

STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
300 Capitol Mall, 17th Floor
Sacramento, CA 95814

WORKSHOP DRAFT TEXT OF REGULATION

COMPLETE PROPERTY AND CASUALTY RATE APPLICATION

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TITLE 10. INVESTMENT
CHAPTER 5. INSURANCE COMMISSIONER
SUBCHAPTER 4.8. REVIEW OF RATES
ARTICLE 3. GENERAL PROVISIONS

Amend Section 2643.3. Total Aggregate Earned Premiums.

(a) The determination whether rates are excessive or inadequate is made on the basis of the aggregate earned premiums the rates are expected to produce. Thus, the proposed and approved rates are required to reflect the actual distribution of premiums, including discounts, dividends, credits, and other rating factors affecting aggregate premiums. Rates that are neither excessive nor inadequate may still be unlawful and disapproved if they are unfairly discriminatory or otherwise violate chapter 9 (commencing with section 1851) of part 2 of division 1 of the Insurance Code.

(b) ~~Complete Rate applications (Form CAR-1 (last revised 1/94))~~ shall be filed on a line-by-line basis, as set forth in ~~s~~Section 2642.7. The A complete rate application shall include the information required by Section 2648.4, and shall be accompanied by the insurer's rating and rating rule manual, rating plan, all policy forms to which changes would have a rate impact, or such other documents as may be necessary to show the distribution of premium within the line. The Commissioner shall require the filing of such other information as he or she deems necessary to review the application.

(c) The earned premium of retrospectively rated and loss-sensitive insurance shall be the manual premium.

NOTE: Authority cited: Sections 1861.01 and 1861.05, Insurance Code; *20th Century v. Garamendi* (1994) 8 Cal.4th 216. Reference: Sections 1861.01 and 1861.05, Insurance Code; *Calfarm Insurance Company v. Deukmejian* (1989) 48 Cal.3d 805.

TITLE 10. INVESTMENT

CHAPTER 5. INSURANCE COMMISSIONER

SUBCHAPTER 4.8. REVIEW OF RATES

ARTICLE 4. DETERMINATION OF REASONABLE RATES

Amend Section 2644.27. Variance Request.

(a) A request that the maximum permitted earned premium or minimum permitted earned premium should be adjusted is referred to as a “variance request.”

(b) Requests for variances shall be filed with the Rate Regulation Branch, Filing Bureau on pages 11a and 11b of the Prior together with the insurer’s Approval complete Rate Application pursuant to sSection 2648.4. All such variance requests shall specifically:

(i) identify each and every variance request;

(ii) identify the extent or amount of the variance requested and the applicable component of the ratemaking formula;

(iii) set forth the expected result or impact on the maximum and minimum permitted earned premium that the granting of the variance will have as compared to the expected result if the variance is denied; and

(iv) identify the facts and their source justifying the variance request and provide the documentation supporting the amount of the change to the component of the ratemaking formula.

(c) Requests for variances shall be filed at the same time as the ~~prior approval~~ insurer’s complete rate application to which it applies or after the filing of the complete rate application and before any final determination regarding that application. Public notice of all variance requests shall be provided as set forth in California Insurance Code ~~S~~sections 1861.05, subdivision (c) and 1861.06.

(d) A variance request shall be deemed approved sixty days after public notice unless:

(i) a consumer or his or her representative requests a hearing within forty-five days of public notice and the Commissioner grants the hearing, or determines not to grant the hearing and issues written findings in support of that decision, or

(ii) the Commissioner on his or her own motion determines to hold a hearing.

(e) Variance requests shall be determined in conjunction with the related prior approval application or rate hearing thereon.

(f) The following are the valid bases for requesting a variance:

(1) That the insurer should be allowed relief from the efficiency standard for bona fide loss-prevention and loss-reduction activities as set forth below.

(A) The insurer meeting the qualifications set forth below may obtain an increase in the applicable efficiency standard by the amount of its “Allocated Costs” for its Special Investigations Unit (“SIU”) expense for the most recent year. The term SIU as used in this section has the same meaning as that term has in Section 2698.30, subdivision (o). The term “Allocated Costs” means those costs set forth in subsection (iii) and attributable to investigations of claims made on the line of insurance subject to Insurance Code section 1861.05, subdivision (b) for which the variance is sought.

(i) An insurer may recover its “Allocated Costs” for its SIU expenses only in its approved rate filing for the line of insurance affected by the SIU investigation costs.

(ii) Affiliated insurers who utilize the same SIU unit may recover the portion of their “Allocated Costs” for their SIU expenses attributable to investigations of claims made on the line of insurance in the rate application only in one approved rate application for the line affected by the Allocated SIU costs. The term “Affiliated Insurers” has the same meaning as that term has in Insurance Code ~~§~~section 1215.

(iii) The only recoverable SIU expenses are those expended for investigators whose sole duties are investigation of insurance fraud, software dedicated solely to analysis of data for indications of insurance fraud, training of employees whose sole duty is the investigation of fraud and equipment to be used solely by the insurer's SIU. The recoverable expenses do not include the costs of employing or other costs for adjustors or underwriters.

(iv) The only recoverable SIU expenses are for SIU's dedicated to investigation of insurance fraud within the State of California or for the portion of an SIU's operations within California. The burden of demonstrating the amount of SIU expenses, and that those expenses are for the investigation of insurance fraud within the State of California is the insurers.

(v) An insurer may recover the “Allocated Costs” of retaining an independent contractor to perform SIU services as described in sub-paragraph (iii). The variance shall be calculated by multiplying the fees paid for the independent agency with whom the insurer contracts by the percentage of referrals of claims made on the line of insurance for which the rate application and variance application are made and that the contracted agency investigates in California on behalf of the insurer seeking the variance.

(vi) No expense that is included within the Defense and Cost Containment Expense portion of an insurer's complete rate application can be included in whole or in part as the basis for a variance based on SIU expenses. The terms “Defense and Cost Containment Expense” or “DCCE” when used with regard to any variance have the same meaning as those terms have in ~~s~~Section 2644.23, subdivision (c).

(vii) An insurer that asserts that payments to: (1) an independent contractor; or (2) an SIU owned by an Affiliated Insurer; or (3) an SIU independent of an insurer, but which is owned directly or indirectly, in whole or part by the insurer applying for a variance or by an Affiliated Insurer, shall in its variance request, provide the Department of Insurance with documentation showing the costs of investigation for the purported “Allocated Costs” claimed in the variance request. The payments constituting the basis for the variance must be bona fide payments for

investigation of individual cases of suspected insurance fraud. It shall be the burden of the insurer to demonstrate that the costs are bona fide costs for investigation of insurance fraud in the State of California.

(B) An insurer meeting the qualifications set forth below will be allowed to recover its expenses for the most recent year for dedicated loss prevention programs such as brush clearance, driver education, risk management, hazard mitigation or accident prevention. Loss prevention expenses do not include SIU expenses under subsection (A).

(i) An insurer may recover its “Allocated Costs” for its loss prevention expenses only in its approved rate for the line of insurance affected by the loss prevention expenses.

(ii) The insurer must provide documentation detailing the loss prevention program, what additional costs are being incurred and what losses are being prevented.

(iii) Recoverable loss prevention expenses are those expended for employees whose duties are loss prevention, software dedicated to loss prevention, and equipment to be used for loss prevention. Recoverable loss prevention expenses do not include the routine and customary costs of marketing or employing underwriters or adjusters.

(iv) The only loss prevention expenses recoverable are for loss prevention programs dedicated to loss prevention in the State of California or for the portion of the program within California. The burden of demonstrating the amount of loss prevention costs, and that those costs are expended for loss prevention in the State of California is on the insurer.

(2) That the insurer should be allowed relief from the efficiency standard due to any or all of the following:

(A) Higher quality of service, as demonstrated by objective measures of consumer satisfaction; or

(B) Demonstrated superior service to underserved communities, as defined in §Section 2646.6; or

(C) Significantly smaller or larger than average California policy premium, including any applicable fees. These fees include but are not limited to: policy fees, installment fees, endorsement fees, inspection fees, cancellation fees, reinstatement fees, late fees, SR-22, and other similar charges.

(3) That the insurer should be authorized leverage factor different from the leverage factor determined pursuant to §Section 2644.17 on the basis that the insurer either writes at least 90% of its direct earned premium in one line or writes at least 90% of its direct earned premium in California and its mix of business presents investment risks different from the risks that are typical of the line as a whole. The leverage factor shall be adjusted by multiplying it by 0.85. The surplus ratio in §Section 2644.22 shall likewise be divided by 0.85. If an insurer writes at least 90% of its direct earned premium in one line and writes at least 90% of its direct earned premium in California, the insurer will only be authorized one leverage factor adjustment of 0.85.

(4) That the insurer should be granted relief from operation of the efficiency standard for a line of insurance in which the insurer has never previously written over \$1 million in earned premiums annually and in which the insurer has made or is making a substantial investment in order to enter the market. Any such request shall be accompanied by a proposed amortization schedule to distribute the start-up investment.

(5) That the minimum permitted earned premium should be lowered on the basis of the insurer's certification, and the Commissioner's finding, that the rate will not cause the insurer's financial condition to present an undue risk to its solvency and will not otherwise be in violation of the law.

(6) That the insurer's financial condition is such that its maximum permitted earned premium should be increased in order to protect the insurer's solvency. Any application for authorization under this subsection shall include:

(A) A showing of the insurer's condition, based on generally accepted standards such as the National Association of Insurance Commissioners' Insurance Regulatory Information System;

(B) A plan to restore the financial condition;

(C) A showing that, consistent with the claimed condition, the insurer has reduced or foregone dividends to stockholders or policyholders; and

(D) A plan to reduce rates once the insurer's condition is restored, in order to compensate consumers for excessive charges.

(7) That the loss development formula in sSection 2644.6 does not produce an actuarially sound result because

(A) There is not enough data to be credible;

(B) There are not enough years of data to fully calculate the development to ultimate;

(C) There are changes in the insurer's reserving or claims closing practices that significantly affect the data; or

(D) There are changes in coverage or other policy terms that significantly affect the data; or

(E) There are changes in the law that significantly affect the data; or

(F) There is a significant increase or decrease in the amount of business written or significant changes in the mix of business.

(8) That the trend formula in sSection 2644.7 does not produce the most actuarially sound result because

(A) There is a significant increase or decrease in the amount of business written or significant changes in the mix of business;

- (B) There are not enough years of data to calculate the trend factor;
 - (C) There is a significant change in the law affecting the frequency or severity of claims;
 - (D) It can be shown that a trend calculated over a period of at least 4 quarters other than a period permitted pursuant to Section 2644.7, subdivision (b) is more reliable prospectively;
 - (E) There are changes in the insurer's claims closing practices that significantly affect the data; or
 - (F) There are changes in coverage or other policy terms that significantly affect the data.
- (9) That the maximum permitted earned premium would be confiscatory as applied. This is the constitutionally mandated variance articulated in *20th Century v. Garamendi* (1994) 8 Cal.4th 216 which is an end result test applied to the enterprise as a whole. Use of this variance requires a hearing pursuant to 2646.4.
- (g) If there is more than one actuarial analysis of a variance, each of which is based on reliable data and utilizes methods which are shown by qualified expert evidence to be generally accepted as sound by the actuarial community and the appropriate methods for the particular variance, then the variance shall be granted, denied or calculated utilizing the actuarial proposition that results in the soundest actuarial result.
- (h) Notwithstanding any other section of these regulations, the aggregate total adjustment to the efficiency standard for all variances combined shall not exceed the difference between the insurer's most recent year total expense ratio excluding defense and cost containment expenses and the efficiency standard.

NOTE: Authority cited: Sections 1861.01 and 1861.05, Insurance Code; and *20th Century v. Garamendi* (1994) 8 Cal.4th 216. Reference: Sections 1861.01 and 1861.05, Insurance Code; and *Calfarm Insurance Company v. Deukmejian* (1989) 48 Cal.3d 805.

TITLE 10. INVESTMENT
CHAPTER 5. INSURANCE COMMISSIONER
SUBCHAPTER 4.8. REVIEW OF RATES
ARTICLE 8. TIMELINES FOR SCHEDULING AND COMMENCING HEARINGS

Amend Section 2648.1. Scope.

~~(a)~~ Except as provided for herein, this article applies to rate applications submitted pursuant to Insurance Code section 1861.05, subdivision (b), and proceedings commenced by the issuance of a notice of hearing, or other notice or order commencing a proceeding on a rate application issued by the Commissioner pursuant to Insurance Code §section 1861.05, subdivision (c).

~~(b) This article shall not apply to applications for exemption from Insurance Code Section 1861.01(a), file and use rate applications filed prior to November 8, 1989, or applications for rate changes pursuant to Insurance Code Section 1861.05 which are filed prior to July 1, 1993. Refiling of applications for rate changes pursuant to Insurance Code Section 1861.05 shall be made by filing the Department cover sheet entitled "Cover Sheet for Re-Filing of Application for Approval of Insurance Rates," Department form number CA-RA1, dated May 1, 1993, which is incorporated by reference. In addition, for those applications which were submitted with data that is no longer current, updated data must also be submitted with the cover sheet.~~

NOTE: Authority cited: Sections 1861.05 and 1861.055 California Insurance Code. Reference: Sections 1861.05 and 1861.055, California Insurance Code.

Amend Section 2648.2. Receipt of Rate ~~Change~~ Application By Commissioner.

(a) For the purpose of Insurance Code ~~§~~section 1861.05, subdivision (c), a rate ~~change~~ application shall be considered to have been received by the Commissioner on the date that it is received by the Department's Rate Filing Bureau.

(b) Within 14 days of receipt, the Commissioner shall review rate applications for completeness as required by Insurance Code ~~§~~section 1861.05, subdivision (b). If the application includes ~~the forms and exhibits listed in the Filing Checklist, as provided in all information and materials required by Section 2648.4, and the data required therein,~~ it is complete. If the Commissioner determines that the application is not complete because it does not include ~~such forms, exhibits, or the data required therein,~~ all information and materials required by Section 2648.4 for a complete application, notice stating the grounds for incompleteness will be given to the insurer within the 14 day period and the application will be rejected. Within 10 days of the date that such notice is given, the insurer may request a hearing on the rejection.

(c) The hearing shall be held within 10 days of receipt of the request by the Department's Rate Enforcement Bureau. The scope of the hearing shall be limited to the completeness of the application.

(d) If, after a hearing, an application is determined to have been complete when filed, then the 180 day period specified in Insurance Code ~~§~~section 1861.05, subdivision (c) shall have commenced on the date the application was first filed. If the application is determined to be incomplete, then it shall remain rejected.

(e) Rejection of an application for incompleteness shall not bar the refiling of a complete application.

(f) Public notice required by Insurance Code ~~Section~~ 1861.05, subdivision (c) shall be made within 10 days after the Commissioner determines that an application is complete.

NOTE: Authority cited: Sections 1861.05 and 1861.055, California Insurance Code. Reference: Sections 1861.05 and 1861.055, California Insurance Code.

Amend Section 2648.4. Complete Application.

(a) ~~In order to be complete,~~ Pursuant to Insurance Code section 1861.05, subdivision (b), every insurer that desires to change any rate must file a complete rate application which must include the following information required by Insurance Code section 1861.05, subdivision (b), and all information as the commissioner may require in order to perform a complete analysis of a rate application, including but not limited to the exhibits, data, information, and documentation specified by Sections 2641.1 through 2643.8 and Sections 2644.1 through 2644.28. A complete rate application shall also include all of the materials described in subdivisions (b) through (d) of this Section 2648.4.

(b) A complete rate application shall include any and all criteria, guidelines, ~~or~~ systems, manuals, and algorithms the insurer uses to determine whether to accept, examine, inspect, cancel, non-renew, or re-underwrite a risk, or to modify an applicant's or insured's coverage or coverage options.

Specifically, the complete rate application includes, without limitation, any and all of the following:

(1) An insurer's eligibility guidelines as defined in Sections 2360.0 through 2360.7;

(2) Any and all criteria, guidelines, systems, manuals, and algorithms an insurer uses to reduce, increase, or restrict the number of policies written or renewed, or restrict the coverages offered, in specific geographic areas such as ZIP codes, counties, or territories, for any reason, including over-concentration; and

(3) Any method or set of standards, parameters, rules, requirements or procedures that is used by an insurer, agent, broker, or underwriter to assist in the determination of whether to accept, examine, inspect, cancel, non-renew, or re-underwrite a risk, or to modify an applicant's or insured's coverage or coverage options.

(c) A complete rate application shall also include any and all criteria, guidelines, systems, manuals, and algorithms an insurer, agent, broker, or underwriter relies upon to determine the rate, rating rules and coverages for any particular applicant or insured, including optional coverage rates and rules.

(d) A complete rate application shall also include a complete and entire copy of any and all written and electronic descriptions of all of the materials described in subdivisions (a) through (c) of this section.

(e) Pursuant to Insurance Code section 1861.05, subdivision (b), the Commissioner may, in order to perform a complete analysis of a rate application previously deemed complete pursuant to section 2648.2, subdivision (b), require the insurer to submit additional information, forms, templates, exhibits, data and documentation during the Commissioner's review of the application.

~~, which are incorporated by reference application for approval (form CA RA1, 5-1-96 ed.), duplicate of form CA RA1 for return copy, self-addressed envelope with sufficient postage to return the duplicate copy of CA RA1, Rate/Rule/Underwriting Rule Submission Data Sheet (form CA RA2, 5-1-96 ed.), Line of Business (form CA RA3, 5-1-96 ed.), Filing Checklist (form CA RA4, 5-1-96 ed.), Ratemaking Data (form CA RA5, 5-1-96 ed.), Reconciliation Report (form CA RA6, 5-1-96 ed.), Additional Data Required by Statute (form CA RA7, 5-1-96 ed.), Miscellaneous Data (form CA RA8, 5-1-96 ed.), Filing History (to be labeled Exhibit 1), Rate Level History (to be labeled Exhibit 2), Premium Adjustment Factor (to be labeled Exhibit 3), Premium Trend Factor (to be labeled Exhibit 4), Allocated Loss Adjustment Expense (to be labeled Exhibit 5), Loss Development Factors (to be labeled Exhibit 6), ALAE Development Factors (to be labeled Exhibit 7), Loss Trend, ALAE Trend, and Expense Trend (to be labeled Exhibit 8), Catastrophe Adjustment (to be labeled Exhibit 9), Policy Term Distribution (to be labeled Exhibit 10), Credibility Adjustment (to be labeled Exhibit 11), Data Availability Report (to be labeled Exhibit 12), Interjurisdictional Expense Allocations (to be labeled Exhibit 13), Unallocated Loss Adjustment Expense (to be labeled Exhibit 14), Other Expense Items (to be labeled Exhibit 15), Ancillary Income (to be labeled Exhibit 16), Federal Income Tax Rate (to be labeled Exhibit 17), Projected Investment Income Ratio (to be labeled Exhibit 18), Loss Reserves, Loss Adjustment Expense Reserves, and Unearned Premium Reserves (to be labeled Exhibit 19), Insurer's Ratemaking Calculations (to be labeled Exhibit 20), Rate Distribution (to be labeled Exhibit 21), Rate Classification Relativities (to be labeled Exhibit 22), New Program (to be labeled Exhibit 23), Group Filing (to be labeled Exhibit 24), rating rules, and rate pages. The application must also contain a summary and explanation of the purpose for the filing. The Filing Instructions (forms CA IA1 CA I8, 5-1-96, ed.) for these forms and exhibits are incorporated by reference.~~

~~(b) Notwithstanding the completeness determination, the Commissioner may later require the submission of relevant underwriting rules and other relevant documents from an applicant in order to perform a complete analysis of an application.~~

(e) Requests for variances as authorized by section 2644.27 shall be on the following form:

STATE OF CALIFORNIA _____ Insurer Name
DEPARTMENT OF INSURANCE _____ Line of Business

Request for Variance

1. Identify each variance requested.

~~2. Identify the extent or amount of the variance requested and the applicable efficiency standard, rate of return, loss development factors or trend which will result if the variance is granted.~~

~~3. Set forth the expected result or impact on the maximum and minimum permitted earned premium that the granting of the variance will have as compared to the expected result if the variance is denied.~~

~~4. Identify the facts and their source justifying the variance request and provide the documentation supporting the amount of the change in the applicable efficiency standard, rate of return, loss development factors or trend that is being proposed.~~

NOTE: Authority cited: Sections 1861.01 and 1861.055, Insurance Code. Reference: Sections 1861.05, 1861.07 and 1861.055, Insurance Code.