

SUBCHAPTER Q. GENERAL PROPERTY AND CASUALTY RULES
DIVISION 3. MULTIPLE LINES
28 TAC §§5.9750 – 5.9752

INTRODUCTION. The Texas Department of Insurance proposes new 28 TAC §§5.9750 – 5.9752, concerning notice to policyholders and agents of certain changes to property and casualty insurance policies. Sections 5.9750 – 5.9752 implement Senate Bill 417, 85th Legislature, Regular Session (2017).

EXPLANATION. New §§5.9750 – 5.9752 clarify what constitutes a material change under SB 417, ensure consistency with the conspicuousness requirements in the Business and Commerce Code, and clarify the requirements for a clear, plain-language notice of a change in coverage from replacement cost to actual cash value.

SB 417 amended the Insurance Code regarding notice to policyholders and agents of certain changes to property and casualty insurance policies. Before SB 417, insurers that wanted to provide less coverage to an existing policyholder were required to cancel or nonrenew the policy and give the policyholder a new offer. SB 417 created an exception that allows insurers to avoid canceling or nonrenewing the policy by providing policyholders and agents with a notice of material change describing the reductions in coverage.

Under SB 417, a "material change" on renewal is not a nonrenewal or cancellation if the insurer provides the policyholder with written notice of any material change in each form of the policy offered to the policyholder on renewal from the form of the policy held immediately before renewal. SB 417 requires that the notice of material change be clear, provided in a conspicuous place, and in plain language. It also requires the insurer to provide the notice at least 30 days before the renewal date.

Insurers are only required to provide the notice of material change under SB 417 if they offer a policy that reduces coverage, changes coverage conditions, or changes the duties of the policyholder, but do not provide notice of nonrenewal or cancellation. If the insurer chooses instead to nonrenew or cancel and issue a new policy, the notice requirements in SB 417 would not apply. Instead, the insurer would comply with the notice requirements for cancellation or nonrenewal in Insurance Code Chapter 551.

Section 5.9750. The proposal adds new §5.9750, which clarifies the applicability of the proposed sections and provides examples of material changes. Section 5.9750 is necessary to prevent confusion about notices of material change subject to the proposed sections, and to clarify the types of changes that require a notice.

Section 5.9751. The proposal adds new §5.9751, which provides requirements for the notice of material change. It harmonizes the conspicuousness requirement in the proposed sections and Insurance Code §§551.1055(c)(1), 2002.001(b)(2)(A), and 2002.102(c)(1) with the definition of "conspicuous" in Business and Commerce Code §1.201(b)(10). It also clarifies that "material change" includes material changes to the entire policy or to any part of it. Section 5.9751 is necessary to ensure a consistent interpretation of "conspicuous" between the Insurance Code, the Business and Commerce Code, and the proposed sections. It is also necessary to ensure that material changes to one type of risk or coverage—for example, changes to coverage for a roof from replacement cost to actual cash value—are subject to the same notice requirements as material changes to the policy as a whole.

Section 5.9752. The proposal adds new §5.9752, which clarifies that a change from replacement cost coverage to actual cash value coverage is a material change and provides requirements for the notice. For a change from replacement cost to actual cash value coverage, §5.9752 requires that a notice of material change explain the terms "replacement cost" and "actual cash value" in plain language. It also requires that if the

notice uses the term "depreciation," it must also include a plain-language explanation of that term. New §5.9752 also requires that a notice of material change that describes a change from replacement cost to actual cash value coverage must include at least one plain-language example that shows the difference in dollar amounts between coverage before and after the material change. Section 5.9752 includes a sample figure to illustrate a possible way to list the amounts a policyholder might receive for a total roof replacement. Insurers are not limited to using the sample figure, and they may use other content and formatting.

New §5.9752 clarifies that a change in coverage from replacement cost to actual cash value is a material change that requires notice under SB 417. Unlike replacement cost coverage, actual cash value coverage includes a deduction for depreciation, which reduces coverage under a policy. However, the inquiries and complaints TDI has received regarding replacement cost, actual cash value, and depreciation indicate that the differences in coverage are not easy for consumers to understand. As a result, §5.9752 is also necessary to ensure that consumers get clear descriptions and illustrations of actual cash value and replacement cost coverage. Without those explanations, consumers are unlikely to appreciate the impact of a change in coverage from replacement cost to actual cash value, and they are unlikely to be able to make informed coverage choices.

Informal Comments. TDI received comments on an informal draft posted on TDI's website on January 16, 2019. Although TDI specifically requested comments on anticipated costs of compliance with the rule and how the rule describes replacement cost and actual cash value, no comments addressed costs. Two comments requested that the rule be drafted to clearly not apply to surplus lines policies, as the underlying statute does not apply. One comment supported the draft rule text and made additional suggestions

to enhance clarity. One comment requested more insight about what qualifies as a reduction in coverage. The proposed rule reflects those comments.

FISCAL NOTE AND LOCAL EMPLOYMENT IMPACT STATEMENT. Marianne Baker, director of the Property and Casualty Lines Office, has determined that during each year of the first five years the proposed new sections are in effect, there will be no measurable fiscal impact on state and local governments as a result of enforcing or administering the proposed sections, other than that imposed by the statute. This determination was made because the proposed sections do not add to or decrease state revenues or expenditures, and because local governments are not involved in enforcing or complying with the proposed sections.

Ms. Baker does not anticipate a measurable effect on local employment or the local economy as a result of this proposal.

PUBLIC BENEFIT AND COST NOTE. For each year of the first five years the proposed new sections are in effect, Ms. Baker expects that enforcing and administering the proposed sections will have the public benefits of ensuring that TDI's rules conform to Insurance Code §§551.103, 551.1055, 2002.001, and 2002.102, as added or amended by SB 417, and are consistent with the conspicuousness requirements in Business and Commerce Code §1.201(b)(10). Ms. Baker also expects that enforcing and administering the proposed sections will have the public benefit of helping consumers understand the impact of material changes to their policies, especially for changes as significant as moving from replacement cost coverage to actual cash value coverage. This knowledge will enable consumers to shop for and buy policies with the coverage they need, which will reduce the number of unpaid claims and encourage insurers to offer the coverages consumers want.

Ms. Baker expects that the proposed new sections will not increase the cost of compliance with Insurance Code §§551.103, 551.1055, 2002.001, and 2002.102, as added or amended by SB 417. SB 417 creates an optional system that leaves in place the current system. Insurers are free to choose the method by which they make material changes to policies. Insurers are only required to provide the notice of material change if they choose it instead of a notice of nonrenewal. SB 417 gives insurers the option of providing a notice of material change instead of a notice of nonrenewal, which would otherwise be required for reductions in coverage. But insurers may still choose to send a notice of nonrenewal if they are reducing coverage at renewal and, at the same time, an offer to issue a new policy with different coverage.

For insurers that choose to send a notice of material change, the proposed sections clarify the statutory requirements that the notice be conspicuous, in plain language, and clearly indicate the material change. These clarifications will enhance regulatory and industry consistency, leveling the playing field and reducing uncertainty and costs of compliance.

Because insurers can choose whether to provide notice of material change under SB 417 and the proposed sections, or instead choose to provide notice of nonrenewal and offer a new policy; and because the proposed sections are necessary to implement SB 417 by clarifying its requirements, any cost associated with the clarifications the proposed sections require do not result from the enforcement or administration of the proposed new sections.

ECONOMIC IMPACT STATEMENT AND REGULATORY FLEXIBILITY ANALYSIS. TDI has determined that the proposed new sections will not have an adverse economic effect or a disproportionate economic impact on small or micro businesses, or on rural communities. Insurers that are reducing coverage at renewal may choose to issue a notice

of material change under SB 417 and the proposed rule, or they may choose to send a notice of nonrenewal and an offer to issue a new policy with different coverage. As a result, and in accordance with Government Code §2006.002(c), TDI is not required to prepare a regulatory flexibility analysis.

EXAMINATION OF COSTS UNDER GOVERNMENT CODE §2001.0045. TDI has determined that this proposal does not impose a cost on regulated persons. Even if it did, no additional rule amendments are required under Government Code §2001.0045 because proposed §§5.9750 – 5.9752 are necessary to implement legislation. The proposed rule implements Insurance Code §§551.103, 551.1055, 2002.001, and 2002.102, as added or amended by SB 417, 85th Legislature, Regular Session (2017), by clarifying the law's requirements.

GOVERNMENT GROWTH IMPACT STATEMENT. TDI has determined that for each year of the first five years that the proposed amendments are in effect the proposed rule:

- will not create or eliminate a government program;
- will not require the creation of new employee positions or the elimination of existing employee positions;
- will not require an increase or decrease in future legislative appropriations to the agency;
- will not require an increase or decrease in fees paid to the agency;
- will create a new regulation in §§5.9750 – 5.9752 to implement SB 417, 85th Legislature, Regular Session (2017);
- will not expand, limit, or repeal an existing regulation;
- will not increase or decrease the number of individuals subject to the rule's applicability; and

- will not positively or adversely affect the Texas economy.

TAKINGS IMPACT ASSESSMENT. TDI has determined that no private real property interests are affected by this proposal and that this proposal does not restrict or limit an owner's right to property that would otherwise exist in the absence of government action. As a result, this proposal does not constitute a taking or require a takings impact assessment under Government Code §2007.043.

REQUEST FOR PUBLIC COMMENT. TDI will consider any written comments on the proposal that are received by TDI no later than 5 p.m., Central time, on October 28, 2019. Send your comments to ChiefClerk@tdi.texas.gov; or to the Office of the Chief Clerk, MC 113-2A, Texas Department of Insurance, P.O. Box 149104, Austin, Texas 78714-9104. To request a public hearing on the proposal, submit a request before the end of the comment period to ChiefClerk@tdi.texas.gov; or to the Office of the Chief Clerk, MC 113-2A, Texas Department of Insurance, P.O. Box 149104, Austin, Texas 78714-9104. The request for public hearing must be separate from any comments and received by TDI no later than 5 p.m., Central time, on October 28, 2019. If TDI holds a public hearing, TDI will consider written and oral comments presented at the hearing.

STATUTORY AUTHORITY. TDI proposes new §§5.9750 – 5.9752 under Insurance Code §§551.103, 551.1055, 2002.001, and 2002.102, as added or amended by SB 417; and Insurance Code §§551.112, 2002.102(e), 36.002(2)(E), and 36.001.

Insurance Code §551.103(3) provides that if an insurer, without the policyholder's consent, reduces or restricts coverage under the policy by endorsement or other means, then the insurer has canceled the policy. SB 417 amended §551.103(3) to provide an

exception for changes to the policy on renewal for which the insurer provides a written notice of material change under §551.1055.

SB 417 added definitions of "material change" to Insurance Code §§551.1055, 2002.001, and 2002.102. Under those definitions, a "material change" is a change to a policy that, with respect to a prior or existing policy reduces coverage, changes conditions of coverage, or changes the policyholder's duties.

SB 417 added requirements for notice of material change to policyholders under Insurance Code §§551.1055, 2002.001, and 2002.102. The notice of material change must appear in a conspicuous place, clearly indicate each material change to the policy, be written in plain language, and be provided to the policyholder not later than the 30th day before the renewal or expiration date.

Under Insurance Code §§551.1055, 2002.001, and 2002.102, the insurer must provide each of its agents with a written notice that clearly indicates each material change being made to the policy form, in addition to the notice to the policyholder.

Insurance Code §551.112 allows the Commissioner to adopt rules relating to the cancellation and nonrenewal of insurance policies.

Insurance Code §2002.102(e) allows the Commissioner to adopt rules as necessary to implement §2002.102.

Insurance Code §36.002(2)(E) allows the Commissioner to adopt reasonable rules that are appropriate to accomplish the purposes of a provision of Insurance Code Title 10, Subtitles B, C, D, E, F, H, or I. (Insurance Code §§1901.001 et seq., 1951.001 et seq., 2001.001 et seq., 2051.001 et seq., 2101.001 et seq., 2251.001 et seq., or 2301.001 et seq.)

Insurance Code §36.001 provides that the Commissioner may adopt any rules necessary and appropriate to implement the powers and duties of TDI under the Insurance Code and other laws of this state.

CROSS-REFERENCE TO STATUTE. Sections 5.9750 – 5.9752 implement the amendments to Insurance Code §§551.103, 551.1055, 551.110, 2002.001, and 2002.102 enacted by SB 417, 85th Legislature, Regular Session (2017).

TEXT.

§5.9750. Notice of Material Change–Applicability and Examples.

(a) A notice of material change is not a notice of cancellation or nonrenewal. Instead, it is a notice provided under:

- (1) Insurance Code §551.1055;
- (2) Insurance Code §2002.001; or
- (3) Insurance Code §2002.102.

(b) This section and §5.9751 and §5.9752 of this title (relating to Notice of Material Change-Requirements and Notice of Material Change-Change from Replacement Cost to Actual Cash Value) apply to policies and insurers that are subject to Insurance Code Chapter 551, Subchapter C; and Chapter 2002.

(c) Examples of material changes include:

- (1) changes from replacement cost to actual cash value;
- (2) reductions in policy limits;
- (3) increases in deductibles; or
- (4) reductions in coverage, including:

(A) limiting the people or entities insured under the policy;

(B) removing an item or act that was previously covered under the

policy; or

(C) limiting the types of coverage under the policy.

§5.9751. Notice of Material Change–Requirements.

(a) A notice of material change must be conspicuous, as that term is defined in Business and Commerce Code §1.201(b)(10).

(b) If the notice of material change is included in a renewal notice, the first page of the renewal notice must include:

(1) the notice of material change; or

(2) conspicuous text that clearly indicates the location of the notice of material change in the renewal offer.

(c) A material change might be to the entire policy, or to any part of it.

§5.9752. Notice of Material Change—Change from Replacement Cost to Actual Cash Value.

(a) A material change includes a change from replacement cost coverage to actual cash value coverage. The change might be to the entire policy, or to any part of it. This section applies only to changes from replacement cost to actual cash value.

(b) A notice of material change must explain the terms "replacement cost" and "actual cash value." Using plain language, the notice must at a minimum explain that:

(1) for replacement cost, the policy will pay to repair or replace the damaged item based on the current cost of the item; and

(2) for actual cash value, the policy will pay less based on the item's characteristics, such as age or condition.

(c) If the term "depreciation" is in the notice, the notice must use plain language to explain that "depreciation" is the amount of value that an item loses over time, typically through use, wear and tear, or by becoming obsolete.

(d) A notice of material change must include at least one plain-language example that shows the difference in dollar amounts between coverage before and after the material change.

(1) See Figure: 28 TAC §5.9752(d)(1) for one possible way to list the amounts a policyholder might receive for a total roof replacement. Insurers are not limited to using the Figure as the example, and they may use other content and formatting.

Figure: 28 TAC §5.9752(d)(1)

Your policy has changed.

Your policy may now pay less if your home is damaged.

Some items in your policy have changed from replacement cost coverage to actual cash value coverage.

There are two types of coverage for homes and personal items:

- ▶ **Replacement cost coverage:** The policy will pay to replace the damaged items based on current costs.
- ▶ **Actual cash value coverage:** The policy will **pay less** based on the item's characteristics, such as age and condition.

To know what your policy will cover, check your coverage and deductible amounts. The deductible is the amount you must pay before insurance will pay.

Changing from replacement cost to actual cash value coverage can reduce what your policy will pay.

To see how the payment for a home insured for \$200,000 with a 2 percent (\$4,000) deductible might change, **check out the examples below. Your payment will probably be different.**

Example: Actual cash value coverage			
If it costs \$10,000 to replace the roof and the loss is covered at actual cash value:			
	5-year-old roof	10-year-old roof	20-year-old roof
Actual cash value of roof (example only)	\$8,500	\$7,000	\$4,000
Minus 2 percent deductible	- \$4,000	- \$4,000	- \$4,000
Policy might pay	\$4,500	\$3,000	\$0

Example: Replacement cost coverage

If the loss is covered at replacement cost, the policy will pay the same amount for any age roof:

Cost to replace roof	\$10,000
Minus 2 percent deductible	<u>- \$4,000</u>
Policy might pay	\$6,000

(2) If the policy includes a depreciation schedule, the notice of material change must list the form name and page number that contains the depreciation schedule.

CERTIFICATION. This agency certifies that legal counsel has reviewed the proposal and found it to be within the agency's authority to adopt.

Issued in Austin, Texas, on September 13, 2019.

/s/ James Person

James Person, General Counsel
Texas Department of Insurance