



## DEPARTMENT OF CORPORATIONS

Commissioner: Christine W. Bender  
(916) 445-7205  
(213) 736-2741

The Department of Corporations is a part of the cabinet-level Business and Transportation Agency. A Commissioner of Corporations, appointed by the Governor, oversees the Department.

The Department administers several major statutes. The most important is the Corporate Securities Act of 1968, which requires the "qualification" of all securities sold in California. "Securities" are defined quite broadly, and may include business opportunities in addition to the traditional stocks and bonds. Many securities may be "qualified" through compliance with the Federal Securities Acts of 1933, 1934, and 1940. If the securities are not under federal qualification, the commissioner must issue a "permit" for their sale in California.

The commissioner may issue a "stop order" regarding sales or revoke or suspend permits if in the "public interest" or if the plan of business underlying the securities is not "fair, just or equitable."

The commissioner may refuse to grant a permit unless the securities are properly and publicly offered under the federal securities statutes. A suspension or stop order gives rise to Administrative Procedure Act notice and hearing rights. The commissioner may require that records be kept by all securities issuers, may inspect those records, and may require that a prospectus or proxy statement be given to each potential buyer unless the seller is proceeding under federal law.

The commissioner also licenses agents, broker-dealers, and investment advisors. Those brokers and advisors without a place of business in the state and operating under federal law are exempt. Deception, fraud, or violation of any regulation of the commissioner is cause for license suspension of up to one year or revocation.

The commissioner also has the authority to suspend trading in any securities by summary proceeding and to require securities distributors or underwriters to file all advertising for sale of securities with the Department before publication. The commissioner has particularly broad civil investigative discovery powers; he/she can compel the deposition of witnesses and require production of documents. Witnesses so compelled may be granted automatic

immunity from criminal prosecution.

The commissioner can also issue "desist and refrain" orders to halt unlicensed activity or the improper sale of securities. A willful violation of the securities law is a felony, as is securities fraud. These criminal violations are referred by the Department to local district attorneys for prosecution.

The commissioner also enforces a group of more specific statutes involving similar kinds of powers: Franchise Investment Statute, Credit Union Statute, Industrial Loan Law, Personal Property Brokers Law, Health Care Service Plan Law, Escrow Law, Check Sellers and Cashiers Law, Securities Depositor Law, California Finance Lenders Law, and Security Owners Protection Law.

A Consumer Lenders Advising Committee advises the commissioner on policy matters affecting regulation of consumer lending companies licensed by the Department of Corporations. The committee is composed of leading executives, attorneys, and accountants in consumer finance.

### MAJOR PROJECTS:

*"Unsuitable Investments" Alert Bulletin.* On May 3, the Department released its latest in a series of quarterly *Investor Alert* bulletins, which are a cooperative effort of the North American Securities Administrators Association and the Council of Better Business Bureaus, Inc. *Unsuitable Investments* advises investors of the suitability rules and the concomitant responsibilities of securities brokers and salespersons, describes how margin accounts can compound the riskiness of highly speculative investment products, and lists nine guidelines which investors should follow to protect themselves from being sold unsuitable investments.

The project is a result of an analysis of consumer complaints received on the Investor Hotline, which was set up after the October 19 stock market crash. A substantial number of small investors were injured in the crash because broker-dealers placed their funds in "unsuitable investments" (e.g., options and stock index futures) in violation of the "know your customer" rule. Commissioner Bender stated: "Many investors learned a painful lesson on October 19, which was that their stock broker may not have had their best interest in mind when he or she put them into highly risky investments."

*Changes in Regulations Under the Industrial Loan Law.* New section 1101 of the Department's regulations (Title

14 of the California Code of Regulations) under the Industrial Loan Law relating to delayed funds availability was adopted by the Commissioner, approved by the Office of Administrative Law, and became effective on March 23. Section 1101 applies to all industrial loan companies with California offices which accept deposits insured by the Federal Deposit Insurance Corporation. The regulation specifies "reasonable times" for collection and return of items and reasonable times by which depository industrial loan companies must allow withdrawals on certain deposited items—as a matter of right. A number of exemptions and extenuating circumstances specified in section 1101(e) may operate to change the meaning of "reasonable".

*Changes in Regulations Under the Corporate Securities Law.* Pursuant to section 25607 of the Corporate Securities Law of 1968, the Commissioner has adopted Rule 260.607, permitting Department employees to invest in certain securities. In addition, pursuant to section 25610 of the Corporations Code, the Commissioner has waived certain securities investments and transactions reports otherwise required of employees. For example, the semi-annual report due within thirty days of June 30 is waived, but employees are still required to file a report of all securities holdings within thirty days of December 31. The other waiver relates to reports in connection with transactions in the securities of money market and mutual funds, under certain conditions.

*Enforcement.* On March 15, the Commissioner issued an order taking possession and appointed a conservator over Dome Escrow's property, business, and assets in Covina and Manhattan Beach. Barbara Salazar is Dome's president and owner. The action followed a March 11 order to discontinue escrow activities which froze all of Dome's escrow funds and transactions until a complete accounting could be made. In turn, that action followed the discovery that a trust fund shortage in excess of \$800,000 existed, and that Dome had been operating without a bond in violation of California escrow law.

On March 17, the Los Angeles Superior Court granted a preliminary injunction against Supplemental Dental Plans, Inc. (in Los Angeles and Orange) and its chief shareholder and administrator, James H. Kaufman, DDS. A receiver was also appointed over both Supplemental and Kaufman because of indications that Kaufman may have mis-



appropriated Supplemental's revenue. Because of their refusal to correct numerous financial and operational problems, Supplemental and Kaufman are restrained from operating or maintaining a dental health care service plan. Supplemental has filed a Chapter 7 bankruptcy petition.

On March 18, business records, computers, filing cabinets, cardboard boxes and other items of Missman-Kaplan Associates, Ltd. (MKA) and its affiliates, Hacienda Mortgage, Inc., Prosperity Ink., Inc., LNEAC, Inc., KGS, European Holidays Limited, SCS, and Satellite Computer Services, Inc., were searched and seized pursuant to a search warrant. The seizure culminated a series of intertwining events, including alleged Ponzi schemes, fraud, forgery, and conversion. In addition, various successor entities and "new" programs were started to circumvent existing state desist and refrain orders issued to stop those activities. MKA was finally forced into involuntary Chapter 7 bankruptcy, but its main principal, David Missman, took the records with him when he abandoned the corporate offices. The seizure was made to protect the public interest because of continuing violations of the Corporate Securities Law.

On March 18, the Commissioner, in cooperation with the State White Collar Crime Task Force, the Department of Real Estate (DRE), and the Monterey and Santa Cruz County District Attorney's Offices, filed a criminal complaint and issued arrest warrants for mortgage loan broker George Jercich and six other defendants. The complaint contains 95 felony counts, including grand theft, securities fraud, sale of securities without a permit, and conspiracy. Arraignment was held March 24. Jercich operated in Aptos and Carmel under the names of George Jercich, Inc., Carmel Financial Services, and Security Escrow Company. A DRE audit determined that he had been operating at a \$1.3 million deficit and was commingling funds from other various entities; and both DRE and the Department of Corporations had issued desist and refrain orders to Jercich. Jercich and his companies filed for bankruptcy just prior to the Attorney General's request for the appointment of a receiver.

On April 14, the Commissioner issued an order taking possession and appointed a conservator over Duena Escrow Corporation's property, business, and assets in Riverside and Moreno Valley. Duena's president and owner is Dale A. Asptittle. This order followed a previous

order to discontinue escrow activities for operating a trust fund at at deficiency of more than \$275,000.

#### LEGISLATION:

*AB 600 (Isenberg, et al.)*, as amended on February 29, would establish a California Catastrophic Health Insurance Program to provide health insurance to California residents who are not otherwise able to obtain health insurance because of preexisting medical conditions. Premiums could not exceed 150% of the standard individual premium for comparable coverage. Subscriber premiums and the elimination of the present cap on wages subject to the disability insurance tax would fund the program. This bill is pending before the Senate Committee on Industrial Relations.

*AB 2900 (Johnston, Isenberg)*, as amended on June 9, would remove the present prohibition against use of the AIDS blood test for determination of insurability and would indefinitely extend the Insurance Information and Privacy Protection Act. The bill is pending on the Assembly floor at this writing.

*AB 3076 (Stirling)*, as amended on May 18, would require the Attorney General, by July 1, 1989, to study methods of enforcement of the law that requires foreign corporations to obtain a certificate of qualification to transact business in California. This bill passed the Assembly on June 9 and is pending in the Senate Committee on Insurance, Claims and Corporations.

*AB 3313 (Chandler)* would extend existing law relating to the procedure a corporation is required to follow to redeem its certificated securities to the redemption of uncertificated securities. However, it would require the delivery of an officer's certificate, as specified, to the bank or trust company involved in the redemption, unlike the surrender of the shareholder's share certificates which are required to be surrendered in the redemption of certificated securities. This bill was scheduled for an August 1 hearing in the Senate Committee on Insurance, Claims and Corporations.

*AB 3758 (Stirling)* was amended on June 15 and would make various changes in the General Corporation Law relating to the organization and dissolution of corporations formed thereunder, including (1) specifying various matters relating to the form of a certificate of correction; (2) providing that after shares of a class or series have been issued, the provisions of the resolution set forth in a certificate of determination may only be amended as specified;

(3) specifying requirements for approval of the principal terms of a merger reorganization or sale-of-assets reorganization; (4) revising a condition of the authorization of existing law for a corporation to purchase insurance on behalf of its agent from a company owned in whole or in part by the corporation; (5) specifying the indemnification available to a director or officer for breach of duty to a corporation and its shareholders while acting in the capacity as a director or officer to the extent additional rights to indemnification are authorized in the articles of incorporation; and (6) making changes in the procedures for altering and revoking classes or series of shares. This bill passed the Assembly on May 12 and is pending in the Senate Insurance, Claims and Corporations Committee.

*AB 3836 (N. Waters)* passed the Assembly on May 12 and is pending in the Senate Appropriations Committee. As amended on May 6, this bill amends the statute allowing a corporate agent designated for service of process to resign as such agent. This bill would provide that by regulations adopted by the Secretary of State, the resignation of an agent may be effective if the agent disclaims having been properly appointed as the agent.

*AB 4371 (Lancaster)*, as amended on April 19, would, among other things, delete the requirement that the Commissioner and the Regional Director of Region VI of the National Credit Union Administration notify each other when either authorizes a new credit union or expansion of the field of membership of an existing one; and require that when the Commissioner takes possession of a credit union (for specified reasons), he/she does so as a conservator. This bill passed the Assembly on May 6, and is pending in the Senate Banking and Commerce Committee.

*AB 4609 (Stirling)* would permit directors to hold office for a shorter term than the presently-required annual term, when the shorter term is necessary to effectuate a voting shift and if authorized by the articles of incorporation. The bill passed the Assembly on May 12 and is pending in the Senate Committee on Insurance, Claims and Corporations.

*AB 4659 (Stirling)* passed the Assembly on April 28 and is also pending in the Senate Insurance, Claims and Corporations Committee. This bill extends to all nominee holders the requirement that broker-dealers, in whose name or for whom securities are held, must certify to a foreign corporation upon re-



## REGULATORY AGENCY ACTION

quest, the number of shares held for beneficial owners with addresses in this state and outside of this state. It would also permit the lists of beneficial owners of a foreign corporation's securities, provided to the corporation pursuant to Securities and Exchange Commission regulations, to constitute an acceptable certification for the above provisions.

*ACA 62 (Frazee)*, as amended on April 26, would permit a corporation to appear, through an employee, director, or officer, in superior court in an action on appeal from a small claims court judgment, whether or not that person is an attorney. This measure was adopted by the Assembly Committee on Elections, Reapportionment and Constitutional Amendments.

*SB 6 (Robbins)* passed the Senate on January 28 and is now pending in the Assembly Committee on Finance and Insurance. SB 6 would establish a state risk pool to provide health insurance coverage to persons who have been turned down because of a preexisting condition or who cannot afford to purchase coverage. The pool would cover all medically necessary health care services, with a maximum deductible of \$1,000 per year, and maximum out-of-pocket expenses of \$3,000 or \$5,000 per individual or family, respectively. Subscriber premiums would fund the program.

*SB 1755 (Lockyer)*, as amended on May 2, would provide that no cause of action for monetary liability arises against directors, officers, trustees, or duly appointed committee members of certain nonprofit corporations and organizations for acts or omissions within the scope of duties, performed in good faith and believed to be in the best interests of the corporation or organization, provided the corporation or organization maintains liability insurance and certain other criteria are met. The bill also specifies certain acts for which liability is not limited. SB 1755 passed the Senate on May 12 and is pending in the Assembly Judiciary Committee.

*SB 1922 (Montoya)*, as amended May 9, would require the Department of Insurance, in cooperation with the Department of Corporations, to study nonprofit mutual benefit corporations in the field of trade associations and labor unions, and to report to the legislature on or before July 1, 1990. This bill passed the Senate on May 19 and is pending in the Assembly Finance and Insurance Committee.

*SB 2260 (Keene)* was amended on May 12 and would authorize, until January 1, 1995, tax credits under the Per-

sonal Income Tax Law and Bank and Corporation Tax Law for the greater of \$25 per month per covered employee or 50% of the costs incurred during the taxable or income year by an eligible small employer to provide health coverage for eligible employees and the employees' dependents. This bill passed the Senate on June 30, and is awaiting committee assignment in the Assembly at this writing.

*SB 2578 (Robbins)*, as amended on April 4, would require the Commissioner to suspend for a period not exceeding twelve months or to bar from any position of employment, management, or control any broker-dealer, any officer, director, partner, agent, employee of, or person performing similar functions for a broker-dealer if that person has been convicted of any act or omission in violation of specified criminal offenses. This bill passed the Senate on May 12 and is pending in the Assembly Finance and Insurance Committee.

*SB 2716 (Keene)* failed passage in the Senate Committee on Insurance, Claims and Corporations on May 4. As amended on May 2, the bill would have prohibited a corporation from using debt instruments to purchase or refinance a corporation engaged in the harvesting of timber or timber products if, as a result of the transaction, the controlling corporation's debt would exceed 40% of its assets.

The following is a status update on bills discussed in detail in CRLR Vol. 8, No. 2 (Spring 1988) at pages 85-86:

*SB 315 (Montoya)*, which would require persons holding themselves out as financial planners to make specified written disclosure to each client, is still pending in the Assembly Finance and Insurance Committee. (For background information on this issue, see CRLR Vol. 8, No. 2 (Spring 1988) p. 82.)

*AB 2030 (Seastrand)*, which is a companion bill to SB 315, would include financial planners within the definition of "investment adviser." This bill is still pending in the Senate Business and Professions Committee.

*AB 3028 (Lancaster)* passed the Assembly on April 28 and is pending on the Senate floor at this writing. As amended June 16, its provisions would also exempt student loans made pursuant to the Higher Education Act of 1965 and the Public Health Service Act from certain requirements relating to commencement, amount, and duration of periodic repayment schedules.

*AB 3361 (Elder)*, relating to industrial loan companies, was dropped by its

author.

*AB 3362 (Elder)*, as amended on May 10, would (among other things) amend an existing provision that an industrial loan company shall not make any loan or purchase or discount any other obligation that provides for a repayment of principal over more than 120 months; this bill would extend that period to 120 months and 30 days. The bill would also extend similar provisions for certain real estate loans made by industrial loan companies from 30 years to 30 years and 30 days; and require that all appraisal fees charged by industrial loan companies for any loan which is secured primarily by real property must be in connection with an application or a request for a loan having a face amount greater than \$5,000. This bill passed the Assembly on May 16 and is pending in the Senate Banking and Commerce Committee.

*AB 3366 (Johnston)*, which would revise certain definitions under the Franchise Investment Law, passed the Assembly on April 28 and is pending in the Senate Insurance, Claims and Corporations Committee.

*AB 3460 (LaFollette)*, as amended on April 26, no longer pertains to the Department of Corporations.

*AB 4372 (Lancaster)* was amended on April 20, and now provides the following with respect to the Commissioner's authority to regulate credit unions: (1) it would require a credit union, within ten business days of opening, closing, or relocating a branch office, to notify the Commissioner of the location including the mailing address of the branch office; (2) it would provide that certain investigation and examination reports prepared by the Commissioner's representatives shall not be public records; (3) it would revise certain surety and bonding requirements and authorize the Commissioner to adopt regulations with respect to the minimum amount of bond or insurance coverage deemed adequate; and (4) it would revise the duties of credit union directors. This bill passed the Assembly on June 9 and is pending in the Senate Banking and Commerce Committee.

*SB 2636 (Russell)*, which would allow the Commissioner to extend an exemption under the Corporate Securities Law of 1968, passed the Senate on May 19 and is pending in the Assembly Finance and Insurance Committee.

*SB 2838 (Greene)* was amended on May 2. Section 17207 of the Financial Code currently requires each licensed escrow agent to pay the Commissioner



its pro rata share of all cash and expenses incurred in administration of the Escrow Law. The total assessment may not exceed the amount of the first assessment adjusted for changes in cost of living. This bill would, notwithstanding the cost-of-living adjustment limitation, authorize the Commissioner to impose a one-time supplemental assessment of up to \$150. This bill passed the Senate on May 26 and is pending in the Assembly Finance and Insurance Committee.

## DEPARTMENT OF INSURANCE

*Commissioner: Roxani Gillespie*

*(415) 557-3245*

*Toll Free Complaint Number:*

*1-800-233-9045*

Insurance is the only interstate business wholly regulated by the several states, rather than by the federal government. In California, this responsibility rests with the Department of Insurance (DOI), organized in 1868 and headed by the Insurance Commissioner. Insurance Codes sections 12919 through 12931 provide for the Commissioner's powers and duties. Authorization for the Insurance Department is found in section 12906 of the 800-page Insurance Code.

The Department's designated purpose is to regulate the insurance industry in order to protect policyholders. Such regulation includes the licensing of agents and brokers and the admission of insurers to sell in the state.

In California, the Insurance Commissioner licenses 1,300 insurance companies, which carry premiums of approximately \$26 billion annually. Of these, 650 specialize in writing life and/or accident and health policies.

In addition to its licensing function, the DOI is the principal agency involved in the collection of annual taxes paid by the insurance industry. The Department also collects over 120 different fees levied against insurance producers and companies.

The Department also performs the following functions:

(1) regulates insurance companies for solvency by tri-annually auditing all domestic insurance companies and by selectively participating in the auditing of other companies licensed in California but organized in another state or foreign country;

(2) grants or denies security permits and other types of formal authorizations to applying insurance and title com-

panies;

(3) reviews formally and approves or disapproves tens of thousands of insurance policies and related forms annually as required by statute, principally related to accident and health, workers' compensation and group life insurance;

(4) establishes rates and rules for workers' compensation insurance;

(5) regulates compliance with the general rating law. Rates generally are not set by the Department, but through open competition under the provisions of Insurance Code sections 1850 *et seq.*; and

(6) becomes the receiver of an insurance company in financial or other significant difficulties.

Through the California Insurance Code, the Commissioner has the power to order a carrier to stop doing business within the state, but does not have the power to force a carrier to pay a claim, a power reserved to the courts. The Commissioner may hold an administrative hearing to determine whether a particular broker or carrier is complying with state law.

The Commissioner is aided by a staff of over 400, located in San Diego, Sacramento, Los Angeles and San Francisco, the Department's headquarters. The Commissioner directs ten functional divisions and bureaus, including the recently reestablished Consumer Affairs Division. This division has been expanded and now includes the Rate Regulation Division. The Consumer Affairs Division is specifically designed to make the DOI accessible to consumers and more accountable to their needs and questions.

The Consumer Service Bureau (CSB) is part of the Consumer Affairs Division and handles daily consumer inquiries. CSB receives over 300 calls each day. Almost 50% of those calls result in the mailing of a complaint form to the consumer. Depending on the nature of the returned complaint, it is then referred to policy services, investigation or CSB.

Since 1979, the Department has maintained the Bureau of Fraudulent Claims, charged with investigation of suspected fraud by claimants. The California insurance industry claims losses of more than \$100 million annually to such claims. Licensees pay an annual fee of \$150 to fund the Bureau's activities.

A Consumer Advisory Panel has been named by the Commissioner as an internal advisor to the Department of Insurance. The panel will advise the Department on methods of improving existing services and on the creation of new services. It will also assist in the

development and distribution of consumer information and educational materials.

## MAJOR PROJECTS:

*Proposed Medigap Regulations.* Insurance company abuses in selling supplemental insurance policies to Medicare recipients have been the topic of much public debate over the last two years. (See CRLR Vol. 7, No. 4 (Fall 1987) p. 1 for background information.) On March 29, the Insurance Commissioner announced proposed actions to adopt, amend, and/or repeal its regulations relating to the sale of these policies. The Department reports that it will substantially adopt the National Association of Insurance Commissioners' Model Rules and Interpretive Guidelines Governing Advertisements of Medicare Supplement Insurance. In summary, the regulations will establish a consolidated body of regulations implementing, interpreting, and making specific provisions of the Unfair Practices Act; establish minimum standards and guidelines for disclosure of supplemental policy information; establish a procedure for the pre-use filing of advertising materials; and amend or repeal duplicative and/or conflicting regulations.

*California Sues Insurers and Underwriters.* In March, Attorney General John Van de Kamp and eight other state attorneys general filed suit against 31 insurers and underwriters, alleging that they conspired to sharply reduce liability coverage available to public agencies and to eliminate all insurance coverage for environmental damage due to pollution, including spills and long-term seepage. The suit alleges specifically that Allstate Insurance Co., Aetna Casualty and Surety Co., Hartford Fire Insurance Co., and CIGNA Corp. conspired with Lloyd's of London, the Insurance Services Office, and 25 other companies. The Department of Insurance is not participating in the suit.

*Department Issues New Ratemaking Guidelines.* In an attempt to prevent erratic rate swings in the insurance market, the Commissioner issued new ratemaking guidelines for insurers. The bulletin mandates two methods for calculating claims costs as a part of setting a premium for California policies. The first method requires insurers to use their own loss experience to calculate claims costs. The second allows them to use the figures supplied by any licensed rating organization, such as the Insurance Services Office. The major thrust of the bulletin seems to be to require