

STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 21st Floor
San Francisco, California 94105

NOTICE OF PROPOSED ACTION AND NOTICE OF PUBLIC HEARING

Adopt Title 10, California Code of Regulations, Chapter 5, Subchapter 4.75, Article 1, Section 2636 to read as follows:

**SUBCHAPTER 4.75. Homeowners Insurance Rates and Underwriting.
Article 1. Experience Rating in Residential Property Lines of Insurance**

CDI File No. RH06050472

January 31, 2006

SUBJECT OF HEARING

Notice is hereby given that the California Insurance Commissioner (Commissioner) proposes to adopt the regulation described below after considering comments from the public. The Commissioner proposes to adopt Title 10, California Code of Regulations, Chapter 5, Subchapter 4.75, Article 1, Section 2636 to read as follows: **SUBCHAPTER 4.75. Homeowners Insurance Rates and Underwriting. Article 1. Experience Rating in Residential Property Lines of Insurance**

The proposed regulation will implement guidelines relating to the rates charged for policies of residential property insurance and will establish certain acknowledgements to be made pursuant to the sale or renewal of a policy of residential property insurance.

AUTHORITY AND REFERENCE

Per Gov. Code § 11349(b) "Authority" means the provision of law which permits or obligates the agency to adopt a regulation.

The authority for the proposed regulation as it relates directly to rates is Cal. Ins. Code section 1861.05; *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216, 245, Cal. Rptr. 2d 807; *Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal. 3d 805, 258 Cal. Rptr. 161.

The authority for the regulation as it relates to disclosure is Authority: Cal. Ins. Code sections 790; 790.03(a); 790.03(b); 790.10; *Spray, Gould & Bowers v. Associated Internat. Ins. Co.*, (1999) 71 Cal. App. 4th 1260, 84 Cal. Rptr. 2d 552. Cal. Ins. Code §790.10 provides specific authority for the Commissioner to promulgate regulations requiring specific disclosures when the Commissioner determines "conditions warrant" the promulgation of such regulations. The Commissioner has determined that at the present time conditions warrant the promulgation of the proposed regulation as it relates to specific disclosures.

"Reference" means the statute, court decision, or other provision of law which the agency implements, interprets, or makes specific when adopting a regulation.

The following statutes and court decision are referenced as being implemented, interpreted, and made specific by the proposed regulation is Cal. Ins. Code section 1861.05; *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216, 245, Cal. Rptr. 2d 807; *Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal. 3d 805, 258 Cal. Rptr. 161.

The reference for the definition of the term “underwriting” is *Smith v. State Farm Mutual Automobile Ins. Co.* (2001) 93 Cal.App.4th 700, 113 Cal. Rptr. 2d 399.

The reference for that portion of the regulations that focuses on disclosure is Cal. Ins. Code sections 790; 790.03(a); 790.03(b); 790.10; *Spray, Gould & Bowers v. Associated Internat. Ins. Co.*, (1999) 71 Cal. App. 4th 1260, 84 Cal. Rptr. 2d 552

HEARING DATES AND LOCATIONS

The Commissioner will hold a public hearing to provide all interested persons an opportunity to present statements or arguments, either orally or in writing, with respect to this regulation on the following dates at the following locations.

March 28, 2006
10:00 a.m.
45 Fremont Street
22nd Floor Hearing Room
San Francisco, CA 94105

PRESENTATION OF WRITTEN AND/OR ORAL COMMENTS: CONTACT PERSONS

All persons are invited to present oral and/or written comments at the scheduled hearing. Written comments not presented at the hearing must be addressed to the following contact person:

Donald P. Hilla, Senior Staff Counsel
California Department of Insurance
45 Fremont Street, 21st Floor
San Francisco, CA 94105
Telephone: (415) 538-4108
hillad@insurance.ca.gov

Questions regarding the hearing, comments or the substance of the proposed action should be addressed to the above contact person. If the contact person is unavailable, inquiries may be sent to the backup contact person:

Lara Sweat, Staff Counsel
California Department of Insurance
45 Fremont Street, 21st Floor
San Francisco, CA 94105
Telephone: (415) 538-4192
sweatl@insurance.ca.gov

DEADLINE FOR WRITTEN COMMENTS

All written materials must be received by the Commissioner, care of the contact person at the address listed above, by no later than **5:00 p.m. on March 28, 2006**. Any materials received after that time will not be considered.

COMMENTS TRANSMITTED BY ELECTRONIC COMMUNICATION

The Commissioner will accept and strongly encourages written comments transmitted by e-mail, provided they are sent to the following e-mail address: hillad@insurance.ca.gov. The Commissioner also requests a hard copy of the comments electronically submitted. Please place the following in the subject heading of the e-mail: **CDI File No. RH06050472**. Microsoft Word and "PDF" documents may be attached to e-mails. The Commissioner will also accept written comments transmitted by facsimile provided they are directed to the attention of **Donald Hilla** using the following fax number: **(415) 904-5490**. Comments sent to other e-mail addresses or other facsimile numbers will not be accepted. Comments sent by e-mail or facsimile are subject to the deadline for written comments set forth above.

ACCESS TO HEARING ROOMS

The facilities to be used for the public hearing are accessible to persons with mobility impairments. Persons with sight or hearing impairments are requested to notify the contact person for this hearing in order to make special arrangements, if necessary.

ADVOCACY OR WITNESS FEES

Persons or groups representing the interests of consumers may be entitled to reasonable advocacy fees, witness fees, and other reasonable expenses, in accordance with the provisions of subchapter 4.5, title 10 of the California Code of Regulations, in connection with their participation in this matter. Persons interested in inquiring about the appropriate procedures should contact the Office of the Public Advisor at the following address:

California Department of Insurance
Office of the Public Advisor
300 Capitol Mall, 17th Floor
Sacramento, CA 95814
(916) 492-3559

A copy of any written materials submitted to the Public Advisor regarding this rulemaking must also be submitted to the contact person for this hearing. Please contact the Office of the Public Advisor for further information.

INFORMATIVE DIGEST

Summary of Existing Law

California Insurance Code §1861.05 requires the prior approval of the Insurance Commissioner of rates subject to the provisions of the McBride-Grunsky Act. Homeowners or residential property insurance is one such line. *Calfarm Ins. Co. v. Deukmejian, supra*, 48 Cal. 3d 805; *20th Century Ins. Co. v. Garamendi, supra*, 8 Cal. 4th 216 and *State Farm Mutual Automobile Ins. Co. v. Garamendi, supra*, 32 Cal.4th at pp. 1041-1042 are cases dealing with the scope of the Commissioner's authority to promulgate regulations pursuant to California Insurance Code §1861.05. Each of these cases helped define, in one way or another, the Commissioner's broad authority to promulgate regulations pertaining to rates. In *State Farm Mutual Automobile Insurance Company v. Garamendi, supra* 32 Cal. 4th 1029 the California Supreme Court made clear that the Commissioner's authority under Proposition 103 is extremely broad. The court noted that the stated purpose of Proposition 103 is "to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians." (Historical and Statutory Notes, 42A West's Ann. Ins. Code (1993 ed.) foll. § 1861.01, p. 649.)" The Supreme Court also made it clear that Proposition 103 is "not only about rates and rate regulation; it also concerns other factors that may impermissibly affect the availability of insurance."

California Insurance Code Article 6.5 is entitled "Unfair Practices." California Insurance Code § 790 *et seq.* is known as the Unfair Insurance Practices Act. The stated purpose of California Insurance Code §§ 790 *et seq.* is "to regulate trade practices in the business of insurance . . . by defining, or providing for the determination of all such practices in this State which constitute unfair methods of competition or unfair or deceptive acts or practices and by prohibiting the trade practices so defined or determined." California Insurance Code § 790.10 provides the Commissioner with the specific authority to promulgate regulations. California courts have recognized the Commissioner's authority to promulgate regulations which require making certain disclosures relating to insurance products. See *Spray, Gould & Bowers v. Associated Internat. Ins. Co., supra*, 71 Cal. App. 4th 1260. See also *20th Century Ins. Co. v. Garamendi, supra*, 8 Cal. 4th 216; *Calfarm Ins. Co. v. Deukmejian, supra*, 48 Cal. 3d 805; *Smith v. State Farm Mutual Automobile Ins. Co., supra*, 93 Cal.App.4th 700, *State Farm Mutual Insurance Company v. Harry Low*, (2001) 92 Cal. App. 4th 1169; 112 Cal. Rptr. 2d 574, and *State Farm Mutual Automobile Insurance Company v. Garamendi, supra*, 32 Cal. 4th 1029.

In California "an underwriting rule is properly characterized as a rule followed or adopted by an insurer or a rating organization which either (1) *limits* the conditions under which a policy will be issued or (2) *impacts* the rates that will be charged for that policy." *Smith v. State Farm Mutual Automobile Ins. Co.* (2001) 93 Cal.App.4th 700, 113 Cal. Rptr. 2d 399.

POLICY STATEMENT OVERVIEW

The Commissioner has determined that serious problems exist in the California residential property insurance market relating to the availability and affordability of homeowners insurance. Affordability and availability are periodically impacted by economic cycles. Availability is invariably impacted in the wake of natural disasters to which California is especially vulnerable.

Over the last three years the residential property insurance market has experienced severe fluctuations in the availability and affordability of homeowners insurance. As to affordability a substantial number of insurers have in recent years begun to apply premium surcharges when policyholders file claims. The Commissioner has determined that those surcharges must be based on actuarially sound data. As outlined above, the Commissioner's authority to regulate rates is clear and broad.

As a corollary the Commissioner has determined that many California policyholders are not aware of the economic consequences such as the increase in premium attendant to making a claim. The Commissioner has also found that many California policyholders are not aware that should they make a claim their insurer is likely to non-renew their insurance policy. The Commissioner has determined that this is fundamentally unfair and that policyholders should be informed of the consequences of making a claim, both at the point of sale and on an annual basis. The Commissioner's authority in the realm of unfair insurance practices is also clear and broad. The Unfair Insurance Practices act provides express authority for the Commissioner to promulgate regulations to define and make specific the details of those acts or practices that are identified and prohibited by the Unfair Insurance Practices Act.

Per Proposition 103 it is the duty of the Insurance Commissioner to ensure that insurance is fair, available, and affordable for all Californians. The Commissioner has an affirmative duty to monitor the insurance markets and to intercede when problems arise. Considerations of fairness and availability come into play when uninformed insureds make claims against their policies and suffer retribution for doing so. The proposed regulations are intended to address this inherent unfairness.

The stated purpose of the Unfair Practices Act is to "regulate trade practices in the business of insurance . . . by defining, or providing for the determination of, all such practices in this State which constitute unfair methods of competition or unfair or deceptive acts or practices and by prohibiting the trade practices so defined or determined." The Commissioner has determined, that per statute, it is a misrepresentation by omission and deceptive and misleading act to market insurance products and collect premium thereon without informing insurance consumers about the most basic and fundamental aspects of the policy, including what will penalties will be suffered by the insured should they make a claim against their policy.

In the past, on numerous occasions Californians have found it difficult, if not impossible, to purchase residential property insurance in the standard market. The Commissioner wishes to explore taming these volatile market fluctuations in affordability and availability. These regulations are designed to address some of the problems associated with this troubled insurance

market and to provide for a more robust and vigorous insurance marketplace by increasing competition.

Effect of Proposed Action

As outlined in detail above the proposed regulation will implement, interpret and make specific the California Insurance Code sections relating to the calculation of rates and premiums charged for policies of homeowners insurance. The proposed regulation will allow insurance consumers to be better informed about the products they are purchasing and similarly allow insurance consumers to make more informed choices as they shop for insurance. Finally, the regulation will facilitate the Commissioner in preventing the application of excessive, inadequate or unfairly discriminatory rates.

MANDATES ON LOCAL AGENCIES OR SCHOOL DISTRICTS OR COSTS WHICH MUST BE REIMBURSED PURSUANT TO GOVERNMENT CODE SECTIONS 17500 THROUGH 17630

This proposed regulation does not impose any mandate on local agencies or school districts. There are no costs to local agencies or school districts for which Part 7 (commencing with Section 17500) of Division 4 of the Government Code would require reimbursement.

COST OR SAVINGS TO ANY STATE AGENCY

The Commissioner has determined that the proposed regulations will result in no cost or savings to any state agency, no cost to any local agency or school district that is required to be reimbursed, no other nondiscretionary cost or savings imposed on local agencies, and no cost or savings in federal funding to the State.

ECONOMIC IMPACT ON BUSINESSES AND THE ABILITY OF CALIFORNIA BUSINESSES TO COMPETE WITH OTHER STATES

The Department has made an initial determination that in terms of the rates and premium charged for homeowners insurance in California adoption of the proposed regulation may have some statewide adverse economic impact directly affecting business, specifically California insurers' ability to compete with businesses in other states. However, as Proposition 103 requires the Commissioner to ensure that no rate is in effect which is excessive, inadequate or unfairly discriminatory, he is duty bound to act where rates charged do not meet the stricture of Proposition 103.

The types of businesses that may be affected are insurers and insurance underwriters. The Commissioner has not considered proposed alternatives that would lessen any adverse economic impact on business and invites interested parties to submit proposals. Submissions may include the following considerations:

- (i) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to businesses.

- (ii) Consolidation or simplification of compliance and reporting requirements for businesses.
- (iii) The use of performance standards rather than prescriptive standards.
- (iv) Exemption or partial exemption from the regulatory requirements for businesses.

The types of businesses affected by the proposed regulations are insurers that transact residential property insurance in the State of California.

POTENTIAL COST IMPACT ON PRIVATE PERSONS OR BUSINESSES

The Department is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

EFFECT ON JOBS IN CALIFORNIA

The Commissioner is required to assess any impact the regulations may have on the creation or elimination of jobs in the State of California, the creation of new businesses, the elimination of businesses, and the expansion of businesses currently operating in the state. The Commissioner does not foresee that the proposed regulations will have an impact on any of the above but invites interested parties to comment on this issue.

IMPACT ON HOUSING COSTS

The matters proposed herein will have no significant effect on housing costs.

CONSIDERATION OF ALTERNATIVES

The Commissioner must determine that no reasonable alternative considered by the Commissioner or that has otherwise been identified and brought to the attention of the Commissioner would be more effective in carrying out the purposes for which the regulations are proposed or would be as effective as and less burdensome to affected private persons than the proposed action. The Commissioner, however, invites public comment on alternatives to the regulation.

As to the portion of the proposed regulation relating to surcharges no viable alternative was presented to the Commissioner prior to the drafting of this regulation. The Commissioner has not determined other alternatives may be available to address the issues that are the focus of the surcharge portion of the proposed regulation.

As to the disclosure portion of the regulation no viable alternative was presented to the Commissioner prior to the drafting of this regulation. The Commissioner has not determined other alternatives may be available to address the issues that are the focus of the disclosure portion of the proposed regulation.

Performance standards were not considered in relation to the rate portion of this regulation because rates are required to be approved prior to use and the application of a set of standards after the fact would not further the purposes of Proposition 103.

Performance standards were considered in relation to the disclosure portion of the proposed regulation with the objective identified was fairness in the sale of residential property insurance. However, no specific performance standard was proposed that would be more efficient than the disclosure provisions contained in the proposed regulation. The Commissioner has not determined that performance standards might not represent a viable alternative to the disclosure requirements.

The Commissioner continues to study alternatives.

IMPACT ON SMALL BUSINESS

The matters proposed herein will only affect insurance companies, and therefore will not affect small business. (Gov. Code Section 11342.610, subd. (b), para. (2).)

COMPARABLE FEDERAL LAW

There are no existing federal regulations or statutes comparable to the proposed regulation.

TEXT OF REGULATIONS AND STATEMENT OF REASONS

The Commissioner has prepared an initial statement of reasons that sets forth the reasons for the proposed action. Upon request, the initial statement of reasons will be made available for inspection and copying. Requests for the initial statement of reasons or questions regarding this proceeding should be directed to the contact person listed above.

The file for this proceeding, which includes a copy of the proposed regulations, the statement of reasons, the information upon which the proposed action is based, and any supplemental information contained in the rulemaking file, is available for inspection and copying **by prior appointment** at 45 Fremont Street, 21st Floor, San Francisco, California 94105, between the hours of 9:00 a.m. and 4:30 p.m., Monday through Friday. Written requests for the rulemaking file or questions regarding this proceeding should be directed to the contact persons listed above.

FINAL STATEMENT OF REASONS

Upon **written or e-mail** request, the final statement of reasons will be made available for inspection and copying once it has been prepared. Written requests for the final statement of reasons should be directed to the contact person listed above.

AUTOMATIC MAILING

A copy of this notice, including the informative digest, which contains the general substance of the proposed regulations, will automatically be sent to all persons on the Commissioner's mailing list.

WEBSITE POSTINGS

Documents concerning this proceeding are available on the Department's website. To access them, go to <http://www.insurance.ca.gov>. Near the bottom of the page, under "Select a Topic" click on "Consumers". Scroll down to the heading "Regulatory Activity." In this section, scroll down until you see the subheading "Proposed Regulations – Search." Click on the "Proposed Regulations-Search" link. When the "Search" screen appears, you may choose to find the documents by either conducting a search or by browsing for them by name.

To search, enter the Department's regulation file number for these regulations in the "Search for" field. Alternatively, search using as your search term the California Insurance Code number of a code section that the regulations implement (for instance, "1861.05"), or search by key word ("residential" for example). Then, click on the "submit" button to display links to the various filing documents."

To browse, click on the "Browse All Regulations" button near the bottom of the screen. A list of the names of regulations for which documents are posted will appear. Find in the list the "Losses and Loss Exposure" link, and click it. Links to the documents associated with these regulations will then be displayed.

AVAILABILITY OF MODIFIED TEXT OF REGULATION

If the regulations adopted by the Department differ from but are sufficiently related to the original text, the Department will make the modified text available to the public for at least 15 days prior to the date of adoption. Interested persons should request a copy of these regulations prior to adoption from the contact person listed above.

Dated: January 31, 2006

JOHN GARAMENDI
Insurance Commissioner

By: _____
Donald P. Hilla
Senior Staff Counsel