the insured's control, take place after policy issuance or renewal and result in uninsurability;

\*\*\* the Superintendent of Insurance determines that continuation of the present premium volume would jeopardize the insurer's solvency or injure the interests of policyholders or the public, or continuing the policy itself would violate the Insurance Law;

\*\*\* there is a reasonable basis to believe that the insured intends to destroy the insured property in order to collect the insurance proceeds, provided that the insured is notified of the right to seek a ruling on this basis from the Superintendent.

These are now the only permissible grounds for mid-term cancellation of commercial risk, professional liability or public entity insurance policies in New York State. It should be emphasized that forces beyond the control of the insured do not constitute a legitimate basis for those grounds pertaining to changed circumstances. In addition, it should be noted that the notice of cancellation must not only specify the grounds invoked, but also explain the particular reasons in the context of the particular situation. Mailed or delivered to the insured and its authorized agent or broker, the cancellation notice must also indicate that loss information, if any, will be made available upon request.

In sum, any cancellation notice issued before or after June 28, 1986, purporting to become effective on or after June

28,1986, is invalid unless it comports with Section 3426(c). To illustrate, suppose Insurer X had issued a covered policy whose expiration date is October 20, 1986, and on June 15, 1986 it issued a cancellation notice, to become effective on July 1, 1986, stating that for "underwriting reasons" the policy was being cancelled. Since the policy was in effect on June 28, 1986, and the basis given for cancellation insufficient or inconsistent with the provisions of Section 3426(c), the cancellation notice is invalid, and the policy must continue in full force and effect until its expiration in October or unless a cancellation notice based upon permissible grounds can be issued.

#### Mid-term Premium or Rate Increases.

After a newly issued covered policy has been in force for sixty (60) days, or on and after a renewal's effective date, no premium increases during the term of the policy may become effective, except where the additional premium is generated as the result of additional insured value (i.e., additional insured locations, increased limits of coverage, etc.), after issuance or renewal, pursuant to the policy or at the insured's request.

#### Nonrenewal of Policies Expiring Between June 28 and August 26, 1986.

With the exception of certain public entity insurance policies, a policy scheduled to expire during the sixty (60) day period between June 28, 1986 and August 26, 1986 may expire in accordance with the policy, unless it is modified in such interim period. The new law also provides that the notice requirements of former Sections 3426 and 3427 remain operative during this interim period. Through August 26, 1986, a forty-five (45) day notice of nonrenewal continues to be required for all policies insuring physicians, surgeons or podiatrists medical malpractice, hospital medical malpractice, lawyers professional liability or products liability.

#### Special Interim Provisions Regarding Public Entity Insurance Policies.

In order to effectively nonrenew a policy, due to expire during the period June 28, 1986 through September 26, 1986, insuring a municipality, school district or board of cooperative educational services (BOCES), the insurer must give sixty (60) days of fresh notice, pursuant to Section 33 of Chapter 220 of the Laws of 1986. Thus, in the case of such a policy, even if a nonrenewal notice issued prior to June 28, 1986, but after May 29, 1986, a new notice giving a full sixty (60) days must be issued by the insurer for an effective nonrenewal. Any protection period resulting beyond that which would otherwise have been provided will be on the same terms and conditions, except that the rate for any such extension is to be determined pro rata in light of the insurer's current rate level for renewal.

#### Nonrenewal of Policies Expiring on and after August 27, 1986.

The new standards regarding nonrenewal, conditional renewal and alternative notice are effective on August 27, 1986. Under these new standards that place emphasis upon meaningful advance notice, polic[ILLEGIBLE WORDS] scheduled to expire on and after August 27, 1986 will remain in full force effect under the same terms, conditions and rates, unless the insurer give the insured, and its authorized agent or broker, notice of its intention either (i) to not renew the policy or (ii) to condition the renewal of the policy upon stated material changes in terms or conditions.

As described below, the new law incorporates incentives for insurers to mail or deliver such notices within a time frame of at least sixty (60), yet no more than one hundred twenty (120), days in advance of the expiration date for any commercial risk, professional liability or (subject to the special interim protection described above) public entity insurance policy.

A conditional renewal is essentially any renewal where, at the insurer's insistence (rather than a documented, specific request by the insured or its authorized agent or broker), the renewal policy would be changed in any of the following ways:

- (A) liability limits (including addition of an aggregate limit);

(B) type of coverage (e.g., claims-made instead of occurrence, from an old to new occurrence form, defense within limits);

(C) reduction in coverage, via exclusions, endorsements, etc.;

(D) increase in deductible or self-insured retention;

(E) more than a ten percent (10%) premium increase (not attributable to experience rating, retrospective rating, or insured valued added during and pursuant to the policy)(Section 3426(e)(1)(B)).

Timing is important. If the notice required for a nonrenewal or conditional renewal is mailed prior to -- but less than sixty (60) days in advance of -- policy expiration, coverage must remain in full force and effect at the same terms and conditions of the expiring policy for sixty (60) days beyond the date such notice is mailed or delivered, with the rates for the period extending beyond normal policy expiration at the lower of the rates for the expiring policy or the insurer's current rate level.

Suppose, for example, that Insurer Y, which has a covered policy due to expire on September 30, 1986, determines not to renew the policy, and mails out a nonrenewal notice on August 21, 1986. Since the notice went out less than sixty (60) days before expiration, coverage under the same terms and conditions must be provided until October 20, 1986. The rates for the October 1, 1986 to October 20, 1986 extension period will be the lower of the rates of the expiring policy or the current rates applicable to Insurer Y. Had Insurer Y elected to conditionally renew the policy, instead of nonrenewing it, its obligations to the insured would be the same, except that should the insured agree to accept the conditional renewal, the renewal policy's quoted terms, conditions and rates would not become effective until October 21, 1986.

In the event that notice of nonrenewal or conditional renewal is not issued until (or after) policy expiration, the insured is entitled to renewal of the expiring policy, for another required policy period, under the same terms and conditions, at the lower of the expiring policy's rates or the insurer's current rate level, unless the insurer's failure to send the required notice prior to the expiration date was due to inadvertence or clerical error and the insurer has established Section 3426(e) compliance procedures, including maintaining written or electronic records of all noncomplying situations.

#### Alternative Notice Followed by Second Notice.

Because commercial risk, professional liability and public entity insurance present complicated issues, an insurer may issue an alternative notice in the event that it is not yet in a position to determine whether it will nonrenew or conditionally renew a particular policy. The alternative notice to that effect must also state that as soon as possible there will follow a second notice indicating the insurer's exact intention and that, furthermore, coverage remains in effect under the same terms, conditions and rates as the expiring policy until sixty (60) days after the second notice is issued.

For example, Insurer Z has a covered policy scheduled to expire on November 1, 1986 that it will not renew as written but has not yet determined, as of September 2, 1986, whether it will nonrenew or conditionally renew the policy. Insurer Z mails an alternative renewal, advising the insured that a second notice stating the final decision will be forthcoming. On October 1, 1986, the company decides to conditionally renew the policy, and it mails its insured the second notice, in this case a notice of conditional renewal. Coverage must remain in effect under the terms, conditions and rates of the expiring policy until December 1, 1986, at which point the quoted renewal terms and conditions become effective, if the insurer accepts the renewal.

#### Content & Purpose of Notices.

A primary objective of the new law is to maximize understanding and information between insurers and insureds. All notices of cancellation, nonrenewal or conditional renewal must contain specific reasons explaining the insurer's action and refer to the availability of loss information. Generic statements such as "underwriting reasons" are no longer sufficient. For example, notices of conditional renewal generated as a result of changes in the basic policy forms (e.g., the new ISO C[ILLEGIBLE WORDS] occurrence policy) should be accompanied by an explanatory memorandum or booklet clearly describing all material changes made in the policy.

When a notice of conditional renewal results from rate increases or other factors yielding a premium increase exceeding ten percent (10%), an exact dollar amount difference, precise percentage differential, or side-by-side premium comparison is encouraged. The conditional renewal notice must at least indicate \* percentage range a within five percent (5%) (e.g., proposed premium increase between 20% and 25%), or set forth the amount of the proposed premium advising the insured that this figure represents a greater than ten percent (10%) premium increase over the previous policy and that the insured should contact its agent or broker, or the company itself, if the insured needs more specific pricing information than apparent from its own records. The basic reasons for the proposed premium increase should also be explained in the conditional renewal notice.

Given the nature of facultative reinsurance, [ILLEGIBLE WORDS] position that, where the renewal rate for an expiring policy that would [ILLEGIBLE WORDS] otherwise produce a premium increase of more than ten percent (10%) [ILLEGIBLE WORDS] dependent upon the price of facultative reinsurance, thereby creating a conditional renewal, and the insurer is unable to obtain a quote for such reinsurance more than sixty (60) -days in advance of policy expiration, the insurer can use a conditional renewal notice advising the insured th[ILLEGIBLE WORD] facultative reinsurance yet to be arranged is the only reason its renew[ILLEGIBLE WORDS] premium could be increased by more than ten percent (10%), and that the specific premium will be furnished as soon as the insurer is able to obtain facultative reinsurance quotes. Even in such circumstances, however, in no event should the insurer give the insured less than thirty (30) days notice of the specific premium charge for the renewal policy.

#### Blanket Nonrenewals -- Short-Run v. Long-Term.

It has come to the attention of the Department that, in attempting to implement the provisions of Section 3426([ILLEGIBLE WORDS]), some insurers have issued or may be contemplating issuance of mass nonrenewal notices on all expiring policies, including those policies which they may intend to renew. The Department recognizes that the provisions of Section 3426, while designed to embody sound business practices, contain relatively complex and novel notification requirements that many insurers were not prepared to implement in the comparatively short time allowed by the legislation. Whenever appropriate conditional renewal notices cannot yet be prepared by an insurer, alternative notices (rather than blanket nonrenewal notices) represent the recommended approach.

Under all the circumstances, insurers are hereby advised that:

- Until October 31, 1986, nonrenewal notices may be used as a temporary means to facilitate transition, while installing new systems necessary to comply with the new law, provided that:
  - conditional renewal notices are utilised wherever feasible;
  - the insurer exerts prompt good faith best efforts to institute systems and procedures necessary to comply with Section 3426(e); and
  - nonrenewal notices used in lieu of conditional renewal notices or alternative notices expressly indicate that the insurer is in the process of system changeover, plans to renew or conditionally renew the policy and, accordingly, to quote promptly;
- On and after November 1, 1986, the Department will consider use of mass or blanket nonrenewals to be a means of circumventing Section 3426(e), and to be unfair trade practices, subject to market conduct sanctions and appropriate disciplinary action.

Of course, for transition purposes as well as the long-range future, the cost-effective, preferred approach for all

concerned may well be simply to renew as many policies as possible, in such a manner as not to become conditional renewals. Inquiries relating to this Circular Letter, or its subject matter, should be directed to the Property & Casualty Insurance Bureau (212-602-0386) at the Department.

Very truly yours,

[SIGNATURE]

JAMES P. CORCORAN

SUPERINTENDENT OF INSURANCE