# FINAL STATEMENT OF REASONS

**November 17, 2010** **File Number: REG-2010-00001**

## REGULATIONS ON STANDARDS AND TRAINING FOR ESTIMATING REPLACEMENT VALUE ON HOMEOWNERS' INSURANCE

## UPDATED INFORMATIVE DIGEST

The California Department of Insurance ("Department") gave Notice of Regulatory Action on April 2, 2010. Subsequently the Department received a number of comments concerning the noticed proposed regulations. In response thereto, on October 27, 2010, the Department gave Notice of Availability of Changed Text and of Addition of Material to Rulemaking file and of the Amended Text of Regulations. The proposed amended regulations take into consideration the changes requested by the comments received and act to more clearly set forth the obligations of licensees when communicating an estimate of replacement cost in the homeowner insurance market.

The Informative Digest published in the Notice of Proposed Action indicated that the regulations specified certain requirements, including disclosure requirements, for construction cost estimates that did not qualify as replacement costs estimates, as defined. The regulations were subsequently amended to eliminate these separate requirements for construction cost estimates. In the amended text of regulation, the definition of the term "replacement cost" has been broadened, and a definition of the term "replacement cost estimate" has been added, so that these "other" construction cost estimates now fall within the definitions of replacement cost and of replacement cost estimates. However, language has been added in the amended text of regulation restricting the regulations' substantive requirements on the use of these estimates to situations where they are communicated in the context of certain homeowners' insurance policies.

## UPDATE OF INFORMATION CONTAINED IN INITIAL STATEMENT OF REASONS

As above, on October 27, 2010, the Department issued a Notice of Amendment to Text of Regulation. In consideration of public comments received in response to the originally noticed text of regulations the Department has amended the regulations. When the amended text is quoted herein, the amended portion is indicated by <u>double underline</u>, and deletions are indicated by ~~double strikethrough.~~

There were comments that because of the nature of the type of construction, manufactured homes (mobile homes) are generally not reconstructed but replaced following a total loss. The Department concurs that the replacement cost estimate process is different than the process for site-built homes. As the comments suggested, replacement cost estimators for manufactured homes typically do not provide components such as foundation costs, whether the structure is

located on a slope, the type of frame, or nonstandard wall heights.

Based upon comments regarding reference to manufactured (mobile homes), proposed Section 2188.65 (a) (1) and proposed Section 2695.180 (a) are amended as follows:

""Homeowners' insurance policy" shall have the same meaning as "policy of residential property insurance" as defined in subdivision (a) of Insurance Code section 10104~~, except that a policy covering an individually owned mobile home shall also constitute a homeowner's insurance policy~~."

Comments were received that use of the terms "replacement value" and "replacement cost" created ambiguities and clarity problems, as these terms relate to operating provisions of these proposed regulations. Since the standards set forth in these proposed regulations more specifically address that the costs shall include all expenses that would reasonably be incurred to rebuild the structure in its entirety [Section 2695.180(a)] and shall not include a deduction for physical depreciation [Section 2695.180(d)], the terms "replacement value" and "replacement cost" should not be defined so narrowly. Therefore, proposed Section 2188.65 (a) (2) is amended as follows:

"'Replacement value' shall have the same meaning as "replacement cost" and is defined as the amount it would cost to repair, construct, rebuild or replace a ~~completely~~ damaged or destroyed structure.~~, without a deduction for physical depreciation~~."

In the same regard, proposed Section 2695.180 (b) is amended as follows:

" 'Replacement value' shall have the same meaning as "replacement cost" and is defined as the amount it would cost to repair, construct, rebuild or replace a ~~completely~~ damaged or destroyed structure."

Further, to clarify that estimate of replacement value shall have the same meaning as estimate of replacement cost, and to assure that there are no ambiguities concerning their meaning, proposed Section 2695.180 (e) has been added as follows:

"'Estimate of replacement value' shall have the same meaning as 'estimate of replacement cost' and means any estimate, statement, calculation, approximation or opinion, whether expressed orally or in writing, regarding the projected replacement value of a particular structure or structures."

Proposed Section 2188.65 (b) provided California fire and casualty broker-agents and personal lines broker agents ninety days after the effective date of the section to complete one three hour training course. The Department received comments that ninety days would not provide sufficient time in which to complete the course. Additionally, there was concern that those who had already taken the course would be required to take it again. So as to provide broker-agents sufficient time to meet the requirement, the amended language provides for 180 days. Further, the proposed amended regulation clarifies that the requirement is limited to those who have not already completed such training as follows:

"On ~~and~~ or after the day that is ~~ninety~~ 180 days after the effective date of this section, every California resident fire and casualty broker-agent and personal lines broker-agent who has not already taken a homeowners' insurance valuation training course must satisfactorily complete one three-hour training course on homeowners' insurance valuation meeting the requirements of this section prior to estimating the replacement value of structures in connection with, or explaining the various levels of coverage under, a homeowners' insurance policy ~~soliciting individual consumers in order to sell dwelling fire or homeowners' insurance~~. For resident broker-agents, this requirement shall be part of, and not in addition to, the continuing education requirements of Insurance Code section 1749.3. The homeowners' insurance valuation training course needs to be taken only once in order to satisfy the requirements of this subdivision (b). "

Because one of the issues surrounding the need for training on estimating replacement cost surrounds potential underinsurance of dwellings [where there are not sufficient insurance proceeds under the policy], proposed Section 2188.65 (d) (1) is amended as follows:

"How loss settlement provisions in an insurance policy apply to major claims, ~~and~~ the potential causes of underinsurance and the potential effects that underinsurance may have on settlement."

Section 2188.65 (d) (3) required that the broker agent training must include the components of a structure necessary to estimate replacement cost, including but not limited to the listed items. Comments offered that the term "components" alone was unclear. In this regard, the Department has amended the proposed regulations to add the term "features." Further, a number of comments stated that the "including but not limited to" language was problematic. Since the regulations required consideration of specific components, the comments argued that "including but not limited to" would require licensees to consider other components not delineated. In this regard, the amended proposed regulation has been amended as follows:

"The several components and features of a structure necessary to estimate replacement cost, as well as ~~all~~ the other costs incident to reconstruction, including ~~but not limited to~~ at least the following:"

Based upon comments and in the interest of assuring that the regulations are clear concerning the licensees' obligations in estimating replacement value to consider the types of interior features and finishes, the proposed regulations are amended. Proposed amended Section 2188.65 (d) (3) (I) provide a more specific statement that the licensee is required to consider generic types of interior features and finishes, and provide, as well, examples, where applicable, as follows:

"Materials used in, and generic types of, interior features and finishes, such as, where applicable, the type of heating and air conditioning system, type of walls, type of flooring, type of ceiling, fireplaces, type of kitchen and type of bath(s)"

Based upon comments that the proposed regulations were unclear regarding how architect's plans, and permits should be factored into an estimate of replacement cost, the proposed regulations are amended. Further, consideration of "engineering reports" is eliminated as a specifically required component to be considered, as not all rebuilding projects necessitate

engineering reports. In this regard, so as to make clear that it is the *cost* of permits and architect's plans that must be considered, proposed Section 2188.65 (d) (3) (K) is amended as follows:

"Cost of permits and architects plans ~~Architect's plans, engineering reports and permits~~"

Further, based upon the realization that the type of attached garage be considered, proposed Section 2188.65 (d) (3) (M) is amended to add in the size and type of attached garage, and noticed (M) is now lettered (N) as follows:

"(M) Size and type of attached garage; and

(N~~M~~) Additional costs associated with building a single or custom home."

Section 2188.65 (d) (6) did include a review of the California Standard Form Fire Policy and FAIR Plan coverages, as described in California Insurance Code sections 2071 and 10090, respectively, but did not include review of earthquake insurance coverages, including coverage offered by the CEA. In this regard, based upon comments, as so as to clarify that earthquake coverage is included, the text has been amended as follows:

"Review of the California Standard Form Fire Policy and FAIR Plan coverages, as described in California Insurance Code sections 2071 and 10090, respectively; review of earthquake insurance coverages as described in Insurance Code section 10081 et seq., including coverage offered by the CEA."

To assure that licensees and consumers have a clear understanding of the meaning of the terms replacement cost, replacement value, estimate of replacement cost and estimate of replacement value, the terms "construction cost(s)" and "estimate of construction cost" used in the originally noticed regulations, are removed from the proposed amended regulations. Construction cost(s) and estimate of construction cost described estimates that did not include all of the components of an "estimate of replacement cost" as required in Section 2695.183 (a) – (e). In this regard proposed Section 2695.182 (a) is amended to remove the reference. [It should be noted, as well, for the same reason the text has been amended in the following proposed sections to remove "construction cost(s)" and/or "estimate of construction cost(s)": 2190.3 (f), 2695.182 (b), 2695.183, 2695.183 (g) [noticed as subdivision (h)] and 2695.183 (h), 2695.183 (i).] Further, based upon comments, and with the goal of establishing clearly that the regulations create obligations for licensees when they prepare or "communicate" an estimate of replacement cost, only in those circumstances when the application or renewal is for a policy which provides coverage on a replacement cost basis, proposed Section 2695.182 (a) is amended to read:

"In the event an estimate of replacement cost ~~or any estimate of construction costs~~ is provided or communicated by a licensee to an applicant or insured in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis, the licensee shall document and maintain in the applicant's or insured's file the following information:"

In consideration of comments, the proposed regulations are amended to clarify that the documentation to be maintained by licensees relates to the estimate of replacement value. Further, certain comments objected to the term "provide" as arguably establishing some sort of duty to communicate replacement cost estimates, which was not intended. In this regard, the proposed regulations are amended to reflect that the estimate is not necessarily "provided" but rather "prepared." In this regard, proposed Section 2695.182 (a) (1) (2) and (3) are amended as follows:

"The status of the person ~~providing~~ preparing the estimate of replacement value, as the insurer underwriter or actuary or other person identified by the insurer, a broker-agent, a contractor, an architect, a real estate appraiser, or other person or entity permitted to make such an estimate by Insurance Code section 1749.85;

(2) The name, job title, address, telephone number, and license number, if applicable, of the person ~~providing~~ preparing the estimate of replacement value~~ or construction costs~~;

(3) The source from which or method by which the estimate of replacement cost ~~value or construction cost~~ was ~~determined~~ prepared, to include any replacement cost calculator, contractor's estimate, architectural report, real estate appraisal, or other source or method; and

(4) A copy of any reports, inspection reports, contractor's estimates, or other documents used to prepare the estimate of replacement value~~ or construction costs~~.

Comments were offered that it was onerous and unnecessary to have record-keeping requirements when an estimate of replacement cost is provided by a licensee to an applicant to whom an insurance policy is never issued. In consideration of these comments, the following proposed Sections 2190.2 (q), 2190.3 (f), 2695.182 (b) and 2695.183 (i) have been amended and to remove the record-keeping requirement in such circumstances.

Section 2190.2 (q) was added to the originally noticed regulations to refer to the record keeping requirements in the proposed Section 2695.182 and Section 2695.183. Similarly, proposed Section 2190.3 (f) was added to the originally noticed regulations, again, to refer to the record keeping requirements in proposed Section 2695.182 and Section 2695.183. These subsections have now been amended so as to acknowledge that the record keeping requirements as enunciated in amended proposed Section 2695.182 and Section 2695.183 no longer require record keeping when the policy is never issued, as follows:

Section 2190.2 (q): Any documents required to be maintained pursuant to Section 2695.182, except that documents to which the last sentence of Section 2695.182 applies must be maintained for the three-year period specified in that sentence or subdivision (i) of Section 2695.183.

Section 2190.3 (f): "An agent or broker who provides an estimate of replacement cost ~~or any estimate of construction costs~~ to an applicant or insured with respect to a policy of homeowner's insurance shall maintain records and copies as mandated by Section 2695.182 and subdivision (i) of Section 2695.183."

The amended proposed Section 2695.182 (b) makes clear the record keeping requirement [stated in proposed Section 2695.182 (a)] is limited. It applies to licensees who provide an estimate of replacement cost to either an insured or an applicant for insurance. It is limited to an application

for or renewal of a policy that provides coverage on a replacement cost basis, and does not require record retention when the applicant does not buy the insurance policy:

"In the event the estimate of replacement cost ~~or of construction costs~~ is provided by a licensee to an applicant or insured~~,~~ in connection with an application for or renewal of a policy that provides coverage on a replacement cost basis, the licensee shall maintain in the insured's file the records specified in subdivision (a) of this Section 2695.182 for the entire term of the insurance policy or the duration of coverage, whichever terminates later in time, and for five years thereafter. In the event the estimate of replacement cost ~~or of construction costs~~ is provided by a licensee to an applicant to whom an insurance policy is never issued, ~~the licensee shall maintain in the applicant's file the records specified in~~ subdivision (a) of this Section 2695.182 ~~for a period of three years following the time the estimate is generated~~ shall not apply.

To make clear that the proposed regulations do not establish a duty to obtain and maintain information or documents that would not, in the absence of the proposed regulations, come into the possession of a broker-agent in the ordinary course of business, proposed Section 2695.182 (c) is added as follows:

"Notwithstanding any other provision of this Section 2695.182, this section shall impose no duty upon a broker-agent to obtain from the insured and maintain any information or document that in the absence of this section would not come into the possession of the broker-agent in the ordinary course of business."

Again, as with proposed Section 2696.182 (b), proposed Section 2695.183 (i) is amended to make clear the record keeping requirement is limited. It applies to licensees who provide an estimate of replacement cost, only, to either an insured or an applicant for insurance. It is limited to an application for or renewal of a policy that provides coverage on a replacement cost basis, and does not require record retention when the applicant does not buy the insurance policy. Additionally, language is added to proposed Section 2695.183 (i) to specifically address the length of time the records that are required to be retained, are maintained:

"Licensees shall maintain (1) a record of the information supplied by the applicant or insured that is used by the licensee to generate the estimate of replacement cost, ~~estimate or any construction cost estimate~~ and (2) a copy of any ~~replacement cost estimate and any construction cost~~ estimate of replacement cost supplied to the applicant or insured pursuant to subdivision (g)(1) or (~~i~~h) of this Section 2695.183. If a policy is issued, these records and copies shall be maintained ~~in the insured's file~~ for the entire term of the insurance policy or the duration of coverage, whichever terminates later in time, and for five years thereafter. However, if ~~in the event~~ the estimate of replacement cost is provided to an applicant to whom an insurance policy is never issued, the records and copies referred to in the first sentence of this subdivision (i) shall be maintained ~~in the applicant's file for a period of three years following the time the estimate is generated~~ for the period of time the licensee ordinarily maintains applicant files in the normal course of business, provided that such period of time shall be at least sufficient to ensure that the licensee is able to comply with the provisions of this subdivision in the event the policy is issued to the applicant."

Comments argued the noticed regulations were vague and unclear concerning the obligations of a licensee in estimating replacement value. Further, there was concern by those commenting that any reference to "set" or "recommend" placed a legal obligation on licensees that does not exist. In response to the comments, and to make clear that the regulations refer specifically to standards for estimates of replacement value communicated to applicants and insureds in connection with an application or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis, proposed Section 2695.183 is amended as follows:

"Standards for ~~Replacement Cost~~ Estimates of Replacement Value ~~and Other Construction Cost Estimates~~.
No licensee shall communicate an estimate of replacement cost~~, or shall rely on an estimate of replacement cost, to set or recommend a policy limit on a homeowners' insurance policy for~~ to an applicant or insured~~,~~ in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis ~~or to provide to the applicant or insured for his or her consideration~~ unless the requirements and standards set forth in subdivisions (a) through (e) below are met:…"

In consideration of comments, so as to make more clear that the requirements in estimating replacement cost apply to the expenses which would be incurred in rebuilding the structure using like or equivalent construction, and that those required components must include at least what is referenced in the regulations, and not, as stated in the earlier version of the regulation, "but not limited to," which the comments noted as being overbroad, Section 2695.183 (a) had been amended as follows:

"The estimate of replacement cost shall include ~~all~~ the expenses that would reasonably be incurred to rebuild the insured structure(s) in its entire~~l~~ty, including ~~but not limited to~~ at least the following:…"

In consideration of comments, so as to make more clear the components and features to be considered when estimating replacement cost, proposed Section 2695.183 (a) is amended and re-structured. Subsection (a) now provides a list of five cost components to be considered. These components, though referenced in the restructured subdivision (a) are identical to the cost components referenced in the originally noticed regulations except for the following. The originally noticed proposed regulations 2695.183 required a consideration of: "Architect's plans, engineering reports and permits, as well any other plans and reports reasonably necessary to effectuate a complete rebuilding of the structure…" As this component was considered to be overbroad, it has been revised and inserted under proposed Section 2695.183 (a) (4) as "Cost of permits and architect's plans…"

Further, in the interests of clarity, 2695.183 (a) (5) has been amended. There remains a requirement that components and features of the insured structure be considered in estimating replacement cost, but the overbroad language that the estimate include "all other costs incident to construction" is removed from the proposed amended text.

The originally noticed regulations required that the estimate of replacement cost account for the "size of the entire structure…" This proposed Section 2695.183 (a) (5) (F) is amended to read:

"The square footage of the living space…"

The originally noticed regulations required that the estimate of replacement cost account for the materials used in, and types of, interior features and finishes. So as to make more clear the requirements and to give provide further information to licensees concerning their obligations, proposed Section 2695.183 (a) (5) (I) is amended to read:

"Materials used in, and generic types of, interior features and finishes, such as, where applicable, the type of heating and air conditioning system, walls, flooring, ceiling, fireplaces, kitchen, and bath(s)…"

Further, based upon the realization that the type of attached garage be considered, proposed Section 2188.65 (d) (3) (M) is amended to add in the size and type of attached garage, and noticed (M) is now lettered (N) as follows:: "Size and type of attached garage…"

In this regard, as detailed above, proposed Section 2695.183 (a) is amended to read as follows:

"(1) Cost of labor, building materials and supplies;
(2) Overhead and profit; ~~and~~
(3) Cost of demolition and debris removal;
(4) Cost of permits and architect's plans; and
~~(3)~~ (5) Consideration of ~~All~~ components and features of the insured structure, ~~as well as all other costs incident to reconstruction,~~ including, ~~but not limited to~~ at least the following:
(A) Type of foundation;
(B) Type of frame;
(C) Roofing materials and type of roof;
(D) Siding materials and type of siding;
(E) Whether the structure is located on a slope;
(F) ~~Size of the entire structure and, separately, the~~ The square footage of the living space;
(G) Geographic location of property;
(H) Number of stories and any nonstandard wall heights;
(I) Materials used in, and generic types of, interior features and finishes, such as, where applicable, the type of heating and air conditioning system, walls, flooring, ceiling, fireplaces, kitchen, and bath(s);
~~(J) Cost of demolition and debris removal;~~
~~(K) Architect's plans, engineering reports and permits, as well any other plans and reports reasonably necessary to effectuate a complete rebuilding of the structure;~~ ~~and~~
~~(L)~~ (J) Age of the structure or the year it was built;~~,~~ and
(K) Size and type of attached garage."

So as to make clear that proposed Section 2695.183 (b) refers to an estimate of a replacement cost of *dwellings*, specifically, it is amended as follows:

"The estimate of replacement cost shall be based on an estimate of the cost to rebuild or replace the structure taking into account the cost to reconstruct the single property being evaluated, as

compared to the cost to build multiple, or tract, ~~properties~~ dwellings."

In consideration of comments that the regulations were unclear and onerous regarding the requirement that a licensee verify that the sources and methods used to estimate replacement cost proposed Section 2695.183 (e) is amended. The proposed amended regulation has removed any reference to setting or recommending a policy limit, as the comments argued that this language could be interpreted as establishing an obligation on the part of licensees to set or recommend policy limits, which is not the intent of the regulations. Further, the proposed subsection is amended to require that the licensee take reasonable steps to verify the sources no less frequently than annually and that the estimate shall be based on reasonable current sources and methods.

In this regard, proposed Section 2695.183 (e) is amended as follows:

"The ~~A~~ licensee ~~that estimates replacement cost, or that relies upon an estimate of replacement cost produced by another, to set or recommend a policy limit on a homeowners' insurance policy for an applicant or insured, or to provide to an applicant or insured for his or her consideration,~~ shall no less frequently than annually take reasonable steps to verify that the sources and methods used to generate the estimate of replacement cost are kept current to reflect changes in the costs of reconstruction and rebuilding, including changes in labor, building materials, and supplies, based upon the geographic location of the insured structure. The estimate of replacement cost shall be created using such reasonably current sources and methods."

There was concern as expressed in the comments that in order to properly estimate replacement cost, "demand surge" should be considered. Demand surge is a phenomenon characterized by a substantial increase in the cost of construction due to unusually high demand for contractors, building supplies and construction labor. Demand surge typically occurs after a disaster, such as a wildfire, earthquake, or other natural disaster. The originally noticed regulations prohibited licensees from considering demand surge in estimating replacement value. Thus, in consideration of comments that prohibiting "demand surge" in an estimate of replacement cost might limit the ability of the insured or applicant to purchase higher policy limits to account for demand surge, noticed Section 2695.183 (f) has been removed from the proposed regulations. The removed text is as follows:

~~"For purposes of this subdivision (f) "demand surge" is a phenomenon characterized by a substantial increase in the cost of construction due to unusually high demand for contractors, building supplies and construction labor. Demand surge typically occurs after a disaster, such as a wildfire, earthquake, or other natural disaster, in which large numbers of structures are destroyed within a specific geographic area. A replacement cost estimate or construction cost estimate generated by or on behalf of a licensee in connection with a homeowner's insurance policy shall not include consideration for demand surge. The licensee shall disclose to the applicant or insured in the notice or report required under subdivision (h) of this Section 2695.183 the fact that the demand surge has not been, and cannot legally be, taken into account in formulating the estimate. However, nothing in this article shall be interpreted to forbid a licensee from making known to an applicant or insured any coverage options that may be available for obtaining insurance to protect against the contingency of demand surge."~~

The text of the noticed Section 2695.183 (g) is moved to Section 2695.183 (f).
There were comments offered that oftentimes broker-agents, when estimating replacement cost, are required by insurers to use tools, including software programs, provided by the insurance carriers writing the policies. So as to make more clear that although the provisions are binding upon licensees, notwithstanding the fact that information, data or statistical methods used or relied upon by a licensee to estimate replacement cost may be obtained through a third party source, the amended text in subdivision (f), referring to subdivision (k), demonstrates that there is an exception in circumstances when insurers require that a broker-agent utilize a specific source or tool to create an estimate of replacement cost.

"(f) ~~(g)~~ Except as provided in subdivision (k) of this Section 2695.183, ~~T~~the provisions of this article are binding upon licensees, notwithstanding the fact that information, data or statistical methods used or relied upon by a licensee to estimate replacement cost may be obtained through a third party source. Any and all information received by the Department pursuant to this article shall be accorded the degree of confidential treatment required by section 735.5 of the Insurance Code or Chapter 2 of Part 1 of Division 3 of Title 2 of the Government Code, commencing at section 11180."

There were comments that the noticed regulations did not delineate the extent of the obligation on licensees to provide copies of replacement cost estimates to applicants and insureds. The comments noted that oftentimes replacement cost estimates are communicated telephonically. In this regard, proposed Section 2695.183 (g) (1) is amended.

Initially, the word "communicates" is used rather than "uses" to make clear, again, that the regulations apply to communications to an applicant or insured. Further, as noted above in other circumstances, the terms "set" and "recommend" have been removed, as these terms led to comments that the regulations were establishing an obligation on the part of licensees to set or recommend policy limits, which is not the case. The amended language provides that the communication must be related to a policy that provides coverage on a replacement cost basis, and not other policy types. As noted above, the reference to "construction cost" is removed, as well. The amended proposed regulation contains new language stating specifically that if an estimate of replacement cost is communicated to an applicant and the licensee determines an insurance policy shall not be issued, then the licensee is not required to provide a copy of the estimate. Further, the new language provides that if the estimate is communicated telephonically to an insured, the copy shall be mailed no later than three business days after the time of the telephone conversation. Finally, if an estimate is communicated by telephone to an applicant, the copy of the estimate shall be mailed no later than three business days after the applicant agrees to purchase the coverage. Proposed Section 2695.183 (g) (1) [noticed as subdivision (h)] is amended, then, as follows:

"(g)(1) ~~(h)~~ If a licensee communicates ~~uses~~ an estimate of replacement cost ~~or construction costs to set, recommend or communicate about a policy limit on a homeowners' insurance policy for~~ to an applicant or insured~~,~~ in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis, the licensee must provide a copy of the estimate of replacement cost ~~estimate or construction cost estimate~~ to the applicant or insured at the time the estimate is communicated. ~~policy limit is set, recommended or is~~

~~otherwise the subject of communication by the licensee.~~ However, in the event the estimate of replacement cost is communicated by a licensee to an applicant to whom the licensee determines an insurance policy shall not be issued , then the licensee is not required pursuant to the preceding sentence to provide a copy of the estimate of replacement cost. In the event the estimate of replacement cost is communicated by telephone to an insured, the copy of the estimate shall be mailed to the insured no later than three business days after the time of the telephone conversation. In the event the estimate of replacement cost is communicated by telephone to an applicant, the copy of the estimate shall be mailed to the applicant no later than three business days after the applicant agrees to purchase the coverage. ~~If the estimate of replacement cost or construction costs is updated or changed by, or on behalf of, the licensee, the licensee shall provide a copy of the revised estimate of replacement cost to the applicant or insured within sixty (60) calendar days from the time the estimate is generated. The~~

Pursuant to the proposed regulations an estimate of replacement cost must itemize the projected cost of components and features specified in proposed Section 2695.183 (a). Proposed Section 2695.183 (g) (2) [noticed as subdivision (h)] is amended to reflect the changes and restructuring of proposed Section 2695.183 (a) and to specify more precisely that the itemization is related to a homeowners' insurance policy that provides coverage on a replacement cost basis and that the requirement is as to the projected cost. Proposed amended Section 2695.183 (g) (2) [noticed as subdivision (h)] is amended, then, to read as follows:

"An estimate of replacement cost ~~or construction costs~~ provided in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis must itemize the projected cost for each element specified in paragraphs ~~subdivision~~ (a)(1) through (a)(4), and shall identify the assumptions made for each of the relevant components and features listed in paragraph (a)(5), of this Section 2695.183."

Clarification was needed concerning circumstances when a licensee revises an estimate of replacement cost and communicated it to an applicant or insured. In this regard, proposed newly amended Section 2695.183 (h) now requires that the licensee comply with proposes amended Section 2695.183 (g) (1) or provide the estimate simultaneously with the renewal offer. Further, this subdivision shall not apply to updates or revisions solely from the application of an inflationary provision in the policy, itself, or an inflation factor applied at renewal. As important, the amended language states that the subdivision does not obligate a licensee to recalculate an estimate of replacement cost annually. In this regard, in keeping with the effort to make clear the obligations of licensees, proposed Section 2695.183 (h) is amended as follows:

(h) If an estimate of replacement cost is updated or revised by, or on behalf of, the licensee and the revised estimate of replacement cost is communicated to the applicant or insured in connection with an offer of renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis, the licensee shall provide a copy of the revised or updated estimate of replacement cost to the applicant as provided in paragraph (g) (1) of this Section 2695.183, or to the insured simultaneously with the renewal offer, as the case may be. This subdivision (h) shall not apply when the update or revision to the estimate of replacement cost or the policy limit results solely from the application of an inflationary provision in a policy or an inflation factor. This subdivision (h) shall not obligate a licensee to recalculate an estimate of replacement cost

on an annual basis."

The Department received comments that the regulations were unclear as to what would be considered a misleading statement under Insurance Code Section 790.03. The comments implied that the regulations were establishing an obligation on the part of licensees to set or recommend policy limits, which is not the case. The comments also implied that merely using the words "replace" or replacement" in a conversation with an applicant or insured would limit the ability of a licensee to have a conversation with an applicant or insured without exposing the licensee to liability for making a misleading statement. In this regard, Section 2695.183 (j) has been amended so as to remove reference to the terms "setting" and "recommending" define more clearly and specifically the obligation to communicate an estimate that comports with 2695.183 (a) through (e) [these subdivisions specify with particularity those features and components to be considered when estimating replacement value] as follows:

"To communicate an estimate of replacement value not comporting with subdivisions (a) through (e) of this Section 2695.183 to an applicant or insured in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis constitutes making a statement with respect to the business of insurance which is misleading and which by the exercise of reasonable care should be known to be misleading, pursuant to Insurance Code section 790.03.
~~When setting, recommending or communicating about a policy limit on a homeowners' insurance policy, to characterize using any form of the word "replace" or "replacement" any estimate of construction costs not comporting with subdivisions (a) through (e) of this Section 2695.183 constitutes making a statement with respect to the business of insurance which is misleading and which by the exercise of reasonable care should be known to be misleading, pursuant to Insurance Code section 790.03. Notwithstanding the preceding sentence, a licensee that provides an applicant or insured with any estimate of construction costs that does not satisfy all of the requirements of subdivisions (a) through (e) of this Section 2695.183 shall indicate that it is not an estimate of replacement cost and shall identify and explain in the estimate each of the ways in which the estimate of construction costs that is provided fails to meet the requirements for a replacement cost estimate that are stated in said subdivisions (a) through (e).~~"

The Department received comments that when an insurer requires that a broker-agent utilize a specific source or tool to create an estimate of replacement cost, that the insurer shall provide written procedures and written training materials. In this regard, Section 2695.183 (k) has been amended to make this suggested change. Additionally, non-substantive changes have been made to this section to remove the term "construction costs" and to change the reference to subdivisions (a) through (f) to (a) through (e) in keeping with the re-lettering referenced above:

"When an insurer ~~requires that a broker-agent utilize~~ identifies ~~a~~ one or more specific sources or tools that a broker agent must use to create an estimate of replacement cost ~~or construction costs~~,

(1) the insurer shall prescribe complete written procedures to be followed by broker-agents when they use the sources or tools,

(2) the insurer shall provide the broker-agent with the training ~~or~~ and written training materials necessary to properly utilize the sources or tools according to the insurer's prescribed procedures, and

(3) the insurer, and not the broker-agent, shall be responsible for any noncompliance with ~~the provisions subdivisions (a) through (f) of~~ this Section 2695.183 that results from the failure of the estimate to satisfy the requirements of subdivisions (a) through (e), unless that noncompliance results from failure by the broker-agent to follow the insurer's prescribed written procedures when using the source or tool."

The Department received comments that the regulations were establishing new legal obligations on licensees in violation of California case law and in contradiction to statutory law. Further comments stated that the regulations were, in essence, illegal underwriting requirements. So as to make clear that this is not the intent of the regulations and in consideration of the comments, proposed Section 2695.183 (m) is amended to state specifically that nothing in the article may be construed as requiring a licensee to prepare, communicate or use an estimate of replacement cost as follows:

"No provision of this article shall be construed as requiring a licensee to estimate replacement cost or to set~~,~~ or recommend a policy limit to an applicant or insured~~, a policy limit on a homeowners' insurance policy~~. No provision of this article shall be construed as requiring a licensee to advise the applicant or insured as to the sufficiency of ~~such~~ an estimate of replacement cost."

Further, in consideration of the comments that the proposed regulations are in conflict with California statutory law and somehow would limit a licensee's communication about the California Residential Property Insurance Disclosure, the proposed regulations are amended to add Section 2695.183 (n) as follows:

"No provision of this article shall limit or preclude a licensee from providing and explaining the California Residential Property Insurance Disclosure, as cited in Insurance Code section 10102, explaining the various forms of replacement cost coverage available to an applicant or insured, or explaining how replacement cost basis policies operate to pay claims."

In response to comments that the noticed regulations prevented an applicant or insured from obtaining his or her own estimate of replacement cost, the regulations are amended to add Section 2695.183 (o) as follows:

"No provision of this article shall limit or preclude an applicant or insured from obtaining his or her own estimate of replacement cost from an entity permitted to make such an estimate by Insurance Code section 1749.85."

In response to comments that the noticed regulations illegally mandate underwriting guidelines and interfere with licensees' rights in determining their own eligibility guidelines and minimum policy limits in writing homeowners' insurance policies, the proposed regulations are amended to add Section 2695.183 (p) as follows:

"For purposes of this subdivision (p), "minimum amount of insurance" shall mean the lowest amount of insurance that an insurer requires to be purchased in order for the insurer to underwrite the coverage on a particular property, based upon an insurer's eligibility guidelines,

underwriting practices and/or actuarial analysis. An insurer may communicate to an applicant or insured that an applicant or insured must purchase a minimum amount of insurance that does not comport with subdivisions (a) through (e) of this Section 2695.183; however, if the minimum amount of insurance that is communicated is based in whole or in part on an estimate of the replacement value, the estimate of replacement value shall also be provided to the applicant or insured and shall comply with all applicable provisions of this article. Nothing in this article shall limit or preclude an insurer from agreeing to provide coverage for a policy limit that is greater than or less than an estimate of replacement cost provided pursuant to this article. "

In response to comments regarding the applicability date of the regulations, the regulations have been amended to add Section 2695.183 (q) as follows:

"This article shall apply only to estimates of replacement value that are prepared, communicated or used by a licensee on or after the day that is one hundred eighty (180) calendar days after filing with the Secretary of State."

**UPDATE OF MATERIAL RELIED UPON**

These documents have been added to the Rulemaking File pursuant to the 15 Day Notice:

1. Transcript of Proceedings before the Department of Insurance May 17, 2010
2. NAMIC PADIC comment letter May 11, 2010
3. United Policyholders comment letter May 17, 2010
4. PIFC comment letter May 17, 2010
5. IBA West comment letter May 17, 2010
6. Automobile Club of Southern California comment letter May 17, 2010
7. ACIC comment letter May 17, 2010
8. Insurance Agents and Brokers Association of California comment pleading May 17, 2010
9. Insurance Trade Association, Alliance of Insurance Agents and Brokers, Association of California Insurance Companies, Insurance Agents and Brokers Association of California, National Association of Mutual Insurance Companies, Pacific Association of Domestic Insurance Companies, Personal Insurance Federation of California, Western Insurance Agents Association letter of June 18, 2010 of August 27, 2010
10. Notice of Availability of Change Text and of Addition of Material to Rulemaking File
11. Amended Text of Regulation, October 27, 2010
12. Declaration of Mailing
13. United Policyholders Survey 2007 Wildfire Victims
14. Marshall Swift Beck Estimate screenshot (redacted)
15. AccuCoverage Website screen shot views
16. Union Tribune Article: *Fighting off Fraud After the Disaster*, November 3, 2007
17. Orange County Register article: *Living Under a Risky Roof*, 2007-11-04
18. North County Times article: *Wildfire Pace Aims to Reduce Losses*, November 12, 2007

19. NY Times article: *After Fires, Homeowners Feel an Insurance Pinch,* November 13, 2007
20. North County Times article: *Financial Impact of Rice Canyon Fire Coming into Focus*, November 11, 2007
21. Insurance Journal article: *Survey: 96 Million Households Lack Knowledge on Protecting Electronics,* November 20, 2007
22. Risk and Insurance article: *Burning Through Limits*, December 1, 2007
    Union Tribune article: *Burned-out Homeowners Begin Insurance Process*, November 29, 2007
23. Union Tribune article: *Homeowners Express Concerns Over Insurance*, November 30, 2007
24. North County Times article: *Insurance Commissioner Offers Advice to Fire Victims,* November 30, 2007
25. North County Times article: *Insurance Means More Than Just Paying Premiums*, December 4, 2007
26. Union Tribune article: *Funding Stalled after Wildfires*, December 13, 2007
27. CNN Money article: *Burned out: Recovering From a Fire*, December 12, 2007
28. North County Times article: *Victims of 2003 California Wildfires Lend Their Expertise to the Latest Burned-out Homeowners*, December 14, 2007
29. Malibu Times article: State *Insurance Commissioner Talks to Fire Victims*, December 19, 2007
30. North County Times article: *Keep Your Insurance Up to Date for 2008*, December 27, 2007
31. North County Times article: *Deadline Approaching for Fire Assistance*, January 3, 2008
32. Ventura County Star article: *Area Wildfires Illustrate Need for Adequate Home Insurance,* January 6, 2008
33. L.A. Times article: *Houses Slid Down, Not Hope*, January 5, 2008
34. Klipinger article: *Burned out in the California Hills*, February 2008
35. Insurance Journal article: *Southern California Wildfire Losses Could Reach More than $2 Billion,* January 11, 2008
36. Union Tribune article: Companies, *Underinsured Homeowners Still in Dispute over Settlements Stemming from 2007 Wildfires*, October 12, 2008
37. North County Times article: *Region: Rebuilding Slow in Fire-ravaged Areas*, October 22, 2008
38. L.A. Times article: *A Year Later, Victims Say Carriers Misled Them*, October 23, 2008
39. North County Times article: *Region: Wildfire Victims Demand Help Fighting Insurance Companies*, October 23, 2008
40. Insurance Journal article: *Californians Take Responsibility for Underinsurance*, October 23, 2008
41. San Diego Newstips: *Many Struggle to Rebuild After Last Year's Wildfires*, October 23, 2008
42. L.A. Times article: *Hot Zone*, October 26, 2008
43. Associated Press report: *Victims of San Diego Fires Criticize Insurers*, October 24, 2008

44. L.A. Times article: *Wildfire Victims Burned Again When Coverage Comes Up Short,* November 19, 2008
45. Insurance Journal article: *California Commissioner Declares Insurance Emergency to Expedite Fire Claims Processing*, November 17, 2008
46. Claims article: *Wildfires Add to Catastrophe Counts*, November 18, 2008
47. Insurance Journal article: Study: *SoCal Fires Strike Those Who Often Reject Insurance*, November 21, 2008
48. KCOY report: *November Wildfire Victims Have 30 Days to Register for Federal-State Assistance,* December 18, 2008
49. Insurance Journal article: *California Hosts Insurance Recovery Forum for Wildfire Survivors*, January 9, 2009
50. Napa Valley Register article: *Home Insurance in Wildfire Country*, March 14, 2009
51. Sacramento Bee article: *Agencies Scramble to Meet Rural Residents' Need for Fire Insurance Inspections*, May 29, 2009

**MANDATE UPON LOCAL AGENCIES AND SCHOOL DISTRICTS**

The Department has determined that the proposed regulations will not impose a mandate upon local agencies or school districts.

**ALTERNATIVES**

The Commissioner has determined that there are no alternatives that would be more effective, or as effective and less burdensome to affected persons, than the proposed regulations.

**SUMMARY OF AND RESPONSE TO COMMENTS**

| Commenter | Synopsis or Verbatim Text of Comment | Response |
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| **United Policyholders May 17, 2010 written comments** | UP participated in hearings and an investigation following a 1991 firestorm in Northern California that resulted in an historic fine issued against Allstate Insurance Company and agent Charles Strahan for systematically underinsuring homes in the Oakland/Berkeley hills. We testified again at CDI fact-finding hearings after 2003 wildfires in Southern California. UP has an entire section of our website devoted to "Underinsurance Help". We publish consumer tips and newsletter articles on the topic, ("Underinsurance rears its ugly head again…and again"), and have written articles to call attention to the problem that have been published in national media. We have supported legislation to remedy the problem, we've filed friend of the court briefs to advocate for solutions to the problem. We've participated in three rounds of legislative drafting sessions to select the wording of the California Residential Property Insurance Disclosure form mandated in Insurance Code section 10102, (the "Petris" disclosure). We've conducted consumer surveys to document the extent of the problem, and we've created an entire program; the UP Roadmap to Preparedness Program to do outreach and education throughout the State of California on the importance of insuring to value and not blindly trusting insurance sales agents to set limits correctly. At CDI hearings in 2004, Marshall/Swift/Boeckh executives defended their continued promotion of replacement cost valuation software that spit out inadequate estimates when used in a hurry or by untrained people or people with insufficient information about the property to be insured. They insisted that the software is not defective but acknowledged that users need to spend enough time inputting data or it will not work properly. At the time, insurance executives promised to discontinue the use of the M/S/B "Quick Quote" software, tacitly acknowledging that accurate estimates take time. It is our understanding that | **Response to United Policyholders May 17, 2010 written comments**:<br>(1) The three-hour course was determined by the Curriculum Board's (Section 1749.1 of the California Insurance Code ("Insurance Code") Senate Bill (SB) 2 subcommittee which met on several occasions to establish the topics to be included in the homeowners' insurance valuation training. During these meetings the SB 2 subcommittee reviewed the topics and identified the amount of time necessary to provide adequate instruction for each topic listed in Section 2188.65 (d) and (e). As stated on the Homeowners' Insurance Valuation Outline, which is available on the Department's Web site, the specific amount for each topic equals the three hours for this course.<br>(2) The Department of Insurance does have sufficient resources.<br>(3) This section deals specifically with the training required of producers and does not address the issue of the duty of insurers to provide this information to their sales representatives.<br>(4) In consideration of the comment, the Department has amended proposed Section 2188.65 (d) (6) to include CEA policies.<br>(5) The Department concurs that the section is important. The Department is not taking a position on who is best equipped to provide estimates of replacement cost, only that certain factors be taken into consideration when the estimates are made.<br>(6) In consideration of this comment and others the Department has amended proposed Section 2695.183 (h) and re-lettered it to subdivision (g) so as to make more clear the obligations. If a licensee communicates an estimate of replacement cost to an applicant. the licensee shall provide a copy of the estimate to an applicant. If the estimate is communicated by telephone to an insured, a copy of the estimate shall be mailed to the insured no later than three business days after the conversation. If the estimated is communicated by telephone to an applicant, the |

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| | M/S/B continues to be the hands-down market leader in providing the software that most insurers requires agents to use at the point of sale. UP has tested Accucoverage, the consumer version of M/S/B's home replacement cost estimating software, and it is clear that amount of time spent by the user, the user's familiarity with residential building components and construction lingo, and the extent of information available to the user about the property to be insured are essential to getting a reasonably accurate result. Although UP does not have access to the commercial versions of M/S/B software used by insurers/agents/brokers, we assume the same holds true: For the software to produce accurate results, the user must;<br>- Be trained to use it properly<br>- Be knowledgeable about building components<br>- Have access to detailed information about the structure to be insured from a source such as www.Zillow.com<br><br>But training and familiarity with replacement cost estimating software is only one aspect of being competent to perform the important duties of an insurance sales agent or broker. An understanding of homeowners insurance, endorsements, provisions and the significance of policy language is equally critical. The proposed regulations cover both bases.<br>Specific Comments<br>Adopt Section 2188.65. Broker-agent Training on Estimating Replacement Value.<br>(b) On and after the day that is ninety days after the effective date of this section, every California resident fire and casualty broker-agent and personal lines broker-agent must satisfactorily complete one three-hour training course on homeowners' insurance valuation prior to soliciting individual consumers in order to sell dwelling fire or homeowners' insurance. For resident broker-agents, this requirement shall be | licensee shall mail to the applicant a copy of the estimate no later than three days after the applicant agrees to purchase the coverage.<br>(7) The Department agrees with the comment.<br>(8) The regulation's purpose is to assure that when "replacement cost" is estimated, specific characteristics and components are considered. It does not require that a licensee set or recommend replacement cost. Should a licensee voluntarily undertake this duty, then California law regarding the obligations inherent in that duty would apply. |

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| | part of, and not in addition to, the continuing education requirements of Insurance Code section 1749.3.<br>**(1) Comment: We recommend a series of at least two three hour trainings spaced at least three months apart.**<br>(c) The training required by this section must be approved by the commissioner and shall consist of topics related to dwelling, fire, and homeowners' insurance. Any course taken to satisfy the requirements stated in Section 1749.85 of Insurance Code shall use subject matter described in this article.<br>**(2) Comment: If CDI does not have sufficient resources to review and approve curriculum the first sentence of this section should be deleted.**<br>(d) The broker-agent shall be trained on the differences between homeowners' insurance coverage and other Fire, and Dwelling Property policies, which differences may necessitate differences in coverage or coverage levels. The broker-agent shall also be trained on the basic concepts of property insurance and estimating replacement value, which includes:<br>… (4) The effects of catastrophes on replacement cost. This includes how shortages of construction labor, building supplies, fuel, transportation issues, and permit restrictions can result in increased costs, sometimes referred to as demand surge, and delays in rebuilding.<br>**(3) Comment: Insurers should be specifically charged with the duty to provide this information to their sales representatives.**<br>(5) Review of the significant enhancements and endorsements to the homeowners' insurance policy, and identify of coverages that help protect against underinsurance. The review is to include:<br>(A) what is included and excluded in Building Code Upgrade (Ordinance and Law) Coverage, as defined in California Insurance Code section 10102; and<br>(B) the various types and levels of replacement cost, as defined | |

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| | in California Insurance Code section 10102;<br>(6) Review of the California Standard Form Fire Policy and FAIR Plan coverages, as described in California Insurance Code sections 2071 and 10090, respectively.<br>**(4) Comment: Add "CEA" policies**<br>Adopt Section 2695.181. Standards for Real Estate Appraisers. Subdivision (d) of Insurance Code 1749.85 provides that if the Department of Insurance, by adopting a regulation, establishes standards for the calculation of estimates of replacement value of a structure by appraisers, then on and after the effective date of the regulation a real estate appraiser's estimate of replacement cost shall be calculated in accordance with the regulation. A real estate appraiser, whether or not a licensee, shall not estimate the replacement cost of a structure for use in connection with a homeowner's insurance policy unless the estimate of replacement cost complies with the provisions of subdivisions (a) through (e) of Section 2695.183. Appropriate licensure by the Department of Insurance is required in order to lawfully explain levels of coverage under a homeowners' insurance policy. NOTE: Authority cited: Sections 35, 1631, 1633, 1749.7, 1749.85, and 2051.5, Insurance Code. Reference: Sections 35, 1631, 1633, 1625, 1625.5, 1749.85, 2051.5, and 10087, Insurance Code. **(5) Comment:** This section is critically important. In our view, replacement cost appraisals by disinterested, regulated third party professionals (e.g. Castle Home Inspection Service) are an excellent way of solving the underinsurance problem if they can be done economically.<br>Adopt Section 2695.183<br>(h) If a licensee uses an estimate of replacement cost or construction costs to set, recommend or communicate about a policy limit on a homeowners' insurance policy for an applicant or insured, the licensee must provide a copy of the replacement cost estimate or construction cost estimate to the applicant or insured at the time the policy limit is set, | |

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| | recommended or is otherwise the subject of communication by the licensee. If the estimate of replacement cost or construction costs is updated or changed by, or on behalf of, the licensee, the licensee shall provide a copy of the revised estimate of replacement cost to the applicant or insured within sixty (60) calendar days from the time the estimate is generated. The estimate of replacement cost or construction costs must itemize each element specified in subdivision (a) of this Section 2695.183. **(6) Comment: We support the above provision but suggest eliminating the last sentence to avoid complication.**<br>(k) When an insurer requires that a broker-agent utilize a specific source or tool to create an estimate of replacement cost or construction costs,<br>(1) the insurer shall prescribe procedures to be followed by broker-agents when they use the source or tool,<br>(2) the insurer shall provide the broker-agent with the training or training materials necessary to properly utilize the source or tool according to the insurer's prescribed procedures, and<br>(3) the insurer, and not the broker-agent, shall be responsible for any noncompliance with the provisions subdivisions (a) through (f) of this Section 2695.183, unless that noncompliance results from failure by the broker-agent to follow the insurer's prescribed procedures when using the source or tool. **(7) Comment: UP strong supports this section. Insurers must be held responsible for failing to give their sales representatives adequate training and support.**<br>(*l*) This Section 2695.183 applies to all communications by a licensee, verbal or written, with the sole exception of internal communications within an insurer, or confidential communications between an insurer and its contractor, that concern the insurer's underwriting decisions and that never come to the attention of an applicant or insured.<br>(m) No provision of this article shall be construed as requiring | |

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| | a licensee to estimate replacement cost to set, or recommend to an applicant or insured, a policy limit on a homeowners' insurance policy. No provision of this article shall be construed as requiring a licensee to advise the applicant or insured as to the sufficiency of such an estimate. **(8)**<br>**Comment: United Policyholders recommends that the above section be amended to comport with California law to the effect that: An insurer or licensee that represents him or herself through actions or words as taking responsibility for setting policy limits assumes a duty to do so accurately.** | |
| **National Association of Mutual Insurance Companies (NAMIC) and the Pacific Association of Domestic Insurance Companies (PADIC) May 11, 2010 written comments** | Both the National Association of Mutual Insurance Companies (NAMIC) and the Pacific Association of Domestic Insurance Companies (PADIC) appreciate the opportunity to respond to your notice contemplating proposed amendments to the regulations concerning Standards and Training for Replacement Value on Homeowners' Insurance. PADIC member companies write approximately $1 billion in property and Casualty premium almost exclusively in California. Because the vast majority of PADIC insurance business is written in California, insurance regulation has a much greater impact on our members and, more importantly, our policyholders than companies who write insurance throughout the country. Approximately one half of the premium written by PADIC is in personal lines, including homeowners insurance.<br>NAMIC is a full-service national trade association with more than 1,400 member<br>companies that underwrite 43 percent ($196 billion) of the property and casualty insurance premium in the United States. NAMIC membership includes four of the seven largest property and casualty insurance carriers in the nation, and every size regional, national and state specific property and casualty insurer, including hundreds of farm mutual insurance companies. NAMIC has 106 member insurance carriers | **Response to National Association of Mutual Insurance Companies (NAMIC) and the Pacific Association of Domestic Insurance Companies (PADIC) May 11, 2010 written comments**:<br>(1) This comment is not directed toward a specific section of the regulation and instead argues that the Department has not complied with the necessity requirement as enunciated in Government Code Section 11349 (a). NAMIC and PADIC have made this assertion although neither has asked to nor in fact reviewed the Rulemaking file. The Rulemaking file is replete with more than fifty separate consumer complaints and their files related to underinsurance and replacement cost; testimony at an investigative hearing held by the insurance commissioner on the same issues; declaration and summaries of market conduct examinations on these issues; the 2007 Wildfire Insurance Claim Status Survey/United Policyholders. Pursuant to the 15 Day Notice, the following has been added to the rulemaking file, further evidencing the need for the regulations: MBS report and website information on replacement cost issues; multiple media reports throughout several years reporting on the underinsurance problem from the Orange County Register; the North County Times; Sign On, the Union Tribune, the New York Times, The Insurance Journal, CNN Money, the Associated Press, the Malibu Times, the Ventura |

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| | writing business in the state of California who write approximately 23% of the property and casualty insurance business in the state.<br>Both NAMIC and PADIC oppose the implementation of these proposed amendments because: (a) they do not comply with procedural and substantive requirements of the Administrative Procedures Act (APA), Government Code Section 11349.1; (b) the proposed amendments improperly attempt to either add a new prohibition to the California Insurance Code, section 790 et seq., the Unfair Practices Act (Act), or implement the current Act in a way that is inconsistent with the language and intent of a regulation pertaining to deceptive and misleading insurance practices; c) the contemplated regulatory changes improperly subject insurers to Unfair Practices Act liability exposure for merely complying with the insurer's contractual and regulatory duty to communicate with the policyholder about the consumer's insurance options and the terms/conditions of the policy; and d) the proposed amendments are likely to confuse not enlighten insurance consumers as to the issue of properly selecting appropriate homeowners' insurance coverage limits and endorsements. Section I of these written comments address the above referenced concerns stated in points a), b) and c) of the introductory paragraph and Section II of these written comments address point d) of the introductory paragraph.<br>I. The proposed regulation does not comply with Government Code Section 11349.1<br>Any regulatory act a state agency adopts through the exercise of a quasi-legislative power delegated to the agency by statute is subject to the APA unless statutorily exempted or excluded. (Gov. Code, Sec. 11346). Since no exemption applies in this instance, the proposed regulatory actions of the California Department of Insurance (CDI) must be in compliance with the "necessity, authority, clarity, consistency, reference and non-duplication standards" set forth in Government Code | County Star, the Los Angeles Times, Kiplinger, Claims, KCOY 12, the Napa Valley Register, the Sacramento Bee. It is clear that the regulations are necessary. In 2003, and again in 2007 and 2008 California has experienced significant wildfires leading to the loss of a high number of residential structures. After each of these fires, fire survivors complained about problems including their experience that after the fire they learned that the replacement value estimates made in setting coverage limits for their homes were incomplete or too low, causing underinsurance issues to arise during efforts to rebuild or replace their residences. The significance of the replacement value estimate being complete, which results in the estimate being more accurate, is particularly important given that other than a limited number of homeowners who qualify for guaranteed replacement coverage offered by only a small number of insurers, the vast majority of homeowners have one of three kinds of insurance coverage on their home as defined in the California Residential Property Insurance Disclosure Form from Insurance Code Section 10102:<br>Limited Replacement Cost Coverage With an Additional Percentage which pays replacement costs up to a specified amount above the policy limit;<br>Limited Replacement Cost Coverage With No Additional Percentage which pays replacement costs up to policy limit only;<br>Actual Cash Value Coverage which pays the fair market value of the dwelling at the time of the loss, or the cost to repair, rebuild, or replace the damaged or destroyed dwelling with like kind and quality construction up to the policy limit.<br>Therefore, the necessity of having a more accurate estimated replacement value that is based upon complete, current, validated information is paramount. The failure to take into consideration certain factors at all, or to not fully consider other components, as referenced above, is one source of the underinsurance problem. The comment indicates that there has |

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| | Section 11349.1(a). NAMIC and PADIC contend that the proposed amendments to Subsection 7.5 of Chapter 5 of Title 10 of the Insurance Code fail the "necessity", "authority", and "clarity" requirements necessary for the proposed amendments to be approved by the Office of Administrative Law (OAL).<br>(1) A. The CDI has failed to demonstrate that the proposed changes to the Insurance Code are "necessary" to effectuate the CDI's stated purpose for the regulation<br>Pursuant to Government Code Section 11349 (a), "Necessity means that the record of the rulemaking proceeding demonstrates by substantial evidence the need for a regulation to effectuate the purpose of the statute, court decision, or other provision of law that the regulation implements, interprets, or makes specific, taking into account the totality of the record. For purposes of this standard, evidence includes, but is not limited to, facts, studies, and expert opinion." [emphasis added].<br>NAMIC and PADIC do not believe that the CDI has demonstrated *with substantial evidence* that there is a problem in the California insurance marketplace of consumers being unknowingly and/or unintentionally underinsured in the replacement cost of their homes, and/or that consumers are currently unable to accurately determine their own personal homeowners' insurance coverage needs. Requiring all insurance consumers to pay the cost of solving an unproven problem, one that may only impact a very small percentage of insurance consumers, is unwise, especially in a weak economy where small businesses and insurance consumers are struggling to make ends meet.<br>In the Summary of Existing Law and Policy Statement Overview section of the CDI's Notice of Proposed Action, the CDI states, "[t]he Department and the California Legislature received a *significant number of complaints* by homeowners who lost their residences in the Southern California wildfires . . . ." [emphasis added] | been no showing that the underinsurance occurred because the homeowner was unaware of their coverage needs. The regulations are not based on whether one is underinsured because one is unaware of his insurance needs, but rather that if the term "replacement cost" is used by a licensee in defining what has been estimated, it must assure that the components listed in the regulation are considered in the estimate. If a homeowner chooses to be underinsured, there is nothing in the regulation that prohibits it. The comment states that the Department of Insurance has sufficient regulatory power without the regulations and states that the market conduct mechanisms in place are available to address the issue. The comment provides no facts upon which to base the assertion that the whole system will be fundamentally changed. Market conduct examinations evaluate whether insurers are complying with the law. The regulations establish that there are requirements to be followed when estimating "replacement cost;" that certain training will be necessary; and that record keeping will be required. The regulations work hand in hand with the market conduct examinations and are neither a replacement for nor a duplication of other regulatory authority. The comment asserts that the Department has not established that insurers have engaged in any unfair or deceptive practices that lead homeowners' insurance policyholders to be underinsured. The consumer complaints made to the Department, which are contained in the rulemaking file, include substantial evidence that licensees did not include components necessary to estimate replacement cost, misleading consumers into thinking that a replacement cost estimate was an estimate of what it would cost to completely replace the consumer's house, when in fact, it was not. The comment states that it is not reasonable to conclude that insurance carriers have not been complying with their duty to provide the state mandated California Residential Property Insurance Disclosures. The Residential Property Disclosure requirement of Insurance Code |

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| | It is interesting to note that the CDI has failed to offer any data to support their contention that the CDI has received a "*significant number of complaints"* from homeowners. Further, the CDI has failed to tender any evidence to support the conclusion that a *significant number* of insurance consumers involved in the wildfires were actually underinsured, or if they were underinsured, it was because they were unaware of their homeowners' insurance coverage needs. If the CDI has actual complaints against specific companies, the CDI currently has regulatory procedures to investigate and sanction improper conduct. Moreover, the CDI has failed to demonstrate, let alone "demonstrate by substantial evidence", as required by the APA, that insurers have engaged in any unfair or deceptive practices that lead homeowners' insurance policyholders to be underinsured. This is an important point, because the proposed regulation would include mere "communications" between the policyholder and the insurer pertaining to the policyholder's selection of their homeowners' insurance coverage policy limits within the purview of the Unfair Practice Act. Insurers are in the business of selling insurance products to consumers and may lawfully charge the consumer a higher premium for higher homeowners' insurance coverage limits; therefore, it is hard to believe that insurers would be misleading or deceiving policyholders into being underinsured in their homeowner's insurance coverage limits. Thus, the CDI should be required to demonstrate why its regulatory proposal to expose insurers to Unfair Practice Act liability is "reasonably necessary". Government Code Section 11346.2(b) (1) provides that an Initial Statement of Reasons for a proposed regulatory action shall include a "statement of the specific purpose of the adoption, amendment, or repeal, and the rational for the determination by the agency that the adoption, amendment, or repeal is reasonably necessary...." [emphasis added]. Since the CDI has not presented any data, documentation, or evidence to support a reasonable conclusion | 10102, is not a substitute for the regulations. The disclosure's purpose is related to the insurance "policy." The regulations purpose is to make clear what the term "replacement cost" estimate means. The regulation is not connected to the statute as the comment seems to suggest. The comment goes on to state that there is no evidence that insurance consumers are unable to properly evaluate their personal insurance needs and secure their own estimate of the likely cost to replacement their entire home. The regulations provide the definition of estimated "replacement cost," thereby allowing the consumer to be "informed." The regulations are not related to the pricing of insurance policies nor do they mandate the type of coverage to buy. The regulations purpose is to make clear what the term "replacement cost" estimate means.<br>(2) Again, NAMIC and PADIC provide a comment not directed specifically to any section of the regulations, but argue that the Department lacks the authority to promulgate the regulations under Government Code Section 11349(b). NAMIC and PADIC offer that the Department cannot adopt regulations that have a direct and unavoidable impact upon homeowners' insurance underwriting practices. To support this position, they cite *AIA v. Garamendi*, a de-published case. A de-published opinion may not be cited or relied upon by a party in any other action unless, pursuant to California Rule of Court 8.1115, when it is relevant under the doctrines of law of the case, res judicata, or collateral estoppel; none of which are applicable here. NAMIC and PADIC's reliance on *Jutkowitz v. Bournes, Inc.* 118 Cal.App.3d 102, 106 (1981) is misplaced. This second appellate district case involved ongoing litigation. The proposed regulations do not represent litigation with NAMIC, PADIC or any other party in the AIA v. Garamendi case. Further, even assuming that *AIA v. Garamendi* could be cited, the arguments raised by NAMIC and PADIC are misplaced. The regulations do not have an impact on underwriting practices. The regulations do not specify, require or otherwise |

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| | that insurance carriers have not been complying with their duty to provide the state mandated California Residential Property Insurance Disclosures and/or that insurance consumers are unable to properly evaluate their personal insurance needs and secure their own estimate of the likely cost to replacement their entire home, the proposed regulation fails the APA's "necessity" requirement. B. The CDI has failed to establish that it has "regulatory authority" to add an entirely new section to the Unfair Practices Act; restrict truthful and non-deceptive insurance coverage communications with consumers; and impose new de-facto contractual or statutory duties on homeowners' insurance carriers NAMIC and PADIC do not have concerns with the CDI's claim of authority to properly regulate Broker-Agent Training on Estimating Replacement Value, pursuant to Insurance Code section 1749.85. However, NAMIC and PADIC do contest the CDI's claim of authority to: a) adopt regulations that have a direct and unavoidable impact upon homeowners' insurance underwriting practices; b) restrict truthful and non-deceptive homeowners' insurance coverage limits communications between policyholders and their insurers; and c) impose new de-facto contractual and statutory duties on homeowners' insurance carriers. (2) a) The CDI lacks regulatory "authority" to adopt regulations that have a direct and unavoidable impact upon homeowners' insurance underwriting practices. As the Court of Appeals said in *AIA v. Garamendi*, "[t]he Insurance Code provides no express authority for regulating the underwriting of homeowners' insurance, nor can such expansive authority be implied. Unlike automobile insurance, homeowners' insurance is subject to only a few restrictions, all clearly set forth in the Insurance Code. Reading the Insurance Code to give the Commissioner broad authority to regulate underwriting beyond these specific provisions is inconsistent with the legislative scheme as a whole." Although NAMIC and PADIC appreciate the fact that the legal opinion in *AIA v. Garamendi* | mandate how insurers underwrite homeowner policies. Insofar as the comment references Section 2695.183, this section requires that if the licensee states that it has calculated an estimate of "replacement cost," it will include those components listed in the regulation. In response to NAMIC and PADIC's interpretation of this section as meaning that it precludes a licensee from considering "their policyholder's independent estimate," the regulation applies to licensees, not homeowners. In consideration of this comment and others, proposed Section 2695.183 (o) is added which states that applicants or insureds may obtain his or her own estimate of replacement cost.<br>(3) PADIC and NAMIC argue that the CDI lacks regulatory "authority" to add a new section to the Unfair Practices Act that restricts truthful and non-deceptive insurance coverage communications with consumers. California Insurance Code Section 790.03 states that: "The following are hereby defined as unfair methods of competition and unfair and deceptive acts or practices in the business of insurance… (b) Making or disseminating or causing to be made or disseminated before the public in this state, in any newspaper or other publication, or any advertising device, or by public outcry or proclamation, or in any other manner or means whatsoever, any statement containing any assertion, representation or statement with respect to the business of insurance or with respect to any person in the conduct of his or her insurance business, which is untrue, deceptive, or misleading, and which is known, or which by the exercise of reasonable care should be known, to be untrue, deceptive, or misleading." California Insurance Code Section 790.10 states: "The commissioner shall, from time to time as conditions warrant, after notice and public hearing, promulgate reasonable rules and regulations, and amendments and additions thereto, as are necessary to administer this article." The regulations merely state that it is misleading under Insurance Code Section 790.03 to characterize that an |

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| | was de-published, which means that the legal opinion in the case may not be cited in a different legal proceeding as controlling precedent, it is still an authoritative legal interpretation of the Insurance Code and an appellate court ruling on the CDI's lack of authority to regulate homeowners' insurance underwriting practices. Furthermore, from a procedural law standpoint, the fact that *AIA v. Garamendi* was de-published does not change the fact that the court's ruling is binding upon the parties to the action (the CDI and the three California insurance trades and their respective member companies: American Insurance Association, Association of California Insurance Companies, and Personal Insurance Federation of California). See *Jutkowitz v. Bournes, Inc.* 118 Cal.App.3d 102, 106 (1981).<br>The legal analysis of the Court of Appeals in *AIA v. Garamendi* on whether the CDI has legal authority to regulate homeowners' insurance practices is clearly germane to the issue at hand, because the proposed regulation seeks to impose new restrictions on how insurers may underwriting homeowners' insurance replacement cost coverage limits.<br>NAMIC and PADIC appreciate the fact that the proposed regulations do not specifically reference homeowners' underwriting practices. However, the proposed replacement cost and construction cost estimating standards, requirements, and communication restrictions will have a profound adverse impact upon the underwriting process.<br>Section 2695.183 states that "[n]o licensee shall estimate replacement cost, or shall rely upon an estimate of replacement cost, to set or recommend a policy limit on a homeowner's insurance policy . . . unless the requirements and standards set forth in subdivisions (a) through (e) below are met." [emphasis added] The language of this section could be read to mean that an insurer *shall not rely upon* their policyholder's independent estimate of the replacement cost of their home (even if the policyholder has an estimate from a reputable professional | estimate is complete by communicating an estimate that does not include all of the components required to be considered in estimating replacement cost.<br>(4) The noticed regulations stated specifically that that no provisions of the article shall be construed as requiring the licensee to prepare, communicate or use an estimate of replacement cost. Section 2695.183 (m) states specifically that no provision of this article "shall be construed as requiring a licensee to estimate replacement cost or to set or recommend a policy limit." There is no factual basis to support the comment that this provision is incompatible with the specific requirement in subdivision (j). First, the terms "setting" and "recommending" are removed from the original noticed regulations. Second, if a licensee chooses to communicate an estimate of replacement cost it must take into consideration the components listed in estimating it. To make this even more clear, proposed subdivision (j) has been amended as follows: "To communicate an estimate of replacement value not comporting with subdivisions (a) through (e) of this Section 2695.183 to an applicant or insured in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis constitutes making a statement with respect to the business of insurance which is misleading and which by the exercise of reasonable care should be known to be misleading, pursuant to Insurance Code section 790.03."<br>(5) NAMIC and PADIC comment that the regulations are not clear because they are "rife with ambiguous and contradictory requirements…" The comment does not identify any ambiguity, however. It does argue that the regulations are in direct "conflict" with the California Residential Property Insurance Disclosure which sets forth a description of types of homeowners' insurance coverage and the California Residential Property Insurance Bill of Rights. However, the comment does not specifically identify a "conflict" other than to state that |

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| | residential property estimator and is comfortable with the accuracy of their replacement cost estimate) in underwriting the insurance application unless the insurer complies with requirements of this regulation, including subdivision (e), which requires the insurer to "take reasonable steps to *verify* the sources and methods used [by the policyholder's independent estimator] to estimate replacement cost are kept current to reflect changes in costs of reconstruction and rebuilding . . . ." [emphasis added] In other words, the insurer must do their own internal estimate of replacement cost so as to verify the policyholder's estimate, before they can lawfully underwrite the application. Since a homeowners' insurance policy premium may not be calculated (the very essence of the underwriting process - calculating a premium that actuarially reflects the policyholder's risk of loss exposure for desired homeowners' coverage limits) without homeowners' insurance coverage policy limits information, Section 2695.183 clearly and directly effects an insurer's homeowners' insurance underwriting practices, and creates an unavoidable requirement that all insurers calculate their own internal replacement cost estimates in the way set forth by the CDI in the proposed regulation. How is this NOT a regulation of homeowners' insurance underwriting practices? (3) b) The CDI lacks regulatory "authority" to add a new section to the Unfair Practices Act that restricts truthful and non-deceptive insurance coverage communications with consumers**.** The Unfair Practices Act addresses prohibited conduct that is untruthful, deceptive and misleading. The proposed regulation would fundamentally alter and expand the scope of this Insurance Code provision to prohibit how certain words ("replace" and "replacement") may be used and/or communicated to consumers. Subdivision (j) states, "[w]hen setting, recommending or communicating about a policy limit on a homeowners' insurance policy, to characterize using any form of the word 'replace' or 'replacement' any estimate of | neither the Disclosure nor the Bill of Rights provide that "an insurer shall ultimately be legally responsible for estimating and/or verifying the value of the applicant's or policyholder's residence, and improvements or renovations to the residence." Though the comment asserts that the regulations create this legal responsibility, the comment fails to cite a section in the regulations that says this, or even implies it. The comment is disingenuous because the regulations do not create this duty. The Disclosure and Bill of Rights speak specifically to the homeowner insurance policy, itself. The regulations say nothing about the definition of policies described in the Disclosure and does nothing to change those descriptions. Again, while the comment claims that there is confusion as to whether the policyholder or the insurer bares the responsibility for determining the homeowners' insurance policy limits, NAMIC and PADIC fail to cite a section that creates the ambiguity. The comment recommends that the regulations be tabled "until after the state legislature evaluates AB 2022 (Gaines), Property Insurance: Residential Disclosure, which amends the Property Insurance Disclosure to simplify and clarify the description of the various types of homeowners' insurance coverages available to the consumer and provides additional information pertaining to insurance coverage limits." Again, the comment is not related to the actual regulations as the regulations do not apply to descriptions of homeowners' insurance policies or insurance coverage limits. To make this more clear, the proposed regulations have been amended by adding subdivision (n) to Section 2695.183 as follows: "Nothing in this article shall limit or preclude a licensee from providing and explaining the California Residential Property Insurance Disclosure, as cited in Insurance Code section 10102, explaining the various forms of replacement cost coverage available to an applicant or insured, or explaining how replacement cost basis policies operate to pay claims."<br>(6) The comment states in broad terms that "NAMIC and |

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| | construction cost not comporting with subdivisions (a) through (e) of this Section 2695.183 constitutes making a statement with respect to the business of insurance which is misleading. . . ."The list of prohibited behavior in the Unfair Practice Act was established by the state legislature, with no formal granting of broad discretion to the CDI to expand the scope of the Act. Therefore, any additions to the list of prohibited behavior should be addressed by the state legislature not by way of agency regulation, especially when the proposed addition to the Unfair Practices Act exceeds the legislative intent of the prohibition against untruthful, deceptive or misleading conduct. (4) c) The CDI lacks regulatory "authority" to impose new de-facto contractual or statutory duties on homeowners' insurance carriers**.** NAMIC and PADIC appreciate that the proposed regulation specifically states that "[n]o provision of this article shall be construed as requiring a licensee to estimate replacement costs, to set, or recommend to an applicant or insured, a policy limit on a homeowners' insurance policy." However, this provision is entirely incompatible with the specific requirement in subdivision (j) which relates to "setting, recommending, or communicating about a policy limits on a homeowners' insurance policy" and requires that the insurer verify the replacement estimate created by a professional estimator or by the policyholder. In effect, the proposed regulation imposes a de-facto contractual or statutory duty on homeowners' insurance carrier to verify the accuracy of replacement cost estimates provided to them by the applicant or policyholder. (5) C. The proposed regulation fails the "clarity" test of the APA, because it is rife with ambiguous and contradictory requirements and is in direct conflict with the state mandated California Residential Property Insurance Disclosures Government Code Section 11349(c) defines "Clarity" to mean "written or displayed so that the meaning of regulations will be easily understood by those persons directly affected by them." | PADIC believe that insurance consumers benefit from vigorous "market competition and common-sense public policy regulations." In fact, the regulations promote fair competition and common sense public policy by assuring that consumers have a consistent understanding of what is included in t a "replacement cost" estimate, so that the consumer can make a better and more informed decision in comparing premiums among insurers, on what insurance products to buy and what amount of coverage should be purchased. While NAMIC and PADIC opine that the regulation will not promote market competition, because it will adversely impact how different insurance carriers conduct their homeowners' insurance underwriting practice, it does not explain how or cite to a regulation to support this conclusion. NAMIC and PADIC claim that there will be "new" cost-drivers associated with having to verify how professional reconstruction estimators calculate their estimates. The regulations do not require that licensees must verify "how" estimators calculate their estimates. The regulations require that the sources and methods are kept current. In response to this comment, and others, to further make clear the obligation of a licensee in this regard, the text of proposed Section 2695.183 (e) has been amended as follows: "The licensee shall no less frequently than annually take reasonable steps to verify that the sources and methods used to generate the estimate of replacement cost are kept current to reflect changes in the costs of reconstruction and rebuilding, including changes in labor, building materials, and supplies, based upon the geographic location of the insured structure. The estimate of replacement cost shall be created using such reasonably current sources and methods." Further, with respect to the NAMIC and PADIC comment, they do not represent that their members do not currently "verify" that the sources and methods of their estimator vendors are kept current. In this regard, there has been no factual basis offered that "new" costs will be associated with regulatory compliance. |

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| | [emphasis added]. Current state law specifically requires insurers to provide to applicants or policyholders a copy of the California Residential Property Insurance Disclosure, which sets forth a description of types of homeowners' insurance coverage, such as actual cash value coverage, guaranteed replacement cost coverage, etc. Existing law also requires every California Residential Property Insurance Disclosure be accompanied by a California Residential Property Insurance Bill of Rights. Neither the Property Insurance Disclosures nor the Bill of Rights state that an insurer shall ultimately be legally responsible for estimating and/or verifying the value of the applicant's or policyholder's residence, and improvements or renovations to the residence. However, the proposed regulation arguably creates such a legal duty. Therefore the proposed regulation, in it entirety, creates greater uncertainty and confusion as to whether the policyholder or the insurer bares the responsibility for determining the homeowners' insurance policy limits. NAMIC and PADIC believe that the proposed regulation needs to be compatible with the state mandated Property Insurance Disclosures and Bill of Rights. Consequently, we respectfully recommend that the proposed regulations be tabled until after the state legislature evaluates AB 2022 (Gaines), Property Insurance: Residential Disclosure, which amends the Property Insurance Disclosure to simplify and clarify the description of the various types of homeowners' insurance coverages available to the consumer and provides additional information pertaining to insurance coverage limits. (6) II. The proposed regulation is inconsistent with the best interest of the insurance consumer. NAMIC and PADIC believe that insurance consumers benefit from vigorous market competition and common-sense public policy regulations. The proposed regulation will not promote market competition, because it will adversely impact how different insurance carriers conduct their homeowners' insurance underwriting practice. It will also create new administrative | Additionally, NAMIC and PADIC comment that the because the regulation "…subjects insurers to Unfair Practices Act liability exposure if they assist or even communicate with the policyholder about the estimated replacement cost, insurers will be discouraged (from a risk-prevention standpoint) from assisting their policyholder's or applicant in evaluating their personal insurance coverage needs." As noted in response to NAMIC and PADIC's comment (3) above, the comment reaches this conclusion without a factual basis. The regulation states simply that it is misleading under Insurance Code Section 790.03 (b) to characterize that an estimate is complete by communicating an estimate that does not include all of the components required to be considered in estimating replacement cost. In response to this comment and others, the text of Section 2695.183 (j) has been amended as referenced above in response to comment (4). |

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| | cost-drivers associated with having to verify how professional reconstruction estimators calculate their estimates. Consumers and insurers retain the services of these estimator experts, because they have the experience, professional acumen, and resources necessary to conduct a complex, multi-variable assessment necessary to estimate the cost of rebuilding a personal residence. Asking the insurers to verify the validity and accuracy of their expert's work will be quite expensive and these new cost-drivers will likely be passed on to the consumer in the form of higher insurance rates and/or reduced customer services. This is of particular concern to small to mid-sized domestic insurers, because they don't have the internal "scale of economy" necessary to absorb these new administrative costs and burdens, and may have to purchase new estimating software systems and equipment, and/or retain estimator experts to comply with the estimator verification requirement of the regulation. These new costs could ultimately impact their ability to be competitive in the insurance marketplace and provide new insurance products to the consumer. Additionally, since the proposed regulation subjects insurers to Unfair Practices Act liability exposure if they assist or even communicate with the policyholder about the estimated replacement cost, insurers will be discouraged (from a risk-prevention standpoint) from assisting their policyholder's or applicant in evaluating their personal insurance coverage needs. In effect, the proposed regulation could limit a consumer's access to important insurance coverage information, deny them the benefits of their carrier's assistance, and adversely impact the many small to mid-sized insurers who have developed a market niche based upon comprehensive customer services. | |
| **Association of Mutual Insurance Companies** | CHRISTIAN RATAJ: Good morning. My name is Christian Rataj with National Association of Mutual Insurance Companies. We're a national trade association of property and casualty insurers. We have 1,400 | **Response to Association of Mutual Insurance Companies (NAMIC) and the Pacific Association of Domestic Insurance Companies (PADIC)testimony at public hearing on May 17, 20010 in Los Angeles, CA**: |

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| **(NAMIC) and the Pacific Association of Domestic Insurance Companies (PADIC) testimony at public hearing on May 17, 20010 in Los Angeles, CA** | members nationwide and 106, where about 23 percent of the property casualty insurance is here in the State of California. Since there's going to be a lot of specific testimony about certain aspects of the proposed regulation, I won't go into recommendations. I just want to take a step back and look at this from a standpoint of the person who sat next to me on my flight this morning, flying from Colorado to California. California resident, and we were sitting there just chattering. And the first thing, what do you do and what are you coming out for, and I explained. And got into this a little bit. And talked a little bit about the regulations. And he said, "Well, what's the purpose of this?" And I think it was a good place to start. So I said, "Well, you know, from a public policy objective, I think one can look at this and say it's really intended to say that consumers are not unknowingly and unintentionally being underinsured. Because some people may decide to be knowingly or intentionally because of the cost assessment, putting braces on their kids and saying, hey, we've got to weigh (inaudible) risk of loss. Because that's what the insurance transaction is. You pay a premium based upon your risk exposure and the coverages you want. And you make that decision how much you want. There's plenty of insurance coverages available, and insurers are more than willing to sell to those policyholder. So I sat there and said, okay, well, if the purpose of this is to make sure the people are not unknowingly or unintentionally underinsured, let's look and see if it accomplishes that objective, whether it exceeds that objective, or whether it frustrates that objective. So (inaudible) raises some thoughts here We're looking at the regulations and see that the Department is trying to accomplish that public policy objective by three things. One is by aggressive producer training curriculum. And then it doesn't have a concern with that. The second is by setting forth some replacement cost estimating standards and requirements. And we do have some concerns about that, and I'll set forth those concerns in a few moments. And the third approach was to | (1) The testimony states, as does NAMIC and PADIC's written comment, that there is no necessity or authority for the regulations. The Department incorporates fully its response to the written comment, enumerated as comment (1) above. Additionally, the testimony indicates that there has been no showing that those who are underinsured did not underinsure intentionally. However, the testimony does not provide factual basis for this assertion.<br>The regulations are not based on whether one is unintentionally or intentionally underinsured, but rather that if a licensee communicates an estimate of replacement cost, the estimate must be complete and contain all the components that a reasonable consumer would assume be part of a complete rebuild of the structure. To do otherwise, creates consumer confusion and is misleading. If a homeowner chooses to be intentionally underinsured, there is nothing in the regulation that prohibits it.<br>The testimony offers that one should be an "informed consumer." The regulations provide that an estimate be complete and not missing any components that a reasonable consumer would assume be part of a complete rebuild of the structure thereby allowing the consumer to be "informed." The witness testified that he was looking for a car and that he was able to choose the options he wanted based on what he wanted to pay. The regulations are not related to the pricing of insurance policies nor do they mandate the type or amount of coverage to buy.<br>(2) The witness states that because of the Residential Property Disclosure requirement of Insurance Code 10102, there is no need for the regulations. Again, the disclosure's purpose is related to the insurance "policy." The regulations purpose is to make clear what the term "replacement cost" estimate means. The regulation is not connected to the statute.<br>(3) The witness, as part of his "necessity" comment testified that the Department of Insurance has sufficient regulatory |

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| | amend and expand the scope of the Unfair Practices Act, creating additional liability exposure for the service, and that we also had some concerns with. So what I thought I'd do is just talk about those two major areas from the rubric of looking at what this person sitting next to me asked me, which was this public policy issues. And I looked at him and I said to myself and I wonder whether or not the regulation fails to comply with the AP requirements of necessity, authority and clarity. Second thing I wanted to talk about – and I'll break this down and lay out the three major areas of concern and then go into them in greater detail. Second one was whether or not the regulation is consistent with or inconsistent with current law, and the inundated property disclosures that all insurers provide to their consumers. The third area was whether or not the regulation is in the best interest of market competition and the insurance consumer, because that's what the person sitting next to me wants to make sure -- does it help them, does it protect them, is it reasonable and necessary -- all of that. (1) So in regards to addressing this whole issues of authority. First of all, the AP requires that the regulation be necessary. If I look through the statement notice here -- and I was like, I guess the first question I have here is there's really know demonstration that there's an underinsured problem.<br>There's a contention that there was -- after the wildfires, some substantial complaints. Those complaints were a lot of things, including the fact people are unhappy after a terrible loss like that in their life. But there's nothing here that sets forth that we received 24,000 complaints specifically about the fact that they were not provided certain information that they needed to make an informed decision about what insurance coverage limitation they have. I don't see anything that talks about that. And then I said, well, also, I think you have so see whether or not the Department has demonstrated that, if there is an underinsured problem, that that underinsured problem is lack -- is because of a lack of knowledge in or it's unintentional, as I first mentioned. Some people may make the conscious | power without the regulations and states that "You already have the market conduct mechanisms in place to address those aberrational cases. And I look at this regulation as why would we want to regulate and fundamentally change the whole system when there may be only a few outlier situations that need to be addressed." However, the witness provides no facts upon which to base his assertion that the whole system will be fundamentally changed. Market conduct examinations evaluate whether insurers are complying with the law. The regulations establish that there are requirements to be followed when estimating "replacement cost;" that certain training will be necessary; and that record keeping will be required. The regulations work hand in hand with the market conduct examinations and are neither a replacement for nor a duplication of other regulatory authority.<br>(4) The witness testified that the Department has no authority to for the "expansion of the Unfair Practices Act." NAMIC and PADIC raised this comment in their written comments and the responses to comments, enumerated (3) and (6) above, are incorporated fully here. Additionally, the witness states that 2695.183 (j) means "if you engage in communication about replacement costs in any fashion, then you could be exposed to the UPA, liability, if you do not follow our set standards, guidelines, use language the way we like, like replacement -- or there's a whole host of words that are listed which may trigger liability for an insurance company."<br>The witness has misstated the purpose and meaning of the regulation. In this regard, based upon this comment and others, to make the meaning even more clear, proposed Section 2695.183 (j) has been amended to read: "To communicate an estimate of replacement value not comporting with subdivisions (a) through (e) of this Section 2695.183 to an applicant or insured in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis constitutes making a statement with |

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| | decision as to look at what is best for their insureds, based upon their budget, their needs their risk of life, how much risk they're willing to accept. I've had insurance now for around 30 some years. My home has never been fully destroyed. I've never had to fully use that coverage. And I think people deserve the right to make the decision as to what their coverage limits should be. And people have the ability to do that. I was looking for a car this past weekend. And I went in there, and it was up to me to figure out what the value was I was going to offer for this vehicle. It was up to me to make the decision, when I looked at two or three competing vehicles, which options I wanted and which options I needed and compare them and weigh the pricing based on that. This one has two air bags. Well, maybe one will be more. Maybe that's why. I mean, that's up to me and that was to my benefit because I got to look at that and decide what price points I wanted to place on these issues. So I think that, you know, as the case law in Everett states, it is the responsibility of policyholder to make that decision, not just here, but in life in general, you have to be the informed consumer, the old caveat emptor concept. The third thing I started to think about was this whole issue of necessity.<br>Is this regulation even necessary. (2) Is the issue of whether or not the Department has demonstrated the current mandatory disclosures, the Petrus discloses, as commonly referred to -- failed to properly inform or adequately inform the consumer. There hasn't been any statement that those aren't doing what they should do, and that is provide information to a consumer for that person to weigh what they need and make that assessment themselves. And of course, since that -- the Petrus disclosures are currently before the Legislature in AB2022, one has to beg the question maybe that should be where this should all go in. And maybe that needs to be approached, what information is going to be provided to the consumer in disclosures versus fundamentally changing responsibilities, creating new legal duties, new legal | respect to the business of insurance which is misleading and which by the exercise of reasonable care should be known to be misleading, pursuant to Insurance Code section 790."<br>(5) As part of the witness' testimony on "necessity and authority" he references AIA v. Garamendi. This comment was made in writing as well and the response thereto is incorporated herein under (1) above.<br>(6) The witness questioned the verification requirements. The response to NAMIC and PADIC comment (6) is incorporated herein. The regulations do not require that licensees must verify "how" estimators calculate their estimates.<br>The regulations require that the sources and methods are kept current. In response to this comment, and others, to further make clear the obligation of a licensee in this regard, the text of proposed Section 2695.183 (e) has been amended as follows: "The licensee shall no less frequently than annually take reasonable steps to verify that the sources and methods used to generate the estimate of replacement cost are kept current to reflect changes in the costs of reconstruction and rebuilding, including changes in labor, building materials, and supplies, based upon the geographic location of the insured structure. The estimate of replacement cost shall be created using such reasonably current sources and methods."<br>(7) The witness comments that the regulations would prohibit a homeowner from providing his or her own estimate of replacement cost. This is neither the purpose nor intent of the regulations and the text of the proposed regulations does not support this interpretation. To make this more clear, proposed Section 2695.183 (o) has been added to read: "No provision of this article shall limit or preclude an applicant or insured from obtaining his or her own estimate of replacement cost from an entity permitted to make such an estimate by Insurance Code section 1749.85."<br>Further, in response to the witness' comment and others, the terms "set" and "recommend" have been removed from |

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| | liability exposures. Another point that I wanted to mention, because this person that was sitting next to me was quite inquisitive and was filling my head full of thoughts. (3) And that was the question of why doesn't the Department now have the current regulatory power to sufficiently regulate this area. I mean, if you've got a question about whether or not a policyholder calls up to complain and says, "Hey, I was not provided the Petrus disclosures, or a meaningless explanation, or I made an uninformed decision about what my content coverage should be or replacement cost coverage. You already have the market conduct mechanisms in place to address those aberrational cases. And I look at this regulation as why would we want to regulate and fundamentally change the whole system when there may be only a few outlier situations that need to be addressed. Especially since this regulation – as you'll hear from many people -- has a whole host of unintended consequences that are associated with it. So that was my whole first question when I was talking to this person and was looking at whether or not it's necessary, that regulation should be necessary or they shouldn't exist. Second was authority. Does the Department have the authority to regulate as it intends to do. (4) And there's two areas that concern me. One is the expansion of the Unfair Practices Act. And the second one has to do with setting replacement cost estimating standards, which directly, unavoidably impact homeowners insurance. For the first time I look at here, I'm like, okay, when reading that UPA, it talks about restricting untruthful, deceptive, or misleading behavior conduct comments. That's what the whole purpose of it is. But this regulation goes far beyond that. It would actually regulate truthful non deceptive communications between the insurer and the policyholder Subdivision (j) specifically refers to communications. And communications come in many<br>different forms. And communications come in a whole<br>range of scopes. But this just comes out and says, hey, if you engage in communication about replacement costs in any | proposed Section 2695.183 (j) as referenced above in response to witness comment (4).<br>(8) The witness provided testimony that the regulations are lacking in clarity. The comment does not identify any ambiguity, however. It does argue that the regulations are in direct "conflict" with the California Residential Property Insurance Disclosure which sets forth a description of types of homeowners' insurance coverage and the California Residential Property Insurance Bill of Rights. However, the comment does not specifically identify a "conflict" other than to state that neither the Disclosure nor the Bill of Rights provide that "an insurer shall ultimately be legally responsible for estimating and/or verifying the value of the applicant's or policyholder's residence, and improvements or renovations to the residence." Though the comment asserts that the regulations create this legal responsibility, the comment fails to cite a section in the regulations that says this, or even implies it. The comment is disingenuous because the regulations do not create this duty. The Disclosure and Bill of Rights speak specifically to the homeowner insurance policy, itself. The regulations say nothing about the definition of policies described in the Disclosure and does nothing to change those descriptions. The regulations are clear in that they say, specifically, and without ambiguity that "…no licensee shall estimate replacement cost, or shall rely upon an estimate of replacement cost, to set or recommend a policy limit on a homeowner's insurance policy . . . unless the requirements and standards set forth in subdivisions (a) through (e) below are met."<br>If a licensee chooses to communicate an estimate replacement cost, then it must include in that estimate the components identified. Again, while the comment claims that this creates confusion as to whether the policyholder or the insurer bares the responsibility for determining the homeowners' insurance policy limits, the testimony fails to cite a section that creates the ambiguity. |

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| | fashion, then you could be exposed to the UPA, liability, if you do not follow our set standards, guidelines, use language the way we like, like replacement -- or there's a whole host of words that are listed which may trigger liability for an insurance company. So our concern here is, in effect, what the Department is doing in reality is expanding a law that was created by the Legislature that didn't get broad discretion to the Department to say, you guys pick and choose what you want to add as unfair practices. And if you want to prohibit, truthful non deceptive information, go right ahead, even though that may arguably create some First Amendment issues. (5) The other concerns we had with regard to this issue has to do with the replacement cost standards, which may directly unavoidable impact home underwriting. As you will probably hear today, there will be a discussion, I'm sure, about the AIA versus Garamandi case. An unpublished opinion, but unpublished only impacts procedurally whether or not third parties who are not privy to the case, not parties to the case, can actually site it as being controlling and authoritative. But in this case, the parties are here. The insurance trades and the Department of insurance. And more importantly, is the public policy statement that's being made in that case by the Court of Appeals. Their argument is there's nothing in the Insurance Code, expressly or implicitly, that gives authorization to the Department to regulate homeowners' underwriting practices. And that's what this would do. Now, of course, the person sitting next me is like: -- what is the homeowner -- I don't understand that. Explain that. How does this have anything to do with homeowners insurance underwriting. You know, the regulation clearly doesn't reference that. But nonetheless, that's what its direct impact is. Here's the reason why it has a direct and unavoidable impact on that. (Inaudible) you've engaged in some insurance transaction where you, the consumer, transfer some of your risk of loss to the insurer in exchange for an actuarially sound premium. You have to say: I want the following coverages. | The comment recommends that the regulations be tabled "until after the state legislature evaluates AB 2022 (Gaines), Property Insurance: Residential Disclosure, which amends the Property Insurance Disclosure to simplify and clarify the description of the various types of homeowners' insurance coverages available to the consumer and provides additional information pertaining to insurance coverage limits." Again, the comment is not related to the actual regulations as the regulations do not apply to descriptions of homeowners' insurance policies or insurance coverage limits. |

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| | I want the following limits. And you can then look at my risk portfolio and make an assessment of what my premiums shall be based upon that. Well, this regulation specifically goes into addressing how that coverage limits will be discussed, and even set -- as set forth, I think, it's in 269 -- strike that -- 2695.183, I believe, it's (e). Let me make sure I get that right. (e) refers to the verification provision. So, basically, what's going on here is that the regulation will directly impact information that an insured needs. It's a central part of what they do to provide the policyholder with a premium. That's why it directly impacts homeowners' underwriting. (6) Moreover, this subdivision (e), which refers to verification, sets forth a requirement that the insurer verify that any estimate they receive for replacement cost is current and accurate. (7) And when one reads the language of this section, it's pretty clear that one could argue that a policyholder shows up at the insurance company representative's office and says, "Hey, my brother is a contractor. He knows all about this. He has minimal cost to replace my home.<br>I'm very confident in him. He's a very talented multimillion dollar construction guy. Here is what I have for an estimate." The insurer couldn't rely on that because the language specifically says here -- and I'll read it. It's 2695.183.<br>"No licensee shall estimate, replacement cost, or shall reply upon and estimate of replacement cost to set" --<br>Once again, "set" goes right to the underwriting process. You need to have a limit in order to get a premium.<br>-- "to set or recommend a policy limit on a homeowner's insurance policy, unless the requirements of this standard set forth are met." So I don't see how this could be anything but a direct and unavoidable restriction or regulation on the homeowners' underwriting process. And as I said, I believe that that's inconsistent with AIA v. Garamandi. There's also a concern here, going back to this APA requirement, we talked about necessity, we talked about authority.<br>(8) I think there's also a clarity issue. One of my colleagues | |

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| | already started to some of the concerns and recommendations about certain provisions as to clarity. I won't go into the detail other than the fact that just looking at what I just read, what does it mean to set? What does it mean to recommend? What does it mean to communicate? And how does this regulation clarity-wise mesh with the mandatory disclosures?<br>I mean, if there was inconsistency there; I think that would raise questions as to the clarity how the regulation currently will work with the established laws in place. And of course, there's some internal inconsistencies. In one place in the regulations, it says that insurers do not have a duty or requirement to estimate. But then on the other hand, in subdivision (e), it says you must verify. Well, how do you verify the estimate unless you internally do an estimate. And then, of course, that raises the question how do you do an estimate of expert. You hire an expert because they have all the experience, the resources, the information, to put together this very complex multivariable analysis of what replacement cost is.<br>And then this says to you, okay, go to your expert and evaluate and verify that your expert is doing what they should be doing. So hire an expert to evaluate your expert. That is like me being required to verify that the dentist who is working on my teeth is doing what the dentist told me he said he had done on my teeth. I can't do that. If I could do that, it would be economically prohibitive. And that would be a problem for all insurers and consumers, they'll end up being the ones who will pay the price, but it will also be harmful for smaller carriers that do not have the scale of economy to engage in that without monumentally changing their pricing structure. In addition to those concerns I set forth here, I also have some concerns about whether or not the proposed regulation imposes some new de facto legal duties and liabilities on insurers. So specifically, this verification requirement. There's nothing in the current law that requires insurers to verify.<br>I mean, as a trial lawyer -- not in this state but in other states -- I | |

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| | would argue that one could possibly make a run in the courts with the argument that this says you insure because your duty to verify that estimate from a third party estimating source, you're kind of guaranteeing the estimate as being accurate, as being valid, as being current.<br>And therefore, if there is any problem with that, you're on the hook liability-wise. We're going to sue you. And then you can fight over what the intent of this regulation was, what the plain meaning of this regulation is, what the legal implications of this regulation are. Once again, those kinds of expenses become cost drivers for insurance companies, and cost drivers, like in any business, gets passed on to the Ultimate consumer.<br>Also of concern in here is contractual Rights, because right now, it's pretty clear that the insurer provides the product, the policyholder provides the information for the product. They make the decision as to what coverage is, what coverages limits, what exclusions that they have that they can control.<br>Of course, some exclusions are pursuant to policy that they don't get to negotiate over, but they can choose certain things. It interferes with that and starts to tell the insurer and policy owners what must be considered, what must be discussed, how it must be discussed in regard to replacement costs.<br>And then the last concern I have here is whether or not this is really in the best interest of the insurance consumer. As I mentioned, there is some confusion here in this regulation internally, but also what message does it say? Does it create confusion as to the issue of who ultimately has the duty to estimate the insurer's personal insurance needs?<br>I mean State law, the Everett case says it's up to the policyholder. But this kind of raises some question as to that because of this verification requirement and as to the fact it pertains to all communications that are going on between the parties.<br>Does this have really appropriate and necessary cost drivers? I mean, you don't want to create a regulation that will adversely | |

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| | impact market competition and adversely impact smaller insurers unless it's necessary.<br>And I've already raised some questions about necessity. I also raise the question aboutwhether or not cost drivers ancillary to this are necessary.<br>And then also, it could limit consumer access to information because the tradition here that expose the insurer to Unfair Practices Act liability says if you engage in this setting or the community of replacement costs, you now may be exposed to this Unfair Practices Act.<br>Well, if I was an attorney working for an insurance company I would say stay away. It's going to create liability exposure. Stay away from that. So I mean, the purpose here, once again, is to go back to make sure people make informed decisions so that they're not underinsured, unintentionally, or because of the lack of knowledge. This isn't going to help that. In fact, it's going to make insurance companies do what they do, and that's manage risk, and be cautious about treading in an area where they could see a lot of litigation. | |
| **E2Value, Inc. May 13, 2010 written comments** | Thanks for returning my call. You are right, e-mail is the best way to communicate and I appreciate your invitation to do so. I look forward to seeing you on Monday. The regulations are interesting and look well thought out. It is helpful to the industry, in my opinion, to have everyone singing from the same song book. There are few items that we have questions on and no real answers without your insights. I'm not sure if these topics have been covered and if it has I apologize. However, if not, I hope there can be comments and maybe some answers on the following points: (1) 1) With respect to, (J) Cost of demolition and debris removal; included in the home's replacement cost, how is that to be determined and applied? We ask as typically, each home loss is different or different enough that the amount of demolition and debris will correlate with the extent of the loss and also with the type of loss and less with the type of home and replacement cost. For | **Responses to E2Value, Inc. May 13, 2010 written comments**: (1) Noticed proposed Regulation Section 2695.183 (a) (3) (J) provided that the cost of demolition and debris removal is a factor to be considered in estimating replacement cost. (The demolition and debris removal language has been moved to Section 2695.183 (a) (3) in the proposed regulations issued pursuant to the 15 Day Notice.) The comment points out a legitimate concern when estimating. However, the regulation requires simply that when a replacement cost estimate is prepared, it include what would be "reasonably incurred" in rebuilding the structure. There may be occasions when the estimate, though reasonable, is not exact. In the example referenced in the comment, if the data shows that the majority of homes rendered a total loss are as a result of a fire that burns the home to destruction, as opposed to one that is rendered a total loss as a result of a partial burn and water damage incurred in putting out the fire, then it would be reasonable to make the |

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| | example, let's say there are two identical homes in the same neighborhood with the same or close to the same replacement cost, home A and Home B, one on the upside of the hill (A) in a wildfire and one in a valley (B). The fire moves in such a way that home A is 90% destroyed and home B is 30% destroyed by fire but 60% destroyed by water in attempts to extinguish the fire. Both homes have suffered enough damage to be declared a total loss.<br>Home B will have a far greater debris removal and demolition cost than A as physically more home is there with Home B than A after the loss and therefore more has to be removed. Before the loss, two identical homes in the same neighborhood would receive similar estimates of debris removal/demolition. Yet after the fire, the costs would vary greatly. Therefore, an inequity to the homeowners is introduced to the equation by the regulation before hand and then enforced after the loss. Will the STATE OFCALIFORNIA DEPARTMENT OF INSURANCE outline appropriate cost guides to be used? Will carriers be allowed to introduce their rate models to use that as a guide for the %? Will insureds get refunds or surcharges if the debris removal amount that was calculated is deficient or excessive? How would hazardous or toxic materials be handled? For example, asbestos? Should there be a surcharge for any home built prior to a set date, say 1975, that there is a presumption of hazardous materials (like asbestos) and therefore a higher debris removal charge applied by age of home? In that case, then are renovations and renovation credits allowed if there is some claim of previous removal of hazardous materials prior to the valuation? It might be seen that some insureds will be paying and ultimately not receiving benefits while others will pay less and receive higher benefits from this provision.<br>(2) 2) With respect to the effects of catastrophes on replacement cost. This includes how shortages of construction labor, building supplies, fuel, transportation issues, and permit | estimate based on the fire destroying the home in total. If the data shows otherwise, then the estimate would be reasonable if it considered the cost of demolition and debris removal of a home that is partially burned but rendered a total loss due to the water damage. Also, many homeowners' insurance policies provide for additional or enhanced coverage for demolition and debris removal, usually an additional 5% of the coverage for the dwelling structure. This additional coverage is intended to protect against the contingency that the cost of demolition and debris removal may be higher in certain loss scenarios than in others. The regulations do not, nor will the Department of Insurance otherwise provide, cost guidelines. The regulations do not mandate, nor do they prohibit carriers, from introducing or considering rate models. The regulations do not provide for refunds or surcharges. The regulations do not mandate nor do they prohibit surcharges for homes that may be built with hazardous materials; nor do they provide mandates or prohibitions regarding underwriting due to the age of a home. The regulations do not provide mandates or prohibitions on credits for homeowners who remove hazardous materials. These are underwriting issues left to the insurers.<br>(2) Regarding the comments concerning 2695.183 (f) which relates to demand surge, this subdivision as written has been removed from the text of the proposed regulations, meaning that demand surge may be taken into account in estimating replacement cost. New subdivision (f) does not relate to the subject of demand surge. In this regard, then, neither the noticed proposed regulations, nor the currently proposed amended regulations, provide guidelines to apply a uniform charge. Typically this type of coverage is as disclosed in the Residential Property Disclosure pursuant to Insurance Code 10102, such as Limited Replacement Cost Coverage With an Additional Percentage which pays replacement costs up to a specified amount above the policy limit.<br>The regulations do not mandate requirements for claims |

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| | restrictions can result in increased costs, sometimes referred to as demand surge, and delays in rebuilding. As the size of a catastrophe will impact the "demand surge," what guidelines can we expect or will there be to apply a uniform and equitable catastrophe charge prior to a catastrophe. Within that, if a catastrophe charge is included, how is that tracked for non-catastrophic losses? There is evidence of large demand surges and also no demand surges when homes are finally rebuilt after catastrophes. Once could argue that the claim settlement process shortens the time to get a settlement and the settlement is made in "demand surge" time while the actual rebuilding is done at a time well after the demand surge has past. The settlement process itself can introduce an artificial demand surge that may never materialize. Further, as we are an even increasing world economy, events that are not part of a catastrophe could cause a "demand surge" for non-catastrophic, more one over one losses. Again, an inequity could be passed along and then applied by acts of God and world events not contemplated by the original models. Will the catastrophic demand surge be applied at all times or only after a catastrophe? It could be seen as each year thee needs to be a probable events calculation on catastrophes and world events that would be applied on varying, year to year basis. Ultimately, it might be seen that some insureds will be paying and ultimately not receiving benefits while others will pay less and receive higher benefits from this provision. In both cases, guidelines and limits or scales from the STATE OFCALIFORNIA DEPARTMENT OF INSURANCE might allow a uniform application across homes in the state on an equal basis for each insured. Or, a rate applied to each policy might have a more uniform approach and serve the public better as a homeowner could review the part of the policy that applies to debris removal and/or catastrophe pricing. I am sure there are even better ideas that those out there. Certainly some comments or guidance on those points might be helpful for those looking to comply with the proposed regulations. | settlement practices regarding whether demand surge occurs after a catastrophe, when it occurs, or how the time of rebuilding might impact the effect of demand surge. The regulations state specifically what must be considered in estimating replacement cost. The regulations do not provide for underwriting guidelines concerning a rate to be applied for demand surge. |

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| **Personal Insurance Federation of California (PIFC) May 17, 2010 written comments** | On behalf of the members of the Personal Insurance Federation of California ("PIFC"), we appreciate the opportunity to provide written comments to the California Department of Insurance ("Department") regarding the above-referenced proposed regulations ("proposed regulations").PIFC member companies provide home, auto, flood and earthquake insurance for millions of Californians. Our member companies, State Farm, Farmers, Allstate, Liberty Mutual Group and Progressive, write more than 60 percent of the home and auto insurance sold in this state. They are committed to California despite the oftentimes difficult regulatory climate. We are hopeful to work productively with the Department on the draft regulations, which harm the business climate in California. PIFC has been pleased to participate in several meetings and an informal workshop to discuss the draft regulations. We believe we have communicated a consistent message throughout those discussions, as well as in a comment letter dated February 26, 2010.<br>(1) We have acknowledged the Department's desire for a more rigorous training curriculum for brokers and agents and have indicated, in our previous communications, support for additional training. Also clearly communicated in the February letter, were our serious concerns with Section 2695.183. Those concerns, both legal and practical, remain and are set forth below. The standards specify detailed, yet open ended, criteria that imply a shift in responsibility for determining coverage amounts – in effect treating customers as if they are incapable of making adult decisions. As drafted, the regulations' detailed standards, limitations and prohibitions are not only impractical, but lie outside the scope of authority of the commissioner by attempting to regulate underwriting and imposing new duties and liabilities on the insurer. In short, the draft regulations would make it much more difficult to do business in California and create new theories for enterprising trial lawyers to exploit. We support the | **Response to Personal Insurance Federation of California (PIFC) May 17, 2010 written comments:**<br>(1) PIFC'S introductory comments support the additional training and the Department concurs with those comments. The introductory comments argue that the standards stated in Section 2695.183 to be considered when estimating replacement cost "imply a shift in responsibility for determining coverage amount-in effect treating customers as if they are incapable of making adult decisions." However, neither in the introductory comments, nor the enumerated ones that follow, does PIFC state how the regulations remove from the customer the decision to buy homeowner insurance, to determine the amount of coverage, or what kind of policy to purchase. The regulation provides a definition of the terms "replacement value" and "estimate of replacement value" and will end any ambiguity about what those terms mean, and what components are included in making the estimate. The wide sweeping conclusion by PIFC that the regulations will make it "difficult" to do business in California in not explained by the introductory comment, or later in the specifically enumerated comments. Instead, the regulations will provide licensees and their customers the opportunity to more easily do business in California because a term used previously without definition in the homeowner insurance business will now be more clearly defined and consistent among insurers. PIFC concludes the regulations are based upon "uncertain complaints from a tiny percentage of the population." This comment is without foundation and not explained by reference to any data. The Rulemaking file is replete with: more than fifty separate consumer complaints and their files related to underinsurance and replacement cost; testimony at an investigative hearing held by the insurance commissioner on the same issues; declaration and summaries of market conduct examinations on these issues; the 2007 Wildfire Insurance Claim Status Survey/United Policyholders. Pursuant to the 15 Day Notice, the following has |

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| | Department's interest in a better informed customer, but not government "solutions" that make things worse for all California homeowners based upon uncertain complaints from a tiny percentage of the population. (2) General Comments<br>Because of the nature of the type of construction, manufactured homes are generally not reconstructed but replaced following a total loss. Consequently, the reconstruction value estimation process for manufactured homes is significantly different as compared with site-built homes. Specifically, replacement value estimators for manufactured homes generally do not provide for provisions for cost of foundation, architect's plans/engineering reports/permits, whether the structure is located on a slope, the type of frame, or nonstandard wall heights. Since estimating programs are not generally available for manufactured homes that incorporate all of the provisions required by 2695.183 and because the training required for manufactured homes is significantly different than site-built homes, it would seem appropriate to exempt manufactured homes from the proposed regulations.(3) Proposed Section 2188.65 (d) (3) The "including but not limited to" language is problematic. There are thirteen items that must be included in any training on how to estimate replacement cost. Since not all items may be included, how will licensees know whether or not the training they pay for meets the requirement of the regulation?<br>(4) Proposed Section 2695.182 (a) (3)<br>Delete the term "determined" and insert the term "estimated." Again, information that carriers provide to the applicant or insured is only an estimate. Applicants and insureds, not carriers, determine the amount of coverage to purchase.<br>(5) Proposed Section 2695.182 (a) (4)<br>Many applications are declined or quoted but the applicant chooses not to pursue. It is not relevant to keep information on an application that has never been issued. This would be a very burdensome requirement for insurers and should be deleted. | been added to the rulemaking file, further evidencing the need for the regulations: MBS report and website information on replacement cost issues; multiple media reports throughout several years reporting on the underinsurance problem from the Orange County Register; the North County Times; Sign On, the Union Tribune, the New York Times, The Insurance Journal, CNN Money, the Associated Press, the Malibu Times, the Ventura County Star, the Los Angeles Times, Kiplinger, Claims, KCOY 12, the Napa Valley Register, the Sacramento Bee. It is clear that the regulations are necessary. In 2003, and again in 2007 and 2008, California experienced significant wildfires leading to the loss of a high number of residential structures. After each of these fires, fire survivors complained about problems including their experience that after the fire they learned that the replacement value estimates made in setting coverage limits for their homes was incomplete and too low, causing underinsurance issues to arise during efforts to rebuild or replace their residences. The significance of the replacement value being complete and therefore more accurate is particularly important given that other than a limited number of homeowners who qualify for guaranteed replacement coverage offered by only a small number of insurers, the vast majority of homeowners have one of three kinds of insurance coverage on their home as defined in the California Residential Property Insurance Disclosure Form from Insurance Code Section 10102:<br>Limited Replacement Cost Coverage With an Additional Percentage which pays replacement costs up to a specified amount above the policy limit;<br>Limited Replacement Cost Coverage With No Additional Percentage which pays replacement costs up to policy limit only;<br>Actual Cash Value Coverage which pays the fair market value of the dwelling at the time of the loss, or the cost to repair, rebuild, or replace the damaged or destroyed dwelling with like |

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| | (6) Proposed Section 2695.183<br>The proposed regulation does not meet the requirements of Government Code Section 11349.1 PIFC believes the proposed regulation fails to meet the standards set out in Government Code Section 11349.1 (a), specifically, (a)(1) Necessity, (a)(2) Authority, (a)(3) Clarity and (a)(4) Consistency.<br>(6.1) Necessity<br>"Necessity" means the record of the rulemaking proceeding demonstrates by "substantial evidence" the need for a regulation to effectuate the purpose of the statute, court decision, or other provision of law that the regulation implements, interprets or makes specific, taking into account the totality of the record. For purposes of this standard, evidence includes, but is not limited to, facts, studies and expert opinion. The Department has presented no evidence, other than anecdotal reference, establishing a need for defining in regulation a sole set of standards to be strictly adhered to for estimating replacement cost. The Department appears to be relying on its stated experience, following wildfires, of complaints by some insureds that their coverage was inadequate. While there will, unfortunately, always be some who do not purchase adequate coverage prior to a disaster, the Department jumps to the conclusion that inadequacy following a fire is directly the result of a deficiency in the original replacement value estimate. "After each of these fires, fire survivors complain about problems including their experience that after the fire they learned that the replacement value estimates made in setting coverage limits for their homes was too low, causing underinsurance issues to arise during efforts to rebuild or replace their residences." *(The Department's Initial Statement of Reasons, Specific Purpose and Reasonable Necessity of Regulation).*<br>The Department offers no actual evidence, specific facts, studies or expert opinion to justify dramatically altering the process of estimating replacement cost. No evidence is offered to justify | kind and quality construction up to the policy limit. Therefore, the necessity of having a complete and more accurate estimate of replacement value that is updated regularly is paramount. The failure to take into consideration certain factors at all, or to not fully consider other components, as referenced above, is one source of the underinsurance problem.<br>(2) PIFC suggests that the regulations not apply to manufactured homes because the estimation for reconstruction is different as compared with site-built homes. In consideration of this comment, and others, the Department has amended proposed Section 2188.65(a) (1) and Section 2695.180 (a) to read as follows: ""Homeowners' insurance policy" shall have the same meaning as "policy of residential property insurance" as defined in subdivision (a) of Insurance Code section 10104." Language in the originally noticed regulations applying the regulations to mobile homes has been removed.<br>(3) In consideration of this comment and others proposed Section 2188.65 (d) (3) has been amended to replace "but not limited to" with "at least the following." "<br>(4) In consideration of this comment Section 2695.182 (a) (3) has been amended: to remove "determined" and it now reads: "The source from which or method by which the estimate of replacement cost was prepared, to include any replacement cost calculator, contractor's estimate, architectural report, real estate appraisal, or other source or method;…"<br>(5) In consideration of this comment, the change suggested by PIFC had been incorporated and the regulation has been amended to reflect that the documentation retention requirement does not apply when a policy is not issued. To make this clear, Section 2695.182 (b) is amended to read: "In the event the estimate of replacement cost is provided by a licensee to an applicant or insured in connection with an application for or renewal of a policy that provides coverage on a replacement cost basis, the licensee shall maintain in the insured's file the records specified in subdivision (a) of this |

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| | imposing a single detailed, yet open-ended, set of standards on an entire population of homeowners and their broker-agents, based upon a small percentage of homeowners who may experience coverage issues - and<br>which issues may or may not be resolved by the regulations. As to the statement, "The Commissioner believes that the proposed regulation is necessary to implement, interpret and make specific Section 1749.85," the Department cites the statute as authority for promulgating this regulation and does not distinguish the sections that apply to training and those that would require the strict application of specified standards for estimating replacement cost. PIFC raises no objection to, nor do we challenge, the draft regulations to implement the training curriculum as specified in Insurance Code Section 1749.85(a). This code section however, does not support a necessity standard as applied to proposed Section 2695.183.<br>(6.1) Authority<br>The rulemaking power of an administrative agency is limited by the substantive provisions of the law governing that agency. To be valid, an administrative regulation must be within the scope of authority conferred by the enabling statute or statutes. *(Terhune v. Superior Court (1998) 65 Cal.App.4th 864).* The authority of an administrative agency to adopt regulations is limited by the enabling legislation. *(Beardenv. U.S. Borax, Inc., (2006) 138 Cal.App.4th 429).* Agencies do not have discretion to promulgate regulations that are inconsistent with the governing statute, or that alter or amend the statute or enlarge its scope. *(Slocum v. State Board of Education (2005) 134 Cal.App.4th 429).* The Department cites a string of general authority without reference to specific sections of the proposed regulations. None of these statutes provides the Department the authority to impose a single formula that must be used by an insurer to estimate replacement cost, nor to impose restrictions on communication between an insurer and its insured - including the prohibition of certain words and phrases, nor to impose underwriting | Section 2695.182 for the entire term of the insurance policy or the duration of coverage, whichever terminates later in time, and for five years thereafter. In the event the estimate of replacement cost is provided by a licensee to an applicant to whom an insurance policy is never issued, subdivision (a) of this Section 2695.182 shall not apply."<br>(6) PIFC comments that the proposed regulation does not meet the requirements of Government Code Section 11349.1. However, as mentioned in response to comment (1), the Rulemaking file includes more than fifty separate consumer complaints and their files related to underinsurance and replacement cost; testimony at an investigative hearing held by the insurance commissioner on the same issues; declaration and summaries of market conduct examinations on these issues; the 2007 Wildfire Insurance Claim Status Survey/United Policyholders.. Pursuant to the 15 Day Notice, the following has been added to the rulemaking file, further evidencing the need for the regulations; MBS report and website information on replacement cost issues; multiple media reports throughout several years reporting on the underinsurance problem from the Orange County Register; the North County Times; Sign On, the Union Tribune, the New York Times, The Insurance Journal, CNN Money, the Associated Press, the Malibu Times, the Ventura County Star, the Los Angeles Times, Kiplinger, Claims, KCOY 12, the Napa Valley Register, the Sacramento Bee. It is clear that the regulations are necessary.<br>(6.1)The comment states that the statutes cited by the Department do not provide authority to promulgate the regulations. There is ample authority as cited by the Department. The comment states that none of the statutes cited permit the Department to impose a "single formula" or to "impose restrictions" on communications. This is a misstatement of the regulations. Section 2695.183 requires that if the licensee communicates an estimate of replacement cost, that it will be complete and include consideration of those |

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| | requirements. The Department appears to rely primarily on two provisions of the Insurance Code: Section 1749.85 and Section 790.03.<br>(7) Section 1749.85<br>The department cites the statute as authority for promulgating this regulation and does not distinguish the sections that apply to training and those that would require the strict application of specified standards for licensees estimating replacement cost. The origin of Insurance Code Section 1749.85 is legislation passed in 2005 (SB 2), creating subsections (a) and (b): 1749.85 (a) The curriculum committee shall, in 2006, make recommendations to the commissioner to instruct fire and casualty broker-agents and personal lines broker-agents and applicants for fire and casualty broker-agent and personal lines broker-agent licenses in proper methods of estimating the replacement value of structures, and of explaining various levels of coverage under a homeowners' insurance policy. Each provider of courses based upon this curriculum shall submit its course content to the commissioner for approval. (b) A person who is not an insurer underwriter or actuary or other person identified by the insurer, or a licensed fire and casualty broker-agent, personal lines broker-agent, contractor, or architect shall not estimate the replacement value of a structure, or explain various levels of coverage under a homeowners' insurance policy. *(emphasis added)*. The committee analysis of the legislation confirms the intent was to develop curriculum and improve training: [This bill] "would create pre and post licensure education requirements for agents and brokers…" "This bill would require the DOI to develop a curriculum to instruct broker-agents and other personnel in the office in proper estimation of the replacement cost of the structure, require continuing education in this subject, and prohibit untrained persons from doing estimates, as specified." "Better training and continued training of personnel in how to estimate the replacement cost of a home is therefore critical." (Senate | components enumerated in the regulation. To communicate an estimate that is missing components results in consumer confusion and is misleading. Further, California Insurance Code Section 790.03 states that: "The following are hereby defined as unfair methods of competition and unfair and deceptive acts or practices in the business of insurance…(b) Making or disseminating or causing to be made or disseminated before the public in this state, in any newspaper or other publication, or any advertising device, or by public outcry or proclamation, or in any other manner or means whatsoever, any statement containing any assertion, representation or statement with respect to the business of insurance or with respect to any person in the conduct of his or her insurance business, which is untrue, deceptive, or misleading, and which is known, or which by the exercise of reasonable care should be known, to be untrue, deceptive, or misleading." California Insurance Code Section 790.10 states: "The commissioner shall, from time to time as conditions warrant, after notice and public hearing, promulgate reasonable rules and regulations, and amendments and additions thereto, as are necessary to administer this article." The regulations merely state that it is misleading under Insurance Code Section 790.03 to characterize that an estimate is complete by communicating an estimate that does not include all of the components required to be considered in estimating replacement cost. In consideration of this comment and others, the Department, in order to make even more clear the communications at issue, has amended Section 2695.183 (j) as follows: "To communicate an estimate of replacement value not comporting with subdivisions (a) through (e) of this Section 2695.183 to an applicant or insured in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis constitutes making a statement with respect to the business of insurance which is misleading and which by the exercise of reasonable care should be known to be misleading, pursuant to |

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| | Banking, Finance and Insurance Committee analysis. Chair, and author, Senator Speier). *(emphasis added).*<br>The statute was amended the following year (SB 1847), adding subsections (c) and (d):<br>(c) This section shall not be construed to preclude licensed appraisers, contractors and architects from estimating replacement value of a structure.<br>(d) However, if the Department of Insurance, by adopting a regulation, establishes standards for the calculation of estimates of replacement value of a structure by appraisers, then on and after the effective date of the regulation a real estate appraiser's estimate of replacement value shall be calculated in accordance with the regulation. *(emphasis added).*<br>This section – specifically (a) – gives the Department authority to promulgate regulations related to the curriculum and training of broker-agents on "proper methods of estimating replacement value of structures..."<br>Subsection (b) specifies those who shall not estimate the replacement value: "A person who is not an insurer…or a licensed fire and casualty broker-agent….shall not estimate…or explain various levels of coverage…" and therefore states who may in fact estimate and explain - including broker-agents.<br>Subsection (c) clarifies that the section shall not preclude licensed appraisers and others from estimating replacement value of a structure, however, (d) states that if the Department adopts regulations establishing standards for estimating, "a real estate appraiser's estimate of replacement value shall be calculated in accordance with the regulation." *(emphasis added).*<br>Nothing in the legislation or its history can be read to allow the Department the authority to promulgate regulations applicable to broker-agents for any purpose other than to establish a training curriculum. Section 2695.183 attempts to regulate well beyond curriculum by prohibiting insurers (including broker-agents) from estimating or relying on an estimate unless each and every | Insurance Code section 790.03." This amendment also removes the express prohibition of using the terms "replace" and "replacement", which addresses the concern that this subdivision imposes restrictions on communications.<br>(7) PIFC states that while it raises no objection to, nor does it challenge, the draft regulations to implement the training curriculum as specified in Insurance Code Section 1749.85(a) it believes this code section does not support a necessity standard as applied in proposed Section 2695.183. The Department rejects this comment as 1749.7 states: "The commissioner may, pursuant to Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code, adopt reasonable rules and regulations necessary for the convenient administration of this article." The article contains 1749.85: "(a) The curriculum committee shall, in 2006, make recommendations to the commissioner to instruct fire and casualty broker-agents and personal lines broker-agents and applicants for fire and casualty broker-agent and personal lines broker-agent licenses in proper methods of estimating the replacement value of structures, and of explaining various levels of coverage under a homeowners' insurance policy. Each provider of courses based upon this curriculum shall submit its course content to the commissioner for approval. (b) A person who is not an insurer underwriter or actuary or other person identified by the insurer, or a licensed fire and casualty broker-agent, personal lines broker-agent, contractor, or architect shall not estimate the replacement value of a structure, or explain various levels of coverage under a homeowners' insurance policy. (c) This section shall not be construed to preclude licensed appraisers, contractors and architects from estimating replacement value of a structure. (d) However, if the Department of Insurance, by adopting a regulation, establishes standards for the calculation of estimates of replacement value of a structure by appraisers, then on and after the effective date of the regulation a real estate appraiser's estimate of |

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| | component of the specified standards as specified are met.<br>(8) *Section 790.03*<br>This statute is cited by the department as authority, generally, for the proposed regulation, and specifically, as to 2695.183 (j), which reads:<br>"When setting, recommending or communicating about a policy limit on a homeowners' insurance policy, to characterize using any form of the word "replace" or "replacement" any estimate of construction costs not comporting with subdivisions (a) through (e) of this Section 2695.183 constitutes making a statement with respect to the business of insurance which is misleading and which by the exercise of reasonable care should be known to be misleading, pursuant to Insurance Code Section 790.03. Notwithstanding the preceding sentence, a licensee that provides an applicant or insured with any estimate of construction costs that does not satisfy all of the requirements of subdivisions (a) through (e) of this Section 2695.183 shall indicate that it is not an estimate of replacement cost and shall identify and explain in the estimate each of the ways in which the estimate of construction costs that is provided fails to meet the requirements for a replacement cost estimate that are stated in said subdivisions (a) through (e)."<br>Insurance Code Section 790.03 defines unfair methods of competition and unfair and deceptive acts or practices in the business of insurance. Included in that definition is any statement which is misleading and which is known, or which by the exercise of reasonable care should be known, to be, misleading. The list of prohibited behavior in the Unfair Practices Act was established by the state legislature, with no formal granting of broad discretion to the Department to expand the scope of the Act. Any effort to specify prohibited behavior must be done through legislative action and attempts to do so through regulation exceed the scope of authority of the Department.<br>For the Department to declare a prohibition on terms in any | replacement value shall be calculated in accordance with the regulation." The section anticipates the Department adopting regulations establishing standards for the calculation of estimates of replacement value. Regulation 2695.183 establishes those standards. In addition, the pre and post education are available. Specifically, the pre homeowners' insurance valuation education is stated in Section 2187.3 of the California Code of Regulations (CCR) for the Fire and Casualty Broker-Agent and in Section 2186.4 for the Personal Lines Broker Agent. The post homeowners' insurance valuation education is outlined in the Homeowners' Insurance Valuation Outline which is available on the Department's Web site. The outline specifically states the topics and the amount of time for each topic to equal the three hours for this course.<br>(8) There is nothing new about the prohibition of misleading statements made by licensees. The proposed regulations do nothing more than identify one particular variety of misleading statement which licensees know or should know is misleading: to describe as a replacement cost estimate an estimate that fails to consider all of the elements which no one disputes may in fact need to be paid for in the event of a total loss. We note that the very urgency with which industry representatives, including the commenter, oppose this particular provision is itself powerful evidence of its necessity. The requirements for a replacement value estimate that are set forth in Section 2995.183 of the proposed regulations are really quite modest: The regulations do not require of replacement value estimates any particular degree of accuracy; instead, all the regulations do require that any estimate of replacement cost be complete and must not ignore outright any of the basic cost components universally acknowledged to figure into replacement cost. The fact that there is such strong resistance to this relatively self evident proposition strongly suggests that there are those among the Department's regulated entities who routinely represent as estimates of replacement value estimates that do |

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| | communication with an applicant/insured is, in addition to being invalid for lack of authority, an infringement upon free speech rights. The prohibition is also impractical given the very terms are required in disclosure documents from the insurer to the applicant/insured.<br>**(9)** AIA v. Garamendi<br>An agency has no authority to promulgate a regulation that is inconsistent with controlling law. *(Communities for a Better Environment v. California Resources Agency (2002) 103 Cal.App.4th 98).*<br>No statute cited for purposes of Section 2695.183 provides authority to the Department to regulate underwriting, because the legislature and courts have affirmed that no such authority exists.<br><br>"The Insurance Code provides no express authority for regulating the underwriting of homeowners' insurance, nor can such expansive authority be implied. Unlike automobile insurance, homeowners' insurance is subject to only a few restrictions, all clearly set forth in the Insurance Code. Reading the Insurance Code to give the Commissioner broad authority to regulate underwriting beyond these specific provisions is inconsistent with the legislative scheme as a whole." *(AIA v. Garamendi).*<br>The only statutes that restrict an insurance company's underwriting decisions with respect to homeowners' insurance are Insurance Code sections 676 and 791.12. Other sections set out the basis for canceling a policy (sections 675, 675.5, 676), or prohibit when a policy may be non-renewed (section 675, 676.9, 676.10, 676.1), or prohibit discriminatory practices (section 679.7-679.73). These restrictions are exclusive. The Commissioner and Department have no authority to expand them to include restrictions on estimating replacement costs. As the court noted in *AIA v. Garamendi*, which is binding upon the Department, "An insurer does not have a duty to do business with or issue a policy of insurance to any applicant for insurance. | not, in fact, take into account all the costs that would be incurred in replacing a totally destroyed structure, and who would continue to make such misleading statements if they were not held to account by the promulgation of the provision that says that this kind of misleading statement is, in fact, a violation of the Unfair Practices Act. In consideration of this comment and others, the Department, in order to make even more clear the communications at issue, has amended Section 2695.183 (j) as referenced above in response to comment (6.1).<br>(9) *AIA v. Garamendi*, is a de-published case. A de-published opinion may not be cited or relied upon by a party in any other action unless, pursuant to California Rule of Court 8.1115, when it is relevant under the doctrines of law of the case, res judicata, or collateral estoppel; none of which are applicable here. Further, even assuming that AIA v. Garamendi could be cited, the arguments raised by are misplaced. The regulations do not have an impact on underwriting practices. The regulations do not specify, require or otherwise mandate how insurers underwrite homeowner policies. Insofar as the comment references Section 2695.183, this section requires that if the licensee communicates an estimate of replacement cost, it will be complete and include those components and requirements enumerated in the regulation. Further, PIFC's implication that the regulations preclude a discussion of extended coverage is not supported by the language of the regulation. The comment glosses over 2695.183 (l) which provides: "This Section 2695.183 applies to all communications by a licensee, verbal or written, with the sole exception of internal communications within an insurer, or confidential communications between an insurer and its contractor, that concern the insurer's underwriting decisions and that never come to the attention of an applicant or insured." The comment gives little credence to noticed Section 2695.183 (m) which stated that the article shall not be construed as creating an obligation for a licensee to estimate replacement cost or |

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| | Whether an insurer should be required to offer a particular class of insurance or insure a particular risk are matters of complex economic policy entrusted to the Legislature." Citing *Quelimane Co. v. Stewart Title Guaranty Co.* 19 Cal.4th 26, 43 (1998).<br>No legal basis exists for the Department to restrict insurance companies from estimating and communicating replacement costs, activities that are critical and essential to underwriting decisions.<br>It may be that the Department was attempting to negate the underwriting issue with the language in subdivisions (l) and (m).<br>What is not recognized nor addressed by the draft regulation is that insurance companies are obligated by their underwriting standards, and by the Department's enforcement of those standards, to estimate a replacement cost - which is fundamental to the risk assessment process - and to communicate that cost to the insurance applicant. A simple example will illustrate this reality. Insurance companies offer extended coverage that is usually some percentage above the basic coverage amount. Extended coverage provides a cushion for the unexpected, rapid increases in construction costs, upgrades, additions and other changes that did not trigger the insured to increase the basic coverage. In fact, the Department on several occasions has considered and even pursued requiring insurance companies to offer a 50% extended coverage to policyholders owning homes in areas prone to wildfires. Requiring insurers to offer policyholders extended coverage remains a priority of the Department as outlined in their 2010 Strategic Plan. The stated purpose for the 50% extended coverage proposal is to cover increased costs resulting from, among other things, what the Department calls "demand surge."<br>Extended coverage is based on a basic coverage amount that is equal to or greater than the estimated replacement cost. In fact, extended coverage cannot be provided unless the basic coverage is at least as great as the replacement cost estimated by the insurance company. Hence, to even discuss extended coverage, | recommend policy limits. To make this even more clear, the proposed amended Section 2695.183 (m) reads "No provision of the article shall be construed as requiring a licensee to estimate replacement cost or to set, or recommend a policy limit to an applicant or insured. No provision of this article shall be construed as requiring a licensee to advise the applicant or insured as to the sufficiency of an estimate of replacement cost." The comment provides an "example" regarding discussions with the proposed insured concerning extended replacement cost and concludes that because extended coverage is a function of estimated replacement cost, the regulation mandated underwriting practices. It does not. If the insurer does not want to estimate replacement cost, it is not required to. The regulations merely state that if an insurer chooses to generate an estimate and that estimate is communicated to an applicant or insured, that it be complete and include certain components. If the insurer wishes to offer extended replacement cost coverage, and base it on an estimate of replacement cost, then the components relative to replacement cost would be included. In consideration of this comment and others, and so as to make more clear the intent of the regulations, they have been amended by adding subdivisions (n), (o) and (p) to Section 2695.183 as follows: " (n) No provision of this article shall limit or preclude a licensee from providing and explaining the California Residential Property Insurance Disclosure, as cited in Insurance Code section 10102, explaining the various forms of replacement cost coverage available to an applicant or insured, or explaining how replacement cost basis policies operate to pay claims.<br>(o) No provision of this article shall limit or preclude an applicant or insured from obtaining his or her own estimate of replacement cost from an entity permitted to make such an estimate by Insurance Code section 1749.85.<br>(p) For purposes of this subdivision (p), "minimum amount of insurance" shall mean the lowest amount of insurance that an |

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| | the insurance company has to estimate the replacement cost and communicate that amount to the insurance applicant. Estimating and communicating the replacement cost is integral to making an underwriting decision, that is, whether extended coverage can be provided or not. Section 2695.183 prohibits an insurance company specifically from estimating or communicating a replacement cost unless it complies with subdivisions (a) through (e) of section 2695.183. As such, it directly regulates underwriting.The provisions in subdivisions (l), exempting the requirements of Section 2695.183, from communications between an insurer and contractor concerning underwriting decisions that never come to the attention of the applicant or insured, and subdivision (m) specifying that there is no requirement on the licensee to estimate replacement cost or advise of the sufficiency of such an estimate, have no practical impact on the ability of a licensee to choose an alternative to the standards as set out in (a) though (e) and therefore, the Department has no legitimate claim that the proposed regulations do not regulate underwriting.<br>(10) Everett v. State Farm<br>An agency has no authority to promulgate a regulation that is inconsistent with controlling law. *(Communities for a Better Environment v. California Resources Agency (2002) 103 Cal.App.4th 98).* PIFC is very concerned that the draft regulation will have the impact of shifting the responsibility for establishing policy limits from the insured to the insurer, in conflict with established California law. "It is up to the insured to determine whether he or she has sufficient coverage for his or her needs." *(Everett v. State Farm General Insurance Co. (162 Cal.App.4th 649).* The court in *Everett* also affirmed that Insurance Code sections 10101 and 10102 do not require an insurer to set policy limits that equal the cost to replace the property, nor is an insurer duty bound to set policy limits for insureds. The Department appears to have drafted the regulation to counter this argument from *Everett* with the inclusion of subdivision (m), which | insurer requires to be purchased in order for the insurer to underwrite the coverage on a particular property, based upon an insurer's eligibility guidelines, underwriting practices and/or actuarial analysis. An insurer may communicate to an applicant or insured that an applicant or insured must purchase a minimum amount of insurance that does not comport with subdivisions (a) through (e) of this Section 2695.183; however, if the minimum amount of insurance that is communicated is based in whole or in part on an estimate of replacement value, the estimate of replacement value shall also be provided to the applicant or insured and shall comply with all applicable provisions of this article. Nothing in this article shall limit or preclude an insurer from agreeing to provide coverage for a policy limit that is greater than or less than an estimate of replacement cost provided pursuant to this article."<br>(10) PIFC comments that it is concerned the regulation will have the impact of shifting the responsibility for establishing policy limits from the insured to the insurer, in conflict with established California law. "It is up to the insured to determine whether he or she has sufficient coverage for his or her needs." *(Everett v. State Farm General Insurance Co. (162 Cal.App.4th 649).* The comment acknowledges that the regulations do not do this, and in fact, provide clearly in noticed Section 2695.183 (m) and the amended language referenced above in response to comment (9) that: no provision of this article requires a licensee to estimate replacement cost. The regulations do not require an insurer to set policy limits that equal the cost to replace the property, nor do the regulations establish a duty to set policy limits for insureds. The comment offers that even though the regulations do not establish these duties and specifically state in (m) that there is no such duty to set or recommend a policy limit, "there is an almost unlimited number of ways in which an insurer could be found to have not complied strictly with the detailed standards or with the applicable restrictions if not using the standards, and therefore would be held liable in some way." |

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| | provides, "No provision of this article shall be construed as requiring a licensee to estimate replacement cost to set, or recommend to an applicant or insured, a policy limit on a homeowners' insurance policy. No provision of this article shall be construed as requiring a licensee to advise the applicant or insured as to the sufficiency of such an estimate." However, the alternatives for an insurer who does not comply with (a) through (e) are fraught with liability risks. Using the wrong word or phrase in a discussion with an applicant/insured, inadequately detailing in what way they "fail to meet the requirements" in (a) through (e) – there is an almost unlimited number of ways in which an insurer could be found to have not complied strictly with the detailed standards or with the applicable restrictions if not using the standards, and therefore would be held liable in some way. The absence of a requirement, however, does not speak to the potential liability of an insurer if an estimated replacement cost is given. While the responsibility to determine adequate coverage lies with the insured *(Everett),* there is a recognized exception to that general rule that may apply if an agent makes an affirmative representation of adequate coverage, misrepresents to the insured that an amount is adequate under all circumstances, or fails to provide coverage requested by the policyholder. We read Section 2695.183 as implicitly, directly, or practically, shifting the responsibility of establishing adequate coverage from the insured – where it is today under California law – to the insurer, and contend this exceeds the scope of the Department's authority.<br>**(11)** Clarity<br>Clarity is defined as "written or displayed so that the meaning of the regulations will be easily understood by those persons directly affected by them."<br>An ambiguous regulation that does not comply with the rulemaking procedures of the Administrative Procedures Act (APA) is void. *(Capen v. Shewry (2007) 65 Cal.Rptr.3d 890).*<br>Section 2695.183 creates ambiguities, including the critical issue | However, the comment fails to provide a scenario to support this concern.<br>(11) PIFC comments that the regulation, is unclear and references specifically Section 2695.183 (a) and (j). In consideration of this comment, and others, as the Department noted in its response to PIFC's comment (1) the Department has amended 2695.183 (a) as follows: "The estimate of replacement cost shall include the expenses that would reasonably be incurred to rebuild the insured structure(s) in its entirety, including at least the following." As noted in response to comment (6.1) above Section 2695.183 (j) is amended to read:<br>To communicate an estimate of replacement value not comporting with subdivisions (a) through (e) of this Section 2695.183 to an applicant or insured in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis constitutes making a statement with respect to the business of insurance which is misleading and which by the exercise of reasonable care should be known to be misleading, pursuant to Insurance Code section 790.03."<br>(12) PIFC comments that the regulations are inconsistent. The comment then reasserts its earlier comments and in response, the Department incorporates fully its responses to PIFC comments (1) – (11).<br>(13) As noted in response to comment (11) in consideration of this comment and others, 2695.183 (a) has been amended. The comment inquires whether the regulations seek to change a situation where a broker-agent assists the applicant/insured in estimating replacement cost. The regulations do not seek to change this practice. The comment states that current practice also includes situations where an applicant/insured provides a contractor or other estimate of replacement cost prepared by a third party. With respect to third party estimates of replacement cost, the regulations state specifically that they apply to |

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| | of which party is responsible for determining adequate coverage. Currently, the applicant/insured has full responsibility for providing to the insurer all information necessary for a non-binding estimate of coverage. The broker-agent assists the applicant/insured by utilizing that information to estimate replacement cost, sharing that information, but relying on the applicant/insured to determine the coverage amount best for them. It is very unclear to us how the process would work under the proposed regulations. Section 2695.183(a) reads in part, "the estimate of replacement cost shall include all expenses that would reasonably be incurred to rebuild the insured structure(s) in its entirely, including but not limited to:" and goes on to specify a list. (*emphasis added*). These terms are not only vague, but applied in combination with the other requirements of the regulations, create an impractical scenario for an applicant/insured and their broker-agent in a real-life setting by limiting the words and phrases that can be used, by restricting the ability of the licensee to communicate essential information in order to be able to offer a range of options and products.<br>Subdivision (j) is particularly unclear and yet the consequences of failing to comply create a de facto violation of Section 790.03.<br>(12) Consistency<br>Consistency is defined in Government Code Section 11349 (d) as "being in harmony with, and not in conflict with or contradictory to, existing statutes, court decisions, or other provisions of law. There is no agency discretion to promulgate a regulation which is inconsistent with the governing statute. *(Pulaski v. California Occupational Safety and Health Standards Board (1999) 75 Cal.App.4th 98).* An agency has no authority to promulgate a regulation that is inconsistent with controlling law. *(Communities for a Better Environment v. California Resources Agency (2002) 103 Cal.App.4th 98).*<br>As discussed above, Section 1749.85, applies to training curriculum for broker-agents (subdivision (a) and does place a requirement on real estate appraisers to calculate an estimate of | licensees, not homeowners. In consideration of this comment and others, the regulation's text has been amended to make it even more clear that it applies to licensees as follows: Section 2695.183: "No licensee shall communicate an estimate of replacement cost to an applicant or insured~~,~~ in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis unless the requirements and standards set forth in subdivisions (a) through (e) below are met:" Further, Section 2695.183 (o) has been added which reads: "No provision of this article shall limit or preclude an applicant or insured from obtaining his or her own estimate of replacement cost from an entity permitted to make such an estimate by Insurance Code section 1749.85. " Further, the comment refers to the "set" or "recommend" language found in the noticed regulations and argues that the broker-agent does not set policy limits. The regulations do not require or imply that the broker-agent set policy limits, in fact, the regulations specifically state otherwise. The "set" or "recommend" language referred specifically to the replacement cost estimate. However, based upon this comment and others, the words "set" and "recommend" have been eliminated from the regulations except for in amended Section 2695.183 (m) which states: "No provision of this article shall be construed as requiring a licensee to estimate replacement cost or to set or recommend a policy limit to an applicant or insured. No provision of this article shall be construed as requiring a licensee to advise the applicant or insured as to the sufficiency of an estimate of replacement cost."<br>(14) In response to this comment and others, proposed Section 2695.183 (e) has been amended. The amended section reads as follows: "The licensee shall no less frequently than annually take reasonable steps to verify that the sources and methods used to generate the estimate of replacement cost are kept current to reflect changes in the costs of reconstruction and rebuilding, including changes in labor, building materials, and |

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| | replacement value in accordance with regulations, if adopted by the Department (subdivision (d). The proposed regulations are inconsistent with the statute in that they go beyond training and curriculum and set out standards for estimating replacement cost for licensees (including broker-agents).<br>Also discussed above, the proposed Section 2695.183, is inconsistent with both *Everett v. State Farm* and *AIA v. Garamendi*.<br><u>Questions and issues on specific components of proposed Section 2695.183</u><br>(13 ) Proposed Section 2695.183 (a)<br>The terms, "all expenses that would reasonably be incurred" and "including but not limited to" are open to interpretation and subjective. How can a broker-agent ever be sure of compliance when that judgment will be made at a time of loss that could be far removed from the original process of estimating replacement cost? Currently, the applicant/insured has full responsibility for providing all information necessary for a non-binding estimate of coverage. The broker-agent may assist the applicant/insured by utilizing that information to estimate replacement cost, sharing that information, but relying on the applicant/insured to determine the coverage amount best for them. Does the Department intend that the proposed regulations will require a change in this practice?<br>Current practice also includes situations where an applicant/insured provides a contractor or other estimate of replacement cost prepared by a third party. Would that communication, which would likely include the terms "replace" or "replacement" trigger all of the requirements of this section and put the broker-agent in the position of having to verify that estimate by attempting to complying with subdivisions (a) through (e)?<br>Also, the terms "set" and "recommend" policy limits appear throughout this section inappropriately. The broker-agent does not set policy limits – the broker-agent may use the information | supplies, based upon the geographic location of the insured structure. The estimate of replacement cost shall be created using such reasonably current sources and methods." The regulations do not require that the insurer determine coverage upon renewals, simply that on an annual basis, the licensee take reasonable steps to ascertain that the methods used to estimate replacement costs are kept current. It is not the intent of the regulations to prevent licensees from making use of software tools. Instead, the regulations require that if a licensee uses a software tool, it takes reasonable steps to verify its reliability. This is not an onerous requirement for one holding an insurance license or certificate of authority considering the licensee is using the tool to estimate replacement cost for an applicant or insured.<br>(15) In response to this comment and others the proposed regulations have been amended to take into consideration communications over the phone as well as circumstances where a policy is never purchased in relation to record keeping requirements. Proposed Section 2695.183 (h) has been re-lettered as subdivision (g) and amended as follows: "(1) If a licensee communicates an estimate of replacement cost to an applicant or insured~~,~~ in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis, the licensee must provide a copy of the estimate of replacement cost to the applicant or insured at the time the estimate is communicated. However, in the event the estimate of replacement cost is communicated by a licensee to an applicant to whom the licensee determines an insurance policy shall not be issued, then the licensee is not required pursuant to the preceding sentence to provide a copy of the estimate of replacement cost. In the event the estimate of replacement cost is communicated by telephone to an insured, the copy of the estimate shall be mailed to the insured no later than three business days after the time of the telephone conversation. In the event the estimate of replacement cost is |

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| | provided by the applicant/insured to provide a non-binding estimate of replacement cost. The applicant/insured ultimately determines the appropriate coverage amount.<br>(14) Proposed Section 2695.183 (e)<br>The language requires the licensee to "take reasonable steps to verify that the sources and methods used to estimate replacement cost are kept current to reflect changes…" This subdivision also requires, "The estimate replacement cost shall be created using such current sources and methods." We would appreciate the Department explaining how a licensee can safely comply with this requirement. Particularly given that this section places the liability for failure to comply with any part of the regulation on the insurer, even if a third party estimate is used. Is it the Department's unstated intent to stop broker-agents from giving non-binding estimates using existing software tools?<br>We also question whether this subdivision, or perhaps subdivision (a), is meant to apply to renewals each year. This would create a new and burdensome requirement on insurers, essentially shifting the responsibility of determining coverage from the insured to the insurer – in direct violation of the *Everett* decision. It creates a situation where simply by sending the renewal notice, which includes the terms "replace" and/or "replacement" the requirements of complying with the standards (a) through (e) would apply or place the insurer at risk for being found to have violated Section 790.03 (per subdivision (j)). Can the Department explain what is intended? Does the Department intend to change existing law to force insurers to determine coverage upon renewals, even if a customer does not want this?<br>(15) Proposed Section 2695.183 (h)<br>Many broker-agents handle the initial discussions of a transaction over the phone. This proposed section would require a written copy of any estimate – even a construction cost estimate - to be provided if the discussion included any communication about a policy limit. Many consumers make such calls initially to get a general quote. Would a request for a quote trigger the written | communicated by telephone to an applicant, the copy of the estimate shall be mailed to the applicant no later than three business days after the applicant agrees to purchase the coverage (2) An estimate of replacement cost provided in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis must itemize the projected cost for each element specified in paragraphs (a)(1) through (a)(4), and shall identify the assumptions made for each of the components and features listed in paragraph (a)(5), of this Section 2695.183."<br>(16) In consideration of this comment and others Section 2695.183 (j) has been amended as noted in response to comment (6.1) above<br>(17) This is a restatement of comment (9) and the response thereto is incorporated fully herein.<br>(18) This, as well, is a restatement of comment (9) and the response thereto is incorporated fully herein.<br>(19) In consideration of this comment and others, at least insofar at the time period for the training, the proposed regulations have been amended to provide 180 days in which to comply with the training, rather than the 90 day time frame in the originally noticed proposed regulations. In this regard, proposed Section 2188.65 (b) is amended as follows: "On or after the day that is 180 days after the effective date of this section, every California resident fire and casualty broker-agent and personal lines broker-agent who has not already taken a homeowners' insurance valuation training course must satisfactorily complete one three-hour training course on homeowners' insurance valuation meeting the requirements of this section prior to estimating the replacement value of structures in connection with, or explaining the various levels of coverage under, a homeowners' insurance policy.. For resident broker-agents, this requirement shall be part of, and not in addition to, the continuing education requirements of Insurance Code section 1749.3. The homeowners' insurance |

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| | requirements of this section?<br>Also within this subdivision is a requirement to maintain records of estimates for applicants to whom a policy is never issued. We fail to understand the need for such record retention.<br>(16) Proposed Section 2695.183 (j)<br>We find this among the most troubling and confusing subdivisions in the proposed regulation. Discussed above, we question the restrictions on the communication – and the specific terms – between a broker-agent and an applicant/insured. The terms "replace" and "replacement" are terms contained in the required California Residential Property Insurance Disclosure (Insurance Code Section 10102). The Department is sponsoring a bill in the current legislative session, AB 2022 (Gaines), which we believe is in direct conflict with the proposed regulation.<br>The regulation prohibits a licensee from using the term "replace" or "replacement" if they choose to provide an estimate to the applicant or insured and fail to adhere to the specific and onerous standards outlined in Section 2695.183 subdivisions (a) through (e). The current California Residential Property Insurance Disclosure and AB 2022 (Gaines) is riddled with these terms and are included in the descriptions of each type of coverage listed in the disclosure form. Placing restrictions on how insurers, agents and brokers discuss the different coverage options listed in the disclosure form with the applicant/insured is inconsistent with the terminology outlined in the current statute and pending changes to that statute. Insurers are required by law to provide their policyholders with this disclosure form (which specifically uses the term "replacement")—this regulation clearly restricts communication between agents and their insureds. How is a licensee to describe the different coverage's listed in the current statutory form if they are prohibited from using such terms as "replace" or "replacement"? Would the proposed regulation actually require broker-agents to give estimates of replacement cost – a requirement which is not supported anywhere in California law? PIFC and its member companies are currently | valuation training course needs to be taken only once in order to satisfy the requirements of this subdivision (b)."<br>(20) This comment contends that Section 2695.183 fails to recognize the practical implications of the proposed regulations on the relationship and interaction between a broker-agent/insurer and the applicant/insured. There is nothing in this comment that identifies any section or subsection that supports this conclusion. Rather, it is a general statement that summarizes the first 19 comments. The regulations do not alter the way homeowners purchase insurance. There is no language in the regulations that create a requirement to offer guaranteed replacement coverage; the regulations do not prohibit discussions of insurance policy options (such as extended replacement cost coverage); the regulations do not mandate underwriting requirements; there is no implication in the regulations regarding agent broker motivations. In this regard, to make this even more clear, the proposed regulations have been amended to add subdivision (p) to Section 2695.183 as follows: "For purposes of this subdivision (p), "minimum amount of insurance" shall mean the lowest amount of insurance that an insurer requires to be purchased in order for the insurer to underwrite the coverage on a particular property, based upon an insurer's eligibility guidelines, underwriting practices and/or actuarial analysis. An insurer may communicate to an applicant or insured that an applicant or insured must purchase a minimum amount of insurance that does not comport with subdivisions (a) through (e) of this Section 2695.183; however, if the minimum amount of insurance that is communicated is based in whole or in part on an estimate of replacement value, the estimate of replacement value shall also be provided to the applicant or insured and shall comply with all applicable provisions of this article. Nothing in this article shall limit or preclude an insurer from agreeing to provide coverage for a policy limit that is greater than or less than an estimate of replacement cost provided |

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| | working with the Department to improve upon the existing California Residential Property Insurance Disclosure Form and Homeowners' Bill of Rights in an attempt to make it easier for the consumer to understand the types of coverage's that are offered in the marketplace. Providing consumers with information that helps them understand the types of coverage's that are available will help the consumer make a better choice when purchasing homeowners' insurance. This is the type of communication that all interested parties including the Department, consumer advocates and industry should continue to support.<br>(17) Proposed Section 2695.183 (l)<br>We would simply reiterate here our concerns, expressed repeatedly above, that restricting "communication" will be of no assistance to the applicant/insured. And though the Department may be attempting here to insulate itself from the contention that this section attempts to regulate underwriting in violation of existing law, the argument fails because a company's underwriting guidelines will dictate the need to communicate with an applicant/insured regarding the estimate in order to be able to offer the applicant/insured appropriate options, as illustrated in the example above.<br>(18) Proposed Section 2695.183 (m)<br>Similar to the concern described for subdivision (l), underwriting guidelines will generally require some type of estimate be prepared by the insurer if options such as extended coverage may be appropriately offered. And while this subdivision may offer liability protection to an insurer who does not provide an estimate, it does not appear to offer any protection to an insurer who provides an estimate whether in accordance with the standards set out in this section or an alternative estimate. Without such liability protection, many carriers would likely cease offering extended coverage, which the Insurance Commissioner has repeatedly stated he wants to encourage.<br>(19) Proposed Section 2695.183 – Other Comments | pursuant to this article." |

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| | PIFC has legal and practical concerns over the proposed regulation and the ability of the broker-agents and applicant/insured interaction to be effective should they be implemented. If the Department continues to move forward with the regulations as proposed, however, we would suggest an implementation date of no sooner than one year after the effective date. It will take at least that long for the training and the changes to the business operations that will be necessary.<br>(20) The proposed Section 2695.183 fails to recognize the practical implications of the proposed regulations on the relationship and interaction between a broker-agent/insurer and the applicant/insured. The Department is proposing to drastically alter the way homeowners purchase insurance and what help and options may be offered to them. PIFC companies have attempted to simulate the discussions under the requirements and constraints of the proposed regulation. Strictly adhering to the standards as prescribed leads us to believe that companies will, in effect, be offering Guaranteed Replacement Coverage, a coverage, as the Department points out, that is not generally offered in the market due to the inability to price the associated risk – and certainly not required by law to offer. Choosing not to estimate replacement cost in adherence to the standards, leaves the insurer in a position of having the communication with the applicant/insured severely restricted and because of those restrictions, being unable to offer certain coverage options – such as extended replacement cost – due to underwriting guidelines which require communication regarding replacement cost. Broker-agents have no motivation to sell a lower amount of coverage than is needed to their customer. The implications that agents and insurers do anything less than try to work with the customer to meet their needs is a constant source of frustration felt by the industry. The simple fact is that there is no guarantee under the proposed regulations of any fewer claims of underinsurance that will inevitably arise | |

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| | after each disaster compared to the number the complaints the Department receives under current law. With recognition of the impact to any homeowner who finds themselves with inadequate insurance at a time of loss – due to any number of reasons – the number of insureds in that situation are few compared to the overall insured homeowner population and even to those who suffer a loss. Yet, this proposal would disrupt the relationship and responsibilities of everyone who applies for and purchases homeowners' insurance.<br>PIFC supports improved and additional training requirements for broker-agents. We also support the Department's efforts to better educate homeowners on the importance of choosing adequate coverage limits. We look forward to continuing to work with the Department on ways to decrease the likelihood of insureds having inadequate coverage. The proposed regulation Section 2695.183, however, will not achieve that goal. We respectfully request that the Department withdraw this section from the proposed regulations and instead continue to support the current collective effort by the Department, consumer advocates and industry of AB 2022 (Gaines), a bill that we believe will provide consumers with the knowledge necessary to choose adequate coverage limits. | |
| **Personal Insurance Federation of California (PIFC) testimony given at May 17, 2010 Public Hearing in Los Angeles, CA** | KIMBERLY DELLINGER: Good morning. I'm Kimberly Dellinger. I'm here on behalf of the Personal Insurance Federation. Are members write more than 60 percent of the homeowners insurance in the State. We're very pleased to be here today and offer oral testimony, and will be providing written comments today, as well, also. And as Mr. Sektnan had the privilege of going first, I have the privilege of going last, apparently. And most of what I have to say has been said. But I do want to walk through, with your patience, my 12 pages isprobably, you know, down to a couple of comments that might add something to today's testimony. We've been pleased to participate, both staff and member company representatives, in the meetings and the process over the past few months. | **Response to Personal Insurance Federation of California (PIFC) testimony given at May 17, 2010 Public Hearing in Los Angeles, CA**: Ms. Dellinger testified on behalf of the Personal Insurance Federation of California (PIFC). As she mentioned, her organization's comments were provided in writing to the Department and those written comments have been presented in this Final Statement of Reasons, along with the Department's responses to the comments. In this regard, as Ms. Dellinger did not provide any different comments than those presented in the written comments, but rather, summarized those written comments, the Department incorporates fully herein its response to PIFC's written comments. |

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| | I mean, we have communicated fairly consistent<br>messages and provided some comments on the draft regulation, most of which, I would say, probably have not been addressed in the draft before us. We do support the additional training requirements. We think additional training, any information being given out that can be used in dealing with (inaudible) can be nothing but helpful. So we do support that, as we stated before. We have minor comments there. It is all legally written testimony and I'll walk through those now.<br>Our primary concern remains with Section 2699.183. And that is the standards. The concerns are both legal and practical and how they can possibly be implemented.<br>And again, I would start with the legal, most effectively covered by Mark Sektnan and Mr. Hogeboom; so I won't go through that entirely again. We believe the Department does lack the authority and has not, I believe, (inaudible)<br>Necessity and authority regulations, but those have been adequately.<br>I was going to focus some on the 1749 section on the training, but I have nothing other than what Mr. Hogeboom stated almost word-for-word with my testimony. So I will pass that as well. We do believe that nothing in the legislation or the legislative history, which I also went through, allows the Department to regulate agent/brokers in any way, other than to establish a curriculum. And we have no objection that portion. Also issues with 790.03. I'm in favor of the practices. I think those have been more than adequately stated as well as our concerns. Now, this is inconsistent with the AIA and with Garamandi. And again while these will all be in my written comments, I will not repeat everything that's been said here today. So if I can, I'll focus for the moment and go through, not each of the subdivisions, but a few of them. And a lot of these questions, are not<br>going to answered today. But we did want to let you know that while we had some basic legal concerns, that really, we've attempted over the past several weeks to work with | |

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| | member companies and really trying to walk through practically how will this work. We have the insurance agent runs, we have the insured -- how is this really going to work. Obviously, there are concerns about a shift of liability which has been stated and we're very concerned about really what happens here. And we're also concerned about out own customers and the confusion that's going to be created. Is there really any benefit or is this going to exacerbate the situation of, you know, potential miscommunication. I'll start with subdivision (a). And again, Mr. Sektnan mentioned this. Very briefly, the term "all expenses that would be reasonably incurred" and the other term "including but not limited to" are open to interpretation. How can a broker/agent ever be sure they are in compliance when that judgment will be made at the time of loss down the road, perhaps far beyond when that original communication took place. Currently, the applicant insured has full responsibility for providing all the information necessary for an agent/broker to help and provide a nonbinding estimate of coverage. We assist them. Sometimes there are tools. But it's a sharing of information, really, that begins with the insureds providing the information that would be necessary. And our question is: Does the Department intend with the proposed regulations to require a change in those practices. Current practice also includes the situation where an applicant comes in and provides maybe an unapproved contractor, or an unapproved third party, would that communication that occurs at that point and likely using the term to place a replacement, trigger all the requirements of this section, and put the broker/agent in the position of Having to verify that amendment by attempting to Comply with (a) through (e). Again, I think it's been mentioned before but the term "set" and "recommend" that appear throughout this section are really inappropriate. | |

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| | The broker/agent does not set policy on it. The broker/agent uses the information to try and help an insured come up with a replacement cost and appropriate coverage, but ultimately, both in practice and under current law, that position and duty lies with the insured. Section (e) briefly. I think that one has been covered. One of the questions that the comes up is whether, in this subdivision or maybe in (a) but somewhere throughout this regulation, we believe a new -- or actually apply after renewal as well, not just during the initial conversation. This would create a new and very burdensome requirement on insurers and clearly shift the responsibility at that point from the insured to the insurer or broker/agent about to determine coverage when it was in direct violation of current law. It creates a situation by simply sending the renewal of it, which does not include the term of replace or replacement. The requirement stated in (a) through (e) would apply or place the insured at risk to having violated 791.3. So you see this is a circle we can't get out of. And we're required to provide certain disclosures. We send a renewal notice. We're trying to be helpful. That triggers the responsibility for us to determine a new coverage amount, much like (inaudible) to a flame where it wasn't intended there and how they think it will actually work. Section (j). This is probably the most troubling and confusing subdivision of the proposed regulation. It has been brought up by a couple of -- we certainly question restriction on communication here between the broker/agent and the customer. We just don't -- we can't -- we haven't been able to walk through how that communication would work and we certainly don't see how it's beneficial. Again the terms "replacing" or "replacement" are terms that are in the disclosure and in the policy. How do you have a discussion and not use the terms? We think in the end, really, the insurer or | |

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| | agent/broker will have no option other than (a) through (e) because of the terminology. (Inaudible) have companies working on the Aims Bill 2022 audit disclosure. We think that's been an effective process and we think disclosures<br>are important and probably the direction we should,<br>rather than to set those of standards that seem to<br>get traps everywhere we look. Again (m) -- I don't have the language right in front of me. I think (m) was an attempt to say insurers do not have to do this. You don't have to supply it. But I think what you've heard from several<br>folks here today is the reality of what happens in a<br>conversation, and in order to be able to offer various options, which would extend the coverage, that there's no way around the agent/broker providing some kind of estimate.<br>Again, ultimately, it is the insured's choice, but there is just no way around that. And that, again, comes circles back to several legal arguments that this really is regulating it right.<br>I think that's -- I think rather than repeating what everybody said, I think that's probably it. We see the underlying intent, I think, is certainly to help the consumers. We know that there always places of underinsurance, particularly after<br>a disaster. I think that's true, while it's difficult<br>and/or unfortunate for those people, we'd like to figure a way around it, it will probably always exist.<br>And it's a pretty small percentage to completely disrupt and dismantle a system that probably is working pretty well. I think with additional training requirements and disclosure, we have been trying to solve that (inaudible). | |
| **Association of California Insurance Companies (ACIC) May 17, 2010 written** | The Association of California Insurance Companies (ACIC) is an affiliate of the Property Casualty Insurers Association of America and represents more than 300 property/casualty insurance companies doing business in California. These comments are submitted on behalf of ACIC member companies.<br>(1) Background | **Response to Association of California Insurance Companies (ACIC) May 17, 2010 written comments**:<br>(1) ACIC comments that it is concerned the regulation will have<br>the impact of shifting the responsibility for establishing policy limits from the insured to the insurer, in conflict with established California law. "It is up to the insured to determine |

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| **comments** | In general, ACIC members believe that the responsibility for determining the level of coverage provided in a homeowners insurance policy must be a decision that rests with the insured because that is the person who is seeking protection against potential financial loss; the insured is the person responsible for paying the premium on the policy; the insured is the person who determines his or her own ability to pay that premium; the insured will incur the financial loss consequences of a failure to adequately insure the asset. ACIC members believe that any regulations adopted by the department to control the estimating of replacement value for homes should adhere to the decision of the Court of Appeal in Everett v. State Farm General Insurance Co. (162 Cal.App.4th 649). In affirming the trial court's granting of the insurer's summary judgment motion, the court stated: "Insurance Code sections 10101 and 10102 do not require State Farm to set policy limits that equal the cost to replace the property. Nor is State Farm duty bound to set policy limits for insureds. It is up to the insured to determine<br>whether he or she has sufficient coverage for his or her needs."(Emphasis added.) In the final analysis it is the applicant's right and duty to determine the level of coverage to be purchased in a homeowners insurance policy.<br>Comments on Specific Sections<br>(2) Proposed Section 2188.65(a)(2)<br>The definition of "replacement value" should be amended to add language to clarify that the cost reflects the same quality of building materials and building footprint as the destroyed structure. Such language would help define the insurer's obligation in instances where insured's may seek modifications to their previous structure. This same language should be added to section 2695.180(b).<br>(3) Proposed Section 2188.65(b) To require every resident fire and casualty broker-agent to complete a three-hour training course within 90 days of the regulation's effective date is | whether he or she has sufficient coverage for his or her needs."*(Everett v. State Farm General Insurance Co. (162 Cal.App.4th 649).* The regulations do not do this, and in fact, the noticed regulations provided clearly in 2695.183 (m) that no provision shall be construed as requiring a licensee to estimate replacement cost to set, or recommend to an applicant or insured, a policy limit on a homeowners' insurance policy. However, in consideration of this comment and others, proposed subdivision (m) has been amended to make this concept even clearer: "No provision of this article shall be construed as requiring a licensee to estimate replacement cost or to set or recommend a policy limit to an applicant or insured. No provision of this article shall be construed as requiring a licensee to advise the applicant or insured as to the sufficiency of an estimate of replacement cost." The regulations do not require an insurer to set policy limits that equal the cost to replace the property, nor do the regulations establish a duty to set policy limits for insureds. The comment fails to provide a scenario to support this concern.<br>(2) In consideration of this comment and others, proposed Section 2188.65(a)(2) and Section 2695.180 (b) has been amended to state: "'Replacement value'" shall have the same meaning as "replacement cost" and is defined as the amount it would cost to repair, construct, rebuild or replace a damaged or destroyed structure."<br>(3) Based upon this comment and others the proposed regulation, Section 2188.65(b) has been amended to reflect the suggested 180 day time frame as opposed to the 90 day time frame referenced in the originally noticed regulations.<br>(4) The comment states that there is no need to retain the required documentation in the insured or applicant file as long as it is available elsewhere in the licensee's database. The regulations do not prohibit the documentation being kept in a database, but within the database must be an insured or applicant file. In other words, in order for the documentation to |

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| | unnecessarily hurried. Time will be needed for insurers to develop implementation plans for this new requirement. Licensees should be allowed a minimum of 180 days to complete the required training. A question arises as to whether the section applies to non-resident agents who already meet California continuing education requirements by virtue of their already complying with the continuing education requirements of their home state?<br>(4) Proposed Section 2695.182<br>Subsection (a) requires that the information specified in (1) through (4) be documented and maintained in the applicant's or insured's file. There is no need for the information specified in (1) and (2) to be maintained in each applicant's or insured's file so long as the information is readily available elsewhere in the insurer's or agent's database. Subsection (a)(3) should be amended to delete the term "determined" and instead use the term "estimated" to assure recognition of the distinction between a recommendation by a licensee and the decision which can only be made by the insured. Subsection (b) (4) would require a licensee to retain records relating to the preparation of an estimate for an "applicant to whom an insurance policy is never issued,…." Requiring insurers to maintain such records is not necessary and is a waste of resources. This subsection should be amended by deleting the last sentence in its entirety.<br>(5) Proposed Section 2695.183<br>The threshold issue raised by this section is whether the department has the authority to establish standards for calculating estimates of replacement value that are conducted by insurance licensees. Insurance Code § 1749.85 (d) authorizes the department to establish<br>standards for a real estate appraiser's estimates, but the statute does not authorize the establishment of standards for estimates conducted by other individuals. Subsection (d) was added to the statute to specifically authorize real estate appraisers to | be retrieved as to a particular applicant or insured, it must be available under some identifier so as to link it to that particular applicant or insured. As requested, the word "determined" has been removed from proposed Section 2695.182 (a) (3). Instead, the words "estimate" and "prepared" are now used. Regarding the comment that maintaining records for a policy that is never issued would be unnecessary and a waste or resources, proposed Section 2695.182 (b) has been amended and (c) has been added in response to this concern as follows: "(b) In the event the estimate of replacement cost is provided by a licensee to an applicant or insured~~,~~ in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis, the licensee shall maintain in the insured's file the records specified in subdivision (a) of this Section 2695.182 for the entire term of the insurance policy or the duration of coverage, whichever terminates later in time, and for five years thereafter. In the event the estimate of replacement cost is provided by a licensee to an applicant to whom an insurance policy is never issued, subdivision (a) of this Section 2695. shall not apply.<br>(c) Notwithstanding any other provision of this Section 2695.182, this section shall impose no duty upon a broker-agent to obtain from the insurer and maintain any information or document that in the absence of this section would not come into the possession of the broker-agent in the ordinary course of business."<br>(5) The comment argues that Section 1749.85 of the Insurance Code does not provide authority for the regulations insofar as they relate to regulation Section 2695.183, in particular. However, the comment fails to address Sections 730, 790.03, 790.04, 790.10, 1749.7, and 2051.5 of the Insurance Code, which are cited in addition to 1749.85. The sections, taken as a whole, provide authority for the regulations. The Department does not rely solely on the language of Subdivision (d) of Ins. Code section 1749.85 as authority to promulgate regulations |

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| | prepare estimates. Nothing in the legislative history of the statute suggests that the legislature intended to authorize the department broad authority to establish estimating standards applicable beyond real estate appraisers.<br>(6) The standards in section 2695.183 should apply only to real estate appraisers. The introductory sentence to this section would apply to a licensee who provides an estimate of replacement costs "to set or recommend a policy limit on a homeowners insurance policy for an applicant or insured…." This provision would implicitly shift the responsibility for establishing estimated replacement costs as the basis for setting policy limits for structures from the property owner to the insurer. That shift is unwarranted, unnecessary, and inadvisable.<br>(7) The language, contained in the first sentence of the section as well as subsections (e), (h) and (j), uses the term "set" to describe the action of a licensee. That term should be deleted throughout the proposed regulations because it fails to recognize the distinction between a licensee who recommends a policy limit and the applicant/insured who retains the responsibility to set and decide the policy limit.<br>(8) Subsection (a)(3) requires that estimates of replacement cost include "[a]ll components and features of the insured structure… including, but not limited to:…" Although this subsection lists specific aspects of an estimate that must be included, the use of the term "all" creates a gap in the provision's clarity because a licensee does not know what features, if any, may be required by the department other than those listed in (A) through (L). The word "all" should be deleted.<br>(9) Subsections (a)(3)(J) and (K) should be deleted. For example, architects plans may not be required and demolition costs may be covered under another part of the policy.<br>(10) Subsection (d) appears to be inconsistent with the | with respect to broker-agents. We do note the legislative history suggests that the Department does, in fact, have the authority to promulgate the regulations.<br>(6) The term "licensee" is comprehensively defined at § 2695.180(d), and that definition does not include real estate appraisers. The Department does not need to construe the term "real estate appraiser" as including licensee who make estimates of replacement value, since the Department manifestly has authority to regulate the conduct of its own licensees. (Indeed it would be highly incongruous and clearly not the intent of the Legislature for the Department to be given more authority to regulate real estate appraisers than its own licensees.) Subdivision (a) of Ins. Code Section 1749.85 give the commissioner the power to approve course content on the basis of whether or not it instructs broker-agents "in proper methods of estimating the replacement value of structures," at any rate. However, it is possible that a real estate appraiser may also be a licensee of the Department. Clearly, though, not all real estate appraisers are in fact licensees of the Department. The inclusion of the phrase "whether or not a licensee" in § 2695.181 of the proposed regulations is necessary in order to make clear that, even if a real estate appraiser is not a licensee, the estimate that the real estate appraiser produces must nonetheless satisfy the requirements expressed in subdivisions (a) through (e) of Section 2695.183. Since in that section those requirements are presented in terms of what a licensee must do, real estate appraisers could interpret those provisions as inapplicable to them, were in not for the inclusion of the phrase "whether or not a licensee" in §2695.181. The comment mentions, as well, that the terms "set" or "recommend" in some way would implicitly shift the responsibility for establishing estimated replacement costs. This is not the case. So as to make this more clear, the terms "set" and "recommend" have been removed from the amended proposed regulations other than a reference to them in Section |

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| | definition of replacement cost because this subsection prohibits a deduction for physical depreciation. This restriction should be deleted.<br>(11) Subsection (g) appears to be an attempt to hold licensees accountable for work done by other professionals. Use of third party vendors is common in any business enterprise and insurers' reliance on such vendors in this instance is clearly appropriate and lawful. More importantly, use of such vendors benefits an applicant who must make a decision regarding the level of coverage to obtain. Subsection (g) should be rewritten to allow vendors to certify the validity of their own estimates.<br>(12) Subsection (h) would require that a licensee provide a copy of the replacement cost estimate at the time the limit is set and further requires a copy of any revised estimate within 60 days from the time the estimate is generated. Several problems arise with these requirements. For example, in instances where the estimates are generated by obtaining information from applicants or insured over the telephone, providing a copy of the estimate at that time is impractical, maybe even impossible. Licensees should be allowed a reasonable period of time – perhaps 15 days – to provide the information. Furthermore, there is no valid reason for requiring licensees to provide copies of reports to applicants who are not issued policies.<br>(13) Subsection (i) should be amended to clarify that the record-keeping requirement only applies to a licensee who recommends a replacement estimate. The last sentence of the subsection should be deleted in its entirety to clarify that the record keeping applies only in instances where a policy is actually written.<br>(14) Subsection (j) provides that use of the word "replace" or "replacement" applicable to any estimate of construction costs not in compliance with this section constitutes a misleading statement violative of Insurance Code §790.03. Section 790.03 cannot be relied upon as authority for subsection (j) because | 2695.183 (m) which provides that nothing in the regulations requires a licensee to set or recommend policy limits, as follows: "No provision of this article shall be construed as requiring a licensee to prepare, communicate, or use an estimate of replacement cost to set~~,~~ or recommend a policy limit…"<br>(7) The comment misread the noticed regulation as the terms "set" and "recommend" apply to the estimate of replacement cost, and do not apply to a licensee setting or recommending policy limits. Again, as referenced in response to comment (6), those terms have been removed from the regulation other than their reference in Section 2696.183 (m).<br>(8) In consideration of this comment, and others, the Department has amended Section 2695.183 as follows: "(a) The estimate of replacement cost shall include the expenses that would reasonably be incurred to rebuild the insured structure(s) in its entirety, including at least the following:…"<br>(9) The regulations require that an estimate communicated to an applicant or insured be complete. To omit two important cost factors that are reasonably incurred in the rebuilding of a dwelling structure would render the estimate incomplete, less accurate and misleading. Also, demolition and debris removal costs are a primary component of the replacement and a rebuilding of a structure and these costs are covered under all homeowners' policies under the coverage for the dwelling structure. The fact that many policies provide for additional or enhanced coverage for demolition and debris removal should not remove this component from an estimate of replacement cost. Notwithstanding this, proposed Section 2695.183 has been amended, including re-numbering and re-lettering to make the proposed Section more clear. 2695.183 (a) (2) now reads: "Cost of Demolition and debris removal" and (a) (4) now reads " Cost of permits and architect's plans…" It is important for these components to be considered when estimating replacement cost, as costs related to demolition and debris removal as well as permits and architect's plans are necessarily |

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| | the subsection would create entirely new substantive requirements for licensees to follow as a condition to using those terms like "replacement." Under the guise of definition, the regulation substantively expands the prohibition of the Unfair Claims Practices Act. That cannot be done by regulation, but must done, if at all, by legislation. (15) ACIC also believes that the regulations should more thoroughly and carefully incorporate ecommerce concepts into these provisions. As more and more insurers – indeed commerce generally – is conducted on the Internet, further analysis is warranted to assure that these regulations adequately recognize the realities of that aspect of the insurance business. For example, in e-commerce an insurer may provide an insurance quote based solely on information provided by the applicant. The applicant may then purchase a policy – in some instances without ever speaking with an insurance agent or broker. Application of the proposed regulations to these circumstances should be examined and clarified. (16) As a final note, ACIC would like to suggest that the department consider the potential real world impact of promulgating these regulations. By creating a cumbersome and costly process for providing customers with estimates of home construction costs that are necessary for the purpose of determining insurance coverage, the department may be exposing insurers and agents to substantially enhanced liability in those instances where they fail to strictly adhere to the specified estimating requirements. Faced with potentially significant liability, insurers and agents may decide that state law, in effect, thwarts their ability to serve potential customers. The department could find Insurers and agents declining the opportunity to assist customers in making their own determinations about the scope of their homeowners' insurance coverage. ACIC believes that such an unintended, but perfectly legitimate, consequence would be a disservice to the insurance marketplace. It is ACIC's position that the changes described in this statement must be | related to the cost of rebuilding a structure. Pursuant to new subdivision (p) in proposed Section 2695.183, a licensee is not required to estimate replacement cost, necessarily, in communicating that an applicant or insured must purchase a minimum amount of insurance: "For purposes of this subdivision (p), "minimum amount of insurance" shall mean the lowest amount of insurance that an insurer requires to be purchased in order for the insurer to underwrite the coverage on a particular property, based upon an insurer's eligibility guidelines, underwriting practices and/or actuarial analysis. An insurer may communicate to an applicant or insured that an applicant or insured must purchase a minimum amount of insurance that does not comport with subdivisions (a) through (e) of this Section 2695.183; however, if the minimum amount of insurance that is communicated is based in whole or in part on an estimate of replacement value, the estimate of replacement value shall also be provided to the applicant or insured and shall comply with all applicable provisions of this article. Nothing in this article shall limit or preclude an insurer from agreeing to provide coverage for a policy limit that is greater than or less than an estimate of replacement cost provided pursuant to this article."<br>(10) 2695.183 (d) is not inconsistent with the definition of replacement cost as Insurance Code Section 2051.5(a) prohibits the deduction for physical depreciation under a replacement cost policy. This statute reads: "Under an open policy that requires payment of the replacement cost for a loss, the measure of indemnity is the amount that it would cost the insured to repair, rebuild, or replace the thing lost or injured, without a deduction for physical depreciation, or the policy limit, whichever is less." The intent of not including reference to physical depreciation in Section 2695.180(b) is that including it creates a more narrow definition of when these regulations would be triggered. For example, if we had a "physical depreciation " reference in Section 2695.180(b), a licensee |

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| | incorporated. | could attempt to assert that its estimate *does* deduct for physical depreciation, and therefore, does not fall under the definitions of "replacement cost" or "estimate of replacement cost" so the entire regulations do not apply to the licensees estimates. This would result in a licensee being able to circumvent the regulations. Also, since Section 2695.183(d) expressly prohibits a deduction for physical depreciation, referencing this term in Section 2695.180(b) is unnecessary.<br>(11) The comment states that a licensee should not be required to verify the validity of a third party source used by a licensee to estimate replacement cost, and instead, argues that the third party source should "certify the validity of their own estimates." Simply put, it is not the third party source that has the relationship with the insured or applicant, nor is it the third party source communicating a replacement cost estimate to an insured or applicant. In this regard, the licensee is required to take reasonable steps to assure that the tools he or she or it is using are reliable. Understanding that in some cases, agents and brokers may be compelled by insurers to use specific sources or tools to estimate replacement cost, and to make clear that the agents and brokers are not bound by obligation to verify the validity of the source, noticed Section 2695.183 (g) has been amended and re-lettered. It is now subdivision (f) and states a follows: "Except as provided in subdivision (k) of this Section 2695.183, the provisions of this article are binding upon licensees…" Proposed subdivision (k) now reads: "When an insurer identifies ~~a~~ one or more specific sources or tools that a broker agent must use to create an estimate of replacement cost,<br>(1) the insurer shall prescribe complete written procedures to be followed by broker-agents when they use the sources or tools,<br>(2) the insurer shall provide the broker-agent with the training and written training materials necessary to properly utilize the sources or tools according to the insurer's prescribed procedures, and |

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| | | (3) the insurer, and not the broker-agent, shall be responsible for any noncompliance with this Section 2695.183 that results from the failure of the estimate to satisfy the requirements of subdivisions (a) through (e), unless that noncompliance results from failure by the broker-agent to follow the insurer's prescribed written procedures when using the source or tool."<br>(12) The Department accepts this point. Based on this comment, and others, new (h) has been added to Section 2695.183 (h) has been amended and re-lettered as proposed subdivision (g) as follows "(1) If a licensee communicates an estimate of replacement cost to an applicant or insured, in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis, the licensee must provide a copy of the estimate of replacement cost to the applicant or insured at the time the estimate is communicated. However, in the event the estimate of replacement cost is communicated by a licensee to an applicant to whom the licensee determines an insurance policy shall not be issued, then the licensee is not required pursuant to the preceding sentence to provide a copy of the estimate of replacement cost. In the event the estimate of replacement cost is communicated by telephone to an insured, the copy of the estimate shall be mailed to the insured no later than three business days after the time of the telephone conversation. In the event the estimate of replacement cost is communicated by telephone to an applicant, the copy of the estimate shall be mailed to the applicant no later than three business days after the applicant agrees to purchase the coverage (2) An estimate of replacement cost provided in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis must itemize the projected cost for each element specified in paragraphs (a)(1) through (a)(4), and shall identify the assumptions made for each of the components and features listed in paragraph (a)(5), of this |

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| | | Section 2695.183."<br>(13) In consideration of this comment and others, 2695.183 (i) is amended as follows: "Licensees shall maintain (1) a record of the information supplied by the applicant or insured that is used by the licensee to generate the estimate of replacement cost, and (2) a copy of any estimate of replacement cost supplied to the applicant or insured pursuant to paragraph (g)(1), or subdivision (h), of this Section 2695.183. If a policy is issued, these records and copies shall be maintained for the entire term of the insurance policy or the duration of coverage, whichever terminates later in time, and for five years thereafter. However, if the estimate of replacement cost is provided to an applicant to whom an insurance policy is never issued, the records and copies referred to in the first sentence of this subdivision (i) shall be maintained for the period of time the licensee ordinarily maintains applicant files in the normal course of business, provided that such period of time shall be at least sufficient to ensure that the licensee is able to comply with the provisions of this subdivision in the event the policy is issued to the applicant."<br>(14) The Department does have the authority to promulgate regulations concerning Insurance Code Section 790.03 pursuant to Insurance Code Section 790.10 which states: "The commissioner shall, from time to time as conditions warrant, after notice and public hearing, promulgate reasonable rules and regulations, and amendments and additions thereto, as are necessary to administer this article." Proposed Section 2695.183 (j) has been amended to read: "To communicate an estimate of replacement value not comporting with subdivisions (a) through (e) of this Section 2695.183 to an applicant or insured in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis constitutes making a statement with respect to the business of insurance which is misleading and which by the exercise of reasonable care should be known to be |

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| | | misleading, pursuant to Insurance Code section 790.03." This amendment also removes the express prohibition of using the terms "replace" and "replacement", which appears to be the main reason for this concern and comment.<br>(15) The Department appreciates the comment that more and more commerce is conducted on the Internet The comment requests that there be further analysis to assure that these regulations adequately "recognize the realities of that aspect of the insurance business." The comment suggests that, in e-commerce, an insurer may provide an insurance quote "based solely on information provided by the applicant" and that the applicant may purchase a policy without every speaking with an agent or broker. In fact, the regulations have been constructed with these issues in mind. Proposed Section 2695.183 (m) specifically states that no provision of the article shall be construed as requiring a licensee to estimate replacement cost to recommend a policy limit. Further, this subdivision states clearly that no provision of article shall be construed as requiring a licensee to advise an applicant or insured whether a replacement cost estimate is sufficient. In this regard. Further, subdivision (o) states specifically that no provision of the article shall preclude and applicant or insured from obtaining his own estimate of replacement cost. In this regard, the regulations do take into consideration various circumstances, including those which may involve internet transactions and phone transactions; and situations where the applicant or insured wishes to obtain their own estimate of replacement cost<br>(16) Again, the Department appreciates ACIC's concerns regarding the real world impact of the proposed regulations. The regulations have been written with the "real world" in mind and the proposed regulations in fact will make the transaction process less confusing, more workable and more efficient. As the rulemaking file makes clear, there is great confusion now regarding what is meant by the concept of estimated replacement cost. These proposed regulations make crystal |

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| | | clear what is to be considered in creating an estimate of replacement cost. ACIC is concerned that the regulations are "creating a cumbersome and costly process for providing customers with estimates of home construction costs that are necessary for the purpose of determining insurance coverage." In fact, the proposed regulations establish an organized, straight forward approach that eliminates confusion for consumers and licensees as to what is required when estimating replacement cost and communicating the estimates. The comment states its conclusion that the "department may be exposing insurers and agents to substantially enhanced liability in those instances where they fail to strictly adhere to the specified estimating requirements." However, ACIC fails to identify any provisions in the proposed regulations that support the comment. The opposite is true. The regulations are not cumbersome or difficult to follow. The obligations of a licensee are clear with respect to communications concerning estimating replacement cost. |
| **Association of California Insurance Companies (ACIC) testimony given at May 17, 2010 Public Hearing in Los Angeles, CA** | MARK SEKTNAN: Good morning. I'm violating the general that one should never go first. But there wasn't a flurry out there so I decided to step up. By name is Mark Sektnan. I'm with the Association of California Insurance Companies. And I thank you for the opportunity to be here today. We do have several concerns with the proposed regulations, some of which I'll cover in my statement today. We will provide a statement before the end of business today I also want to thank you for providing the pre-notice discussion that we had earlier. Several of the issues that we had brought up in the pre-notice discussions have been addressed in regulation. In general, ACIC members believe that the responsibility for determining the level of coverage provided in a homeowners insurance policy must be a decision that rests with the insured. Quite simply, it is the insured who is paying the premium. It is the insured who is insuring the risk. And it is the insured who has the greatest | **Response to Association of California Insurance Companies (ACIC) testimony given at May 17, 2010 Public Hearing in Los Angeles, CA**: Mr. Sektnan testified on behalf of the Association of California Insurance Companies (ACIC). As he mentioned, his organization's comments were provided in writing to the Department and those written comments have been presented in this Final Statement of Reasons, along with the Department's responses to the comments. In this regard, as Mr. Sektanan did not provide any different comments than those presented in the written comments, but rather, summarized those written comments, the Department incorporates fully herein its response to ACIC's written comments. |

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| | knowledge of what their property may or may not be worth. They are the ones that know whether or not they have specialty furnishings. They're the ones that know whether or not they have special concern with their own construction.<br>ACIC members also believe that any regulations adopted by the Department to control the estimated replacement value for homes should adhere to the decision of the Court of Appeal in Everett v. State Farm General Insurance Co., which again points out that it is the insured that makes these types of decisions insurance. The insurance company's responsibility is to recommend and to work with their insureds for the ultimate decision to make sure they are being insured.<br>Now, to make a comment on some of the specific sections.<br>Proposed Section 2188.65(a)(2): The definition of "replacement value" should be amended to add language to clarify that the cost reflects the same quality of building materials and building footprint as the destroyed structure.<br>Such language would help define the insurer's obligation in instances where insureds may seek modifications to the previous structure. This same language should also be added to Section 2695.180(b). All of these code sites will be in my written testimony, which I will submit at the end of the day. In Section 2188.65(b), we feel that 90 days is too short of a period to require the fire and casualty broker-agents to have all their training done. We think it might be -- because it's going to take time for the insurers to set up their programs. It's going to take time for the third-party vendors to set up their programs, we think they should be allowed a minimum of 180 days to complete their required training.<br>There is also a question as to whether or not the section applies to non-resident agents who have already met the California continuing education requirements by virtue of complying with the continuing education requirements in their home state. That's something you might want to take a look at. Proposed Section 2695.182. Subsection (a) requires that | |

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| | the information specified in various sections be documented and maintained in the applicants or insured's file. We don't believe that there's any need to maintain this information in each applicant's or insured's file so long as the information is available elsewhere in the insurer's or agent' database. A lot of this is not policy, but it is information that is shared on the mainframe. And we think as long as it's successful, it should meet the criteria specified by the Department. 7 Subsection (a)(3) should be amended to delete the term "determined" and use the term "estimated" to assure recognition of the distinction noted above between a recommendation by a licensee and the actual coverage decision which can only be made by the insured. Subsection (b) would require a licensee to retain records relating to the preparation of an estimate for an "applicant to whom an insurance policy is never issued...." Requiring insurers to maintain such records is not necessary and would be waste of their resources. This subsection should be amended by deleting the last sentence. Proposed Section 2695.183, we generally question the Department's authority to establish<br>standards for calculating estimates of replacement<br>value that are conducted by insurance licensees. This statute very clearly provides the Department the authority to do this for real estate appraisers, but it is silent on the issue of<br>insurance licenses. And we believe that the Legislature did not give the Department the authority to draft these types of rules for licensees. We also have the following specific<br>concerns with the proposed regulations. In Section 2695.183, which is the bulk of it, Subsection (a), that first kind of non – first opening paragraph, the language contained in this subsection as well as the subsections (e), (h) and (j), uses the term "set" to describe the action of a licensee. That term should be deleted throughout the proposed regulations because it fails to recognize the distinction between the licensee who recommends the policy limit and the applicant/insured who retains the responsibility to decide the policy limit. Some of these issues were addressed in | |

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| | the pre-notice discussion conversation we had, but they still remain in other places. The language in this section should also be amended to clarify that the record-keeping requirement only applies to a licensee who recommends a replacement estimate which is used by the applicant to set the policy limit. And Subsection 2695.183(a)(3) -- and I have to say, I did have a hard time following all the numbering, especially on the Internet, the section was very hard to read -- requires that estimates of replacement costs including "all components and features of the insured structure...including, but not limited to:..." Although this subjection lists specific aspects of an estimate that must be included, the use of the term "all" creates a gap in the provisions's clarity because a licensee does not know what features, if any, may be required by the Department other than those listed in (A) through (L). The word "all" should be deleted. Subsections (a)(3)(J) and (K) should be deleted. Architect plans are not always required and demolition costs may be covered under another part of the policy. Subdivision (g) appears to be an attempt to hold licensees accountable for work done by other professionals. Use of third-party vendors is common in any business enterprise and insurers' reliance on such vendors in this instance is clearly appropriate and lawful. More importantly, the use of such vendors benefits an applicant who must make a decision regarding the level of coverage to obtain. Subsection (g) should be rewritten to allow vendors to certify the validity of their own estimates.<br>Subdivision (h) would require that a licensee provide a copy of the replacement cost estimate at the time the recommendation is made and further requires a copy of any revised estimate within 60 days from the time the estimate is generated. Several problems arise with these requirements. For example, in instances where the estimates are generated by obtaining information from applicants or insureds over the telephone, | |

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| | providing them with a copy of the estimate at this time is impractical, probably even impossible. Licensees should be allowed a reasonable period of time -- perhaps 15 days -- to provide the information. Furthermore, there is no valid reason for requiring licensees to provide copies of reports to applicants who are not issued policies.<br>ACIC appreciates the opportunity to comment on the proposed regulations. We will submit our final comments before the end of the day. | |
| **Agents and Brokers Association of California written comments May 17, 2010** | On April 2, 2010, the California Department of Insurance ("Department") issued a Notice of Proposed Action (the "Notice") and an Initial Statement of Reasons, pursuant to which the Insurance Commissioner ("Commissioner") proposed to adopt regulations regarding fire and casualty broker-agents' duties to ensure the accuracy of homeowners' insurance replacement value estimates (the "Proposed Regulations"). The Notice permits written comments to be submitted no later than 5:00 p.m. on May 17, 2004, with a public hearing scheduled for 10:00 am that same day.<br>These written comments set forth legal and policy objections to the Proposed Regulations.<br>During our testimony at the May 17th public hearing, we suggested that the Commissioner reconsider and withdraw the Proposed Regulations.<br>A. Background of Interested Persons Opposing the Regulation<br>Insurance Agents and Brokers Association of California (the "Association") is a non-profit<br>trade association dedicated to protecting the rights of licensed property and casualty producers, both independent and captive.<br>B. Summary of the Regulations<br>The Proposed Regulations affect the duties of California producers in selling and soliciting homeowners' insurance and would do the following:<br>• Add new § 2188.65 to the California Code of | **Response to Agents and Brokers Association of California written comments May 17, 2010:** The commenter's first comments directed to the proposed text of regulation summarize the proposed regulations. The commentary is fairly accurate, up until the section entitled "Summary of Objections," discussed at length below. However, certain statements made in the introductory sections require correction, as follows.<br>(1) The record keeping requirements set forth in the proposed regulations are not onerous. They merely require producers to maintain records of the estimates they provide to insureds, as well as the supporting documents and information used to generated those estimates. It is a common business practice in many fields for businesses bidding on a job to retain the quotes they produce and the documents and information upon which those quotes are based. Maintaining these records is merely prudent and is therefore a practice which many producers do and would undertake even in the absence of regulations. Furthermore, in the amended text of regulation the Department has added language clarifying that the regulations do not require producers to maintain documents or information that would not come into their possession in the ordinary course of business. Section 2695.183©. In light of these facts, it is simply inaccurate to characterize as onerous the record keeping requirements set forth in the proposed regulations.<br>(2) The proposed regulations do not, in fact, "make it the legal obligation of the producers to ensure that new standards for |

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| | Regulations ("CCR");<br>• Amend existing § 2190.2 of the CCR;<br>• Amend existing § 2190.3 of the CCR; and<br>• Add new Article 1.3 to the CCR.<br>The Proposed Regulations (a) set forth additional educational requirements for fire and casualty broker-agents and personal-lines broker-agents (referred to herein simply as "producers" or "licensees"); (b) impose (1) onerous record maintenance requirements on such producers; and (c) (2) make it the legal obligation of the producers to ensure that new standards for providing estimates of replacement or construction costs are met in each insurance transaction. The amendments to §§ 2190.2 and 2190.3 conform existing regulations to the proposed new records maintenance requirements added by Proposed Regulation § 2695.182.<br>Training. Proposed new § 2188.65 would require resident producers to take one 3-hour training course on homeowners' insurance valuation. Subsection (d) of that proposed provisions sets forth details of what topics the course must include.<br>Records Maintenance. Under the Proposed Regulation, any licensee who provides an estimate of replacement cost or construction cost to an applicant or insured would be required to document and maintain in its files specified information including the source from or method by which the value was determined and a copy of any reports or other documents used to estimate the value. See Proposed § 2695.182. Licensees are further required to keep records of any information supplied by the applicant/insured that is used to generate the estimate and a copy of the estimate given to the applicant/insured. See Proposed § 2695.183(i). All of the listed information must be kept for the later of the term of the policy or the duration of coverage plus 5 years thereafter. (3) Licensees are also required to keep this information even if the estimate is provided to an applicant to whom a policy was | providing estimates of replacement costs are met in each insurance transaction." If the producer does not estimate replacement value, then the regulations do not oblige the producer to follow the standards. In cases where it is the insurer and not the producer that is producing the estimate, it is the insurer and not the producer that must ensure the standards are followed.<br>(3) In the amended text of regulation we have deleted the language requiring records to be kept for estimates given to applicants to whom a policy is never issued.<br>(4) Here, the commenter ignores the fact that if a licensee does not estimate replacement value, then the proposed regulations impose no duty upon the licensee beyond the requirement that producers receive the necessary training. Accordingly, his reference to "these requirements" is overbroad. It is true, however, that the proposed regulations prohibit licensees from escaping their responsibility not to make misleading statements to applicants or insureds by first having a third party source produce the misleading statement and then conveying it to the applicant or insured. In this situation, the licensee has indeed made a misleading statement, notwithstanding the fact that the misleading statement was produced on behalf of the licensee by another.<br>(5) The commenter describes the exceptions to proposed Section 2695.183 stated in subdivision (*l*) as "very limited." Again, the commenter omits to mention that the scope of proposed Section 2695.183 is limited by the section's own terms to communications made by a licensee of an estimate of replacement value. No other communications fall within the section's purview. Accordingly, for all practical purposes the exceptions to proposed Section 2695.183 are in fact very broad indeed, since most communications by licensees are utterly unaffected by the proposed regulations in the first place.<br>(6) It would be more accurate to say that the proposed regulations are necessary to ensure that replacement cost |

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| | never issued – in such cases, the documents must be maintained for 3 years following the time the estimate is generated.<br>Standards for Replacement or Construction Cost Estimates. Proposed § 2695.183 provides that no insurance licensee can provide an estimate of replacement cost or can rely on an estimate of replacement cost in connection with setting or recommending a homeowners' policy limit unless the requirements of subdivision (a) through (e) of that regulation are met. Briefly, those subdivisions provide:<br>(a) The estimate must include all expenses that would reasonably be incurred to rebuild the insured structure in its entirely including the specific information listed at 2695.183(a).<br>(b) The estimate must be based on an estimate of the cost to rebuild or replace the structure taking into account the cost to reconstruct the single property (as opposed to the cost to build multiple or tract properties).<br>(c) The estimate must not be based on the resale value of the land or the amount or outstanding balance of any loan.<br>(d) The estimate must not include deduction for physical depreciation.<br>(e) A licensee that estimates replacement cost (or relies on the estimate of another) "shall take reasonable steps to verify that the sources and methods used to estimate replacement cost are kept current to reflect changes in the cost of reconstruction and rebuilding…"<br>The regulations prohibit the consideration of "demand surges" that may occur after major events such as an earthquake or wildfire. Demand surge is defined as "a phenomenon characterized by a substantial increase in the cost of construction due to unusually high demand for contractors, building supplies and construction labor." The producer must inform the consumer of the fact that the estimate does not consider demand surges. | estimates are complete and have a chance of being more accurate. In essence, the regulations merely set forth the various components of a dwelling that typically need to be replaced in the event of a total loss. The proposed regulations do not purport to ensure that all such estimates turn out to be absolutely accurate. The regulations do, however, proceed from the basis that it is a misleading statement to communicate an estimate that is incomplete and that omits consideration of certain components of a dwelling known to require replacement in the event of a total loss. In other words, calling something a replacement cost estimate when what is being estimated is necessarily something less than what it could take to replace the structure is a misleading statement. Not a single commenter has called into question this basic premise, because it is so obviously true.<br>(7) Each of the assertions in items (1) through (5) of section C. of the document is to a certain degree false. Similar comments and assertions were responded to above and the same responses apply here. The Department does not contest the assertion in item (4), however, since in the amended text of regulation we have eliminated the record keeping requirement in cases where no insurance policy was ever issued.<br>(8) To the contrary, the proposed regulations easily satisfy each of the named standards of the Administrative Procedure Act (the APA).<br>(9) This statement is meritless, for two reasons: Insurance Code Section 1749.85, not Section 1749.85(d), is listed as reference, and Section 1749.85 is not *the* reference for the proposed regulations. Rather, it is one of multiple reference sections listed as reference. Further, Insurance Code Section 1749.85(a) also provides reference for the proposed regulations.<br>(10) Even if the assertions preceding this point in the sentence were true (which they are not), this conclusion would be a *non sequitur*. Here and in the following paragraph the commenter confuses and conflates the two distinct concepts of necessity |

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| | (4) The Proposed Regulation specifies that these requirements and standards are "binding" upon the licensee even if the estimate is based on information, data or statistical methods obtained through a third party source. See Proposed § 2695.183(g). The licensee must also provide a copy of the estimate to the applicant or insured "at the time the policy limit is set, recommended or is otherwise the subject of communication by the licensee." See Proposed § 2695.183(h).<br>Section 2695.183(j) states that using the word "replace" or "replacement" when setting policy limits when the estimate does not comply with the regulation is deemed to be misleading pursuant to Code § 790.03.<br>Section 2695.183(k) addresses when an insurer requires a producer to use a specific source or tool for creating estimates. The insurer must prescribe procedures to be followed by the producer and must provide training. The insurer, and not the producer, "shall be responsible for any noncompliance" with the Proposed Regulations (unless the noncompliance results from the producer's failure to follow the insurer's procedures).<br>Subdivision (l) states that section 2695.183 applies "to all communications by a license," with (5) very limited exceptions, that concern the insurer's underwriting decisions and that never come to the attention of the applicant or insured. Finally, subdivision (m) states that nothing in the Article requires a licensee to estimate replacement costs or advise applicant/insureds as to the sufficiency of such an estimate.<br>The Department's Initial Statement of Reasons indicates that the Proposed Regulations were precipitated by a large number of consumer complaints file with the Department after Southern California wildfires. Many California residents lost their homes in the wildfires and discovered that their homeowners' insurance was insufficient to cover the costs to rebuild their homes. Thus, (6) the Department claims that the | and authority. The Department indeed does have express and implied authority to promulgate these regulations, and there is ample material in the rulemaking file to support a showing of necessity.<br>(11) The regulations do not expand the scope of Insurance Code Section 790.03. Insurance Code Section 790(b) identifies as a prohibited act the making of misleading statements with respect to the business of insurance which should be known to be misleading. For a licensee to communicate an estimate of replacement cost where not all the components that may need to be replaced, or other necessary costs, are included in the estimate is just such a misleading statement.<br>(12) The Department does not use the term "real estate appraiser" to refer to its licensees. The term "licensee" is comprehensively defined at proposed Section 2695.180(d), and that definition does not include real estate appraisers. The Department does not need to construe the term "real estate appraiser" as including licensee who make estimates of replacement costs, since the Department manifestly has authority to regulate the conduct of its own licensees. (Indeed it would be highly incongruous and clearly not the intent of the Legislature for the Department to be given more authority to regulate real estate appraisers than its own licensees.)<br>Subdivision (a) of Insurance Code Section 1749.85 give the commissioner the power to approve course content on the basis of whether or not it instructs broker-agents "in proper methods of estimating the replacement value of structures," at any rate. However, it is possible that a real estate appraiser may also be a licensee of the Department. Clearly, though, not all real estate appraisers are in fact licensees of the Department. The inclusion of the phrase "whether or not a licensee" in proposed Section 2695.181 of the proposed regulations is necessary in order to make clear that, even if a real estate appraiser is not a licensee, the estimate that the real estate appraiser produces must nonetheless satisfy the requirements expressed in |

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| | Proposed Regulations are necessary to ensure that replacement cost estimates given to consumers by producers are accurate.<br>(7) C. Summary of the Objections<br>(1) The Proposed Regulations lack authority and reference; Insurance Code § 1749.85 does not support their enactment.<br>(2) Similarly, Insurance Code §790.03 is not proper authority or reference for Proposed Regulation §2695.183(j)<br>(3) The Commissioner has failed to establish the necessity of the Proposed Regulations.<br>(4) There is no necessity for the requirement that producers retain records on estimates provided when no insurance was ever issued.<br>(5) The Proposed Regulations impose an unnecessary burden on insurance producers and serve no purpose but to open insurance producers to unfair penalties and civil litigation.<br>D. Legal Analysis of the Proposed Regulations<br>Under California law, regulations must be consistent and not in conflict with the authorizing statute and must be reasonably necessary to effectuate the statute's purpose. See Cal. Gov't Code § 11342.2. Furthermore, the Office of Administrative Law ("OAL"), which is charged with reviewing state agency regulations, does so in accordance with certain standards prescribed byGovernment Code § 11349.1, including consistency with existing law, necessity, clarity, and non-duplication. Also, there must be proper statutory authority and reference for the Proposed Regulations, such that the Commissioner is implementing or interpreting an existing law as opposed to creating a new law which invades the province of the Legislature. See Cal Gov't Code §§ 11349 and 11349.1. (8) The Proposed Regulations pose a number of problems with respect to these standards.<br>(1) Authority and Reference<br>(9) The reference for the Proposed Regulations | subdivisions (a) through (e) of proposed Section 2695.183. Since in that section those requirements are presented in terms of what a licensee must do, real estate appraisers could interpret those provisions as inapplicable to them, were in not for the inclusion of the phrase "whether or not a licensee" in proposed Section 2695.181.<br>(13) We agree that the term "real estate appraiser" has a plain meaning and therefore does not require definition in these regulations. However, we do not necessarily agree, nor do the regulations require, that in order for proposed Section 2695.181 to apply to a real estate appraiser, that person must be a licensed real estate appraiser. The Legislature obviously knew how to say "licensed appraisers," since it did so in the preceding subdivision. Insurance Code Section 1749.85, sub©(c). Since it did so restrict the term "real estate appraisers" in Subdivison (c), it is fair to read the language in Subdivision (d) as applying to any and all real estate appraisers, whether or not licensed as such. Accordingly it is proper that the proposed regulations likewise refrain from thus restricting the meaning of the term.<br>(14) The legislative history cited by the commenter is inapposite, since the Department does not rely on the language of Subdivision (d) of Insurance Code Section 1749.85 as reference to promulgate regulations with respect to broker-agents.<br>(14.5) We do note, however, that the sentence emphasized by the commenter suggests that the necessity standard can easily be met with regard to the proposed regulations' applicability to both broker-agents and real estate appraisers since the committee staff appears to have received complaints about individuals in both groups "setting policy limits … inaccurately."<br>(15) Additionally, we note that the absence from a legislative committee report of any particular item of information proves nothing. Further, As noted above, the Department does not rely |

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| | is Insurance Code § 1749.85(d), which provides that:<br>"[I]f the Department of Insurance establishes standards for the calculation of estimates of replacement value of a structure by appraisers, then on and after the effective date of the regulation a real estate appraiser's estimate of replacement value shall be calculated in accordance with the regulation."<br><br>Insurance Code § 1749.7 allows the Commissioner to adopt reasonable rules and regulations to administer Article 13.5 [relating to prelicensing and continuing education requirements for certain licensees], which includes Code § 1749.85.<br>As discussed in further detail below, the Proposed Regulations expand the scope of Insurance Code § 1749.85 are not necessary to administer Article 13.5, and (10) therefore, the Commissioner lacks the authority to promulgate the Proposed Regulations.<br>The Commissioner also relies on Insurance Code § 790.03 as the reference for Proposed Regulation § 2695.183(j). Insurance Code § 790.03 sets forth list of "unfair methods of competition and unfair and deceptive acts or practices," which includes making or issuing any misleading statements with respect to the business of insurance. (11) Section 2695.183(j) expands the scope of Insurance Code § 790.03 and is not reasonably necessary to effectuate its purpose, and therefore, the Commissioner lacks the authority to promulgate that provision.<br>(2) Consistency with Existing Law<br>In order to be valid, the Regulations must be "consistent" and not in conflict with the Insurance Code. Cal Gov't Code §§ 11342.2 and 11349.1. Therefore, regulations that "alter or amend the statute or enlarge or impair its scope are void… and no protestation that they are merely an exercise of administrative discretion can sanctify them." Henning v Div. | on the language of Subdivision (d) of Insurance Code section 1749.85 as reference and authority to promulgate regulations with respect to broker-agents.<br>(16) If the Department of Insurance could not promulgate a regulation pertaining to estimates by real estate appraisers, then the statutory language that follows, to the effect that real estate appraisers' estimates shall comply with such regulations, would be absolutely meaningless. We do not believe that a court would construe the first sentence of Subdivision (d) of Ins. Code Section 1749.85 to be a nullity, and so we decline to do so as well. Accordingly, the sentence can indeed serve as part of the reference for Section 2695.181 of the proposed regulations, and Insurance Code Section 1749.7 provides an express grant of quasi-legislative rulemaking authority to implement Insurance Code Section 1749.85. The Department need not confine its rulemaking to interpreting the subject sentence; the Legislature has given the Department quasi-legislative rulemaking authority to adopt such regulations as may be necessary for the "convenient administration" of the provision in question. The statute need not set forth any substantive requirements relating to these estimates; the Legislature remained silent as to any such requirements and has delegated to the Department the function of setting forth such reasonable standards as the Department determines to be convenient for the administration of the article in which the statute appears. There is nothing in 1 CCR 14 that calls into question the suitability of the subject statutory language to serve as reference for the regulation in question.<br>We note also that the commenter fails to point out that proposed Section 2695.181 does not apply to all estimates produced by real estate appraisers. Rather, by the express terms of Section 2695.181, the proposed regulation applies to real estate appraisers only when t□stimate "estimat[ing] the replacement cost of a structure for use in connection with a homeowner's insurance policy." To the extent that real estate appraisers |

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| | of Occupational Saf. & Health, 219 Cal. App. 3d 747, 758-58 (1990). In addition, the Proposed Regulations must be "reasonably necessary" to effectuate the purpose of the statute. Cal. Gov't Code § 11342.2. The Commissioner's determination that the Regulations are necessary must be supported by "substantial evidence." See Cal. Gov't Code § 11350(b)(l).<br>(a) The Proposed Regulations are Not Consistent with Code § 1749.85<br>As noted, Code section 1749.85(d) provides that "if" the Department promulgates a regulation that "establishes standards for the calculation of estimates of replacement value of a structure ***by appraisers, then… a real estate appraiser's estimate of replacement value shall be calculated in accordance with the regulation."*** (Emphasis added). The Department cites this language at the beginning of Proposed Regulation § 2695.181 and states that "[a] real estate appraiser, whether or not a licensee, shall not estimate the replacement cost" without complying with the regulations. (Emphasis added). (12) Thus, it appears that the Department interprets the term "real estate appraiser" to mean any person who produces an estimate of replacement or construction costs, including insurance producers. (13) However, the plain meaning of "real estate appraiser," as well as the language of Insurance Code § 1749.85, indicates that the term is meant to have a much more specific meaning.<br>Real estate appraisers are not commonly understood to mean any person who provides an estimate of replacement costs. Rather, real estate appraisers are specially licensed professionals. In California, they are governed by the Real Estate Appraisers' Licensing and Certification law (See Cal. Bus. and Prof. Code § 11300 et seq.) and are supervised by the Office of Real Estate Appraisers. That this is the intended class of persons to whom § 1749.85(d) applies is supported by | conduct their business by producing such estimates for this purpose, they are engaged in the business of insurance for purposes of Insurance Code Section 790.01; consequently, when they estimate replacement value for use in connection with a homeowner's insurance policy they are subject to Insurance Code Section 790.03 and therefore prohibited from making misleading statements in the same way broker-agents are. Thus, they to are prohibited from calling an estimate an estimate of replacement value when what is actually being estimated is necessarily and estimate of something less than what it would take to replace the home in the event of a total loss. Accordingly, to resolve any question as to reference or authority, in the amended text of regulations we have added to the reference note for Section 2695.181 of the proposed regulations a citation to Insurance Code Section 790.03. Likewise, we have added to the authority note a citation to Insurance Code Section 790.10.<br>(17) The proposed regulations prohibit neither reliance on third party estimates nor the use of divergent methods of producing estimates. Third party estimates that are prepared on behalf of a licensee cannot be used by the licensee as a means of escaping responsibility for making a misleading statement, however, nor can estimates of replacement value omit consideration of cost elements known to be part of what would be required in order to replace the structure in question in the event of a total loss, no matter which method of producing these estimates is used. Not a single commenter has called into question the fact that each of the elements listed in Subdivision (a) of proposed Section 2695.183 may be required to be paid for in the event of a total loss, because each in fact could be. Thus, to describe as a replacement cost estimate and estimate that does not factor in each of these potential cost elements is inherently a misleading statement which is or should to be known to be misleading.<br>(18) There is nothing new about the prohibition of misleading |

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| | the statute's language. Subsection(c), for example, states that the section "shall not be construed to preclude ***licensed appraisers*** … from estimating replacement value of a structure." (Emphasis added).<br>(14) This interpretation is confirmed by the legislative history of the 2006 amendment to Insurance Code § 1749.85. Subdivision (c) and (d) were added to Code § 1749.85 in 2006 by Senate Bill 1847 when real estate appraisers realized that Insurance Code § 1749.85 prevented them from estimating replacement costs in connection with the issuance of homeowners' insurance. The Senate Rules Committee analysis of SB 1847 explained:<br>"The provision that enables appraisers to do estimates of replacement cost under a policy of fire insurance was requested by the California State Government Relations Subcommittee of the Appraisal Institute upon realizing that its members were no longer authorized to estimate replacement cost of homes as of January 1, 2006 due to passage of SB 2 (Speier) in the prior year. Appraisers have long performed this function. Committee staff notes that (14.5) ***the committee received no more complaints about appraisers setting policy limits accurately or inaccurately than it did about insurance agents/brokers or contractors, two professions granted the right to do estimates.*** Committee staff recommended permitting the licensed appraisers of California to once again recommend replacement cost amounts under a fire policy. …" (Emphasis added).<br>Therefore, the term "appraiser was not intended to refer to agent/brokers who produce estimates of replacement value.<br>(15) Significantly, there is no reference in the Senate Rules Committee's discussion of SB 1847 that § 1749.85(d) applies in any way to agents/brokers. This strongly supports the conclusion that it was not intended to have any affect on producers and it cannot reasonably be concluded that the amendments to § 1749.85 were intended to | statements made by licensees. The proposed regulations in this respect do nothing more than identify one particular variety of misleading statement which licensees know or should know is misleading: to describe as a replacement cost estimate an estimate that fails to consider all of the elements which no one disputes may in fact need to be paid for in the event of a total loss. The regulations impose no substantive requirement to the effect that the estimate must turn out to be accurate. Inaccurate estimates of replacement value, in and of themselves, will not be violations of the proposed regulations unless it turns out that when the licensee estimated replacement cost he failed to consider one or more of the cost elements known to be part of the cost of replacing the structure in question. Licensees who thus virtually ensure that the estimate they provide to an applicant or insured will be insufficient to replace the home in the event of a total loss, and yet describe the estimate as a replacement cost estimate, are necessarily making a misleading statement which they know or should know is misleading, and are therefore already committing a prohibited act under the Unfair Practices Act. The regulations will merely state this fact explicitly.<br>(19) Again, the proposed regulations do not need to create a new category of prohibited acts. The category that obtains here is misleading statements.<br>(20) The act that is in question here is calling something a replacement value estimate when what is being estimated is necessarily something short of what it would take to replace the home. The procedure detailed in Insurance Code Section 790.06 is not available here, since the prohibited act in question is in fact defined in Insurance Code Section 790.03, where that prohibited act is defined in the broadest possible terms: "*any* assertion, representation or statement with respect to the business of insurance … which is untrue, deceptive, or misleading, and which is known, or which by the exercise of reasonable care should be known, to be untrue, deceptive, or |

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| | impose or permit the obligations and duties contained in the Proposed Regulations. Attached as Exhibit 1 is a copy of the Senate Rules Committee Analysis.<br>The language of Code § 1749.85(d) shows that it is not independent authority or reference for regulations. It merely states that if the Department promulgates regulations relating to the real estate appraisers' estimates, then real estate appraisers must comply with those regulations notwithstanding that the Department does not otherwise regulate such appraisers. That statute does not set forth any substantive requirements relating to replacement value estimates or the obligations<br>of insurance producers or insurers that the Department could "implement, interpret or make specific." See 1 CCR § 14 (setting forth the "reference" requirement for a valid regulation). Code § 1749.85 does not, in and of itself, permit the Department to promulgate regulations related to real estate estimates. Thus, there would have to be another statute that creates that authorization and there is no such statute in the Insurance Code.<br>(b) The Proposed Regulations are Not Consistent with Code § 790.03<br>As noted, the Department also relies on Insurance Code § 790.03 as authority for Proposed Regulation § 2695.183(j), which states that using the word "replace" or "replacement" in connection with providing an estimate when that estimate does not comply with the regulation is deemed to be misleading within the meaning of § 790.03. The Proposed Regulations go beyond the scope of that statute. (17) There is nothing inherently misleading about relying on third party estimates or utilizing divergent methods of producing such estimates. (18) Proposed § 2695.183(j) imposes am [sic] entirely new *substantive* requirement on producers in the guise of interpreting what "misleading" means. Proposed § 2695.183(j) would essentially define a violation of the Proposed | misleading." Insurance Code Section 790.03, subd. (b) (emphasis added). Thus, the definition of the prohibited act sweeps in the whole gamut of misleading statements, including misleading statements with respect to estimates of replacement costs. Accordingly, Insurance Code Section 790.06 does not apply.<br>(21) To the contrary, since the day the notice of proposed action was published there has been ample evidence in the rulemaking file to satisfy the necessity standard of the APA.<br>(22) The Department accepts this point. We have eliminated this requirement in the amended text of regulation.<br>(23) Additionally we note that the very urgency with which industry representatives, including the commenter, oppose this particular provision is itself powerful evidence of its necessity. The requirements for a replacement value estimate that are set forth in proposed Section 2695.183 of the proposed regulations are really quite modest: The regulations do not require of replacement value estimates any particular degree of accuracy; instead, all the regulations do require in this respect is that, if a licensee chooses to represent an estimate she has produced as an estimate of replacement cost (and licensees are explicitly not required to provide such an estimate) then the estimate must be complete and must not ignore outright any of the basic cost components universally acknowledged to figure into replacement cost. The fact that there is such strong resistance to this relatively unambitious, self-evident, proposition strongly suggests that there are those among the Department's regulated public who routinely represent as estimates of replacement value estimates that do not, in fact, take into account all the costs that would be incurred in replacing a totally destroyed structure, and who would continue to make such misleading statements if they were not held to account by the promulgation of the provision that says that this kind of misleading statement is, in fact, a violation of the Unfair Practices Act. In other words, if the regulations actually were |

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| | Regulations as a "misleading" act under Code § 790.03 and therefore creates a (19) new category of "unfair or deceptive" business practice. The Department has no authority to define a new category of unfair or deceptive act except through (20) the procedures specified under Code § 790.06. That statute states that "[w]henever the commissioner shall have reason to believe that any person engaged in the business of insurance is engaging in this State in any method of competition or in any act or practice in the conduct of the business ***that is not defined in Section 790.03***," which he suspects is unfair or deceptive, he may issue an Order to Show Cause against the license and a hearing must be held on the Order to Show Cause. The Commissioner cannot, by regulation, define a new unfair or deceptive act under Code §790.03.<br>(3) Necessity<br>(21) The Proposed Regulations also fail the necessity test under the Government Code for valid regulations. There is insufficient evidence that the Proposed Regulations as a whole are necessary. (22) In addition, the requirement to keep insurance quotes for at least 3 years when no policy is ever issued is specifically an unnecessary burden on insurance producers. (23) Further, there is no support for the necessity of Proposed § 2695.183(j).<br>(24) The Commissioner has stated that the Proposed Regulations are necessary to ensure that consumers obtain an accurate quote on their homeowner's insurance. (25)The only evidence that the Commissioner has presented in this regard is the statement in the Notice of Proposed Action on page 2 in which he states that "The Department and the California Legislature received a significant number of complaints by homeowners who lost their residences in the Southern California Wildfires of 2003." The Commissioner has not provided any study or data to support this claim. Yet, the Proposed Regulations themselves explain that there is a "demand surge" phenomenon after disasters such as wildfires, | unnecessary because there was really no problem for them to address, as the commenter suggests, then the industry would not protest so vociferously, since it would be unlikely that a significant number of licensees would run afoul of the complained of provision when it became effective. As it is, however, the commenter's protestations reinforce the evidence in the rulemaking file demonstrating that the problems addressed by these regulations are indeed real and widespread.<br>(24) The Initial Statement of Reasons provide that: "The proposed regulation will: (1) set out requirements applicable to replacement value and replacement cost estimates to create a more consistent, comprehensive and accurate replacement cost calculation; (2) set forth training standards for California resident broker-agents, which shall be part of and not in addition to their continuing education requirements, who sell 'omeowner's insurance; (3) set forth standards for real estate appraisers who estimate replacement cost for insurance purposes; (4) require the application of certain standards when estimating replacement cost ; and (5) establish record keeping requirements. The Commissioner believes that the proposed regulation is necessary to implement, interpret, and make specific Section 1749.85."<br>(25) The comment asserts that the regulations fail the necessity requirement. However, Agents and Brokers Association has not requested to, or reviewed the Rulemaking file. The Rulemaking file is replete with: consumer complaints and their files related to underinsurance and replacement cost; Summaries of Market Conduct Examinations and a 2007 Wildfire Insurance Claim Status Survey/ United Policyholders Survey. Further, additional information is in the Rulemaking file pursuant to the 15 Day Notice including testimony at an investigative hearing held by the insurance commissioner on the same issues; MBS report and website information on replacement cost issues; multiple media reports throughout several years reporting on the underinsurance problem from the Orange County Register; the |

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| | which causes a significant increase in the cost to rebuild homes.Moreover, the Proposed Regulations *forbid* the consideration of demand surge in making the estimates of replacement value such that the regulations would do nothing to protect consumers from these increased construction costs. In other words, even if the Proposed Regulations are promulgated, in the next California wildfire, many homeowners' are still likely to find that the their homeowners' coverage is insufficient to cover the inflated costs created by the "demand surge."<br>The Department has presented no other evidence or rationale for the need for the regulations. The Government Code requires "substantial evidence" showing the necessity of the regulations and the department has failed to meet the standard. Moreover, as discussed further below under Section (E), any potential "need" for the Proposed Regulations is far outweighed by its unfairness to and unmanageability for producers and insurers.<br>In addition, there is absolutely no necessity for the requirement under Proposed §§ 2695.182(b) and 2695.183(i) that producers maintain records of insurance quotes for three years even when no insurance was ever issued to the consumer. The only justification the Department offers for this onerous requirement is that the records would "assure that documentation is available<br>so that the Department can meet its statutory obligation to regulate producers and perform market conduct exams to ensure compliance." See Initial Statement of Reasons, pg. 11. This is a legally insufficient reason to justify imposing such a burdensome requirement on producers. First, there is no reason why the Department could not conduct a full examination of producers based on the records relating to actual customers who purchased insurance through the producer. Such information is the basis of all the Department's market conduct examination on producers and | North County Times; Sign On, the Union Tribune, the New York Times, The Insurance Journal, CNN Money, the Associated Press, the Malibu Times, the Ventura County Star, the Los Angeles Times, Kiplinger, Claims, KCOY 12, the Napa Valley Register, the Sacramento Bee. It is clear that the regulations are necessary. In 2003 and again in 2007 and 2008 California experienced significant wildfires leading to the loss of a high number of residential structures. After each of these fires, fire survivors complained about problems including their experience that after the fire they learned that the replacement value estimates made in setting coverage limits for their homes were incomplete and too low, causing underinsurance issues to arise during efforts to rebuild or replace their residences. The significance of the replacement value being complete and more accurate is particularly important given that other than a limited number of homeowners who qualify for guaranteed replacement coverage offered by only a small number of insurers, the vast majority of homeowners have one of three kinds of insurance coverage on their home as defined in the California Residential Property Insurance Disclosure Form from Insurance Code Section 10102: Limited Replacement Cost Coverage With an Additional Percentage which pays replacement costs up to a specified amount above the policy limit; Limited Replacement Cost Coverage With No Additional Percentage which pays replacement costs up to policy limit only; Actual Cash Value Coverage which pays the fair market value of the dwelling at the time of the loss, or the cost to repair, rebuild, or replace the damaged or destroyed dwelling with like kind and quality construction up to the policy limit. Therefore, the necessity of having a complete and more accurate estimated replacement value that is updated regularly is paramount. The failure to take into consideration certain factors at all, or to not fully consider other components, as referenced above, is one source of the underinsurance problem.<br>(26) Proposed Section 2695.183(l) is clear. The comment states |

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| | insurers in all other areas of insurance.<br>Second, the burden to producers outweighs any potential benefits to the Department or consumers of having this extraneous information. Many producers generate hundreds of quotes per week. Under the regulation, they would by required to retain, for several years, all of those quotes which would amount to tens of thousands of pages of data on consumers that are not their actual customers. This would be unmanageable for most producers. Additionally, requiring the retention of extraneous information opens producers up to unnecessary litigation risk. Producers would be involuntarily retaining personal consumer information; information that is not otherwise relevant to the producer's day-to-day business. Producers should not be required to retain any unnecessary personal information which, for example, could accidentally be released to an unauthorized party and subject the producer to liability.<br>Finally, the regulation subjects producers to the potential for unfair regulatory penalty. The Department has admitted that the only purpose of this requirement is for market conduct examinations. Yet, the Department will have plenty of information on the producer's quoting process through the customer files. Thus, it is hard not to get the impression that the sole purpose of requiring the retention of quotes is as a means to impose "gotcha" penalties against the producers for the smallest of perceived, technical violations.<br>There is also no support for the necessity of Proposed § 2695.183(j) to interpret Code § 790.03. The term "misleading," as used in that statute, is not a specialized term that needs the Department's expert interpretation. This further supports the conclusion that the only purpose of the proposed provision is to announce a new "unfair or deceptive" act which, as noted, the Commissioner cannot do by adopting a regulation.<br>(4) Clarity and Duplication | in conclusion that the section "does not make sense and is overbroad" but does not explain the basis for the proposition. Proposed Section 2695.183 (l) is straight forward and perfectly understandable: "This Section 2695.183 applies to all communications by a licensee, verbal or written, with the sole exception of internal communications within an insurer, or confidential communications between an insurer and its contractor, that concern the insurer's underwriting decisions and that never come to the attention of an applicant or insured." This is particularly so as Proposed Section 2695.183 states that: "No licensee shall communicate an estimate of replacement cost, to an applicant or insured, in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis, unless the requirements and standards set forth in subdivisions (a) through (e) below are met…" Not only is the proposed regulation's text clear, but it is consistent with its purpose. The proposed regulation requires that communications of an estimate of replacement cost made to insureds and or applicants take into consideration the standards and requirements enumerated in the proposed regulations. With this proposed section, it makes even clearer that the communications are not meant to, and do not, include specified communications made to others who may be involved in the insurance transaction.<br>(27) In consideration of this comment, and others, proposed Section 2695.183(e) is amended to read: "The licensee shall no less frequently than annually take reasonable steps to verify that the sources and methods used to generate the estimate of replacement cost are kept current to reflect changes in the costs of reconstruction and rebuilding, including changes in labor, building materials, and supplies, based upon the geographic location of the insured structure. The estimate of replacement cost shall be created using such reasonably current sources and methods." The comment raises two clarity objections. The first is that "reasonable" is vague. The second is "how often" are |

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| | Finally, regulations must satisfy the "clarify" and "non-duplication" standards in order to be approved by the OAL. Based on the following, the Regulations, as currently proposed, arguably lack clarity and are duplicative.<br>(26) Proposed § 2695.183(l) lacks clarity. It states that § 2698.183 applies "to all communications by a licensee, with the sole exception of internal communications with an insurer or confidential communications between an insurer and its contractor, that concern the insurer's underwriting decisions and that never come to the attention of the applicant or insured." As section 2695.183 sets forth standards for preparing estimates, it is unclear how it applies to "licensee communications." To apply the valuation standards to all "communications" does not make sense and is overbroad. The Department states that the purpose of this provision is to allow insurers to discuss values internally without having to follow the standards and record keeping requirement. See Initial Statement of Reasons, pg. 17. This is entirely unclear from language of § 2695.183(l).<br>(27) Proposed § 2695.183(e) is also vague and lacks clarity. It provides that producers "shall take reasonable steps to verify that the sources and methods used to estimate replacement cost are kept current to reflect changes in the cost of reconstruction and rebuilding…" It is unclear what would constitute "reasonable" steps. How often are producers required to take such steps?<br>(28) The additional education requirements under Proposed § 2188.65 are duplicative and unnecessary. Fire and casualty producers are already subject to education on "the basic concepts of property insurance and estimating replacement value." Proposed § 2188.65(d). The Department has issued a manual entitled "Educational Objective: California Fire and Casualty Broker-Agent Examination," which sets forth topics that a license applicant is expected to understand in order to pass the licensing examination. | producers required to take reasonable steps. Addressing the second objection first, the language specifies that the steps are to be taken no less frequently than "annually." As to the first objection, use of the word "reasonable" is consistent with the purpose of the proposed regulation. When an estimate of replacement cost is communicated to an insured and or applicant, it is in the best interest of all concerned that the sources and methods used to generate the estimate be current. It does no good if the estimate is based upon information that is not accurate. It is common knowledge that costs of labor, building materials, and supplies change and that the geographic location of the insured structure plays a role in evaluating these costs. The term "reasonable" is defined by Mirriam-Webster Online as: "a : being in accordance with reason - a *reasonable* theory - *b* **:** not extreme or excessive -*reasonable* requests-" In this regard, a fair reading of the proposed regulation is that a reasonable licensee would take steps to assure the validity of the sources and methods used to estimate replacement cost.<br>(28) As the comment notes, the Educational Objective California Fire and Casualty Broker-Agent Examination issued by the Department sets forth topics that a license applicant is expected to understand in order to pass the licensing examination. Again, as the comment notes, one of the topics is "Homeowners Insurance Valuation." and applicants are required to know how to compute "the amount of coverage required to receive full replacement cost coverage." There is no duplication, just the opposite. The proposed regulation supports and compliments the manual. At page 22 of the manual, for example, the Homeowners Insurance Valuation section defines it as relevant to "General Concepts of Section 1749.85 of the CIC (California Insurance Code)." This code section is listed as both authority and reference for the proposed regulations.<br>(29) The comment asserts that the regulations impose onerous duties on insurance producers regarding assuring that third parties are complying with the regulations and further, subject |

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| | Amongst the topics is: "Homeowners Insurance Valuation." The manual notes that applicants must know how to compute "the amount of coverage required to receive full replacement cost coverage."<br>E. Policy Analysis<br>(29) The Proposed Regulations impose onerous duties on insurance producers and unreasonably place the responsibility for compliance on the party with the least control over the estimation process. The Proposed Regulations permits producers to rely on third party estimates, but places the responsibility on the producers to ensure that the third parties are complying with the regulations. It would be all but impossible for the producers to ensure the ongoing compliance of an unrelated third party to the detailed requirements set forth in the regulations. Most producers will not be equipped to police third party appraisers or vendors, yet will be subject to disciplinary action for the failures of such third parties to meet the requirements of the regulations. In that vein, the regulations would require producers to, at all times, have open access to the records of and processes used by such third parties – which such parties are unlikely to grant.<br>The regulations essentially make the producers strictly liable for third party noncompliance. There is no provision that would excuse a producer if they made every reasonable effort to check for compliance, but simply was unaware, for example, that the third party (i) did not operate the way it claimed; (ii) initially complied with the regulations, but at some point ceased without the producer's knowledge; or (iii) made isolated mistakes that are not under producer's control.<br>Producers typically use third party tool at the direction of insurers. The Proposed Regulations would, in such cases, make the insurers strictly liable for the noncompliance of third party vendors. However, insurers do not have any more control over these applications than the | producers to civil liability. Again, this comment begins with a conclusion, but provides nothing to support it. As noted in more detail in response to comment (17), third party estimates that are prepared on behalf of a licensee cannot be used by the licensee as a means of escaping responsibility for making a misleading statement, nor can estimates of replacement value omit consideration of cost elements known to be part of what would be required in order to replace the structure in question in the event of a total loss, no matter which method of producing these estimates is used. Not a single commenter has called into question the fact that each of the elements listed in Subdivision (a) of proposed Section 2695.183 may be required to be paid for in the event of a total loss, because each in fact could be. As for the contention that the regulations in some manner provide "ammunition" for a civil action, again, as stated in more detail in response to comments (18) through (20), there is nothing new about the prohibition of misleading statements made by licensees. The proposed regulations do nothing more than identify one particular variety of misleading statement which licensees know or should know is misleading: to describe as a replacement cost estimate an estimate that fails to consider all of the elements which no one disputes may in fact need to be paid for in the event of a total loss. The regulations impose no substantive requirement to the effect that the estimate must turn out to be accurate. Inaccurate estimates of replacement value, in and of themselves, will not be violations of the proposed regulations unless it turns out that when the licensee estimated replacement cost he failed to consider one or more of the cost elements known to be part of the cost of replacing the structure. The act in question is calling something a replacement value estimate when what is being estimated is necessarily something short of what it would take to replace the home. |

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| | producers. Thus, the inherent problems with the regulations would still apply.<br>The Proposed Regulations also unnecessarily subject insurers and producers to the risk of civil liability whenever a consumer has a loss that is not fully covered by his/her policy. Yet, the consumer is in the better position to judge whether the third party valuation is a fair estimate of his/her home's value than either a producer or insurer. Moreover, the Proposed Regulations do not account for the realities of the homeowners' insurance market where some consumers willfully obtain less coverage in order to pay less premium. The existence of the Proposed Regulations would give these same consumers ammunition in a civil action after-the-fact of a loss, allowing them to avoid the consequences of their own choices.<br>Conclusion<br>The Commissioner is seeking to reform producers' duties to consumers through the regulatory process. Since these duties create new substantive duties not otherwise imposed by the Insurance Code, they are invalid under Government Code Section 11349.1. Further, the Proposed Regulations are patently unreasonable as they hold the parties who have the least control over the valuation process liable for noncompliance. For the above reasons, we respectfully request that the Commissioner reconsider and withdraw the Regulations | |
| **Agents and Brokers Association of California testimony at public hearing on May 17, 2010 in Los Angeles, CA.** | MR. HOGEBOOM: Good to see all of you. I will start and then I'm going to turn it over to Joe. You represent a new producer trade association. The attorneys for insurance agents and brokers association in California. Joe will give you a little background about that organization I think when he starts his comments. In fact, it seems like every couple of years, we have a regulation in which the Department is truly attempting to resolve what they consider -- the Department considers to be a necessity for public policy. And clearly, this is one of those. But at the same | **Response to Agents and Brokers Association of California testimony at public hearing on May 17, 2010 in Los Angeles, CA:** Mr. Hogeboom and Mr. Jiminez testified on behalf of the Agents and Brokers Association of California. As Mr. Hogeboom mentioned, written comments were provided to the Department and those written comments have been presented in this Final Statement of Reasons, along with the Department's responses to the comments. In this regard, as Mr. Hogeboom and Mr. Jiminez did not provide any different comments than those presented in the written comments, but rather, |

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| | time, the Department, in proposing the regulation to do so, really has failed to really look to the Legislature to give them the authority to do so. Much of what is in this regulation must come from the Legislature first. And then the Department can move on regulations after that. And I will explain that to you and how that is done. The regs do a couple things. Continuing education through the curriculum board, fine. You certainly have authority to do that. These may be somewhat extensive on what is being -- has to be reviewed, but I certainly understand that. And myself, I don't have any problems with regard to the Curriculum Board providing the -- all of the information that need to be taught and taught to brokers and agents. I'm dealing with brokers and agents here with regard to my testimony.<br>The record keeping, certainly there's authority for record keeping. Although record keeping must be -- I think under the statute, must be reasonable record keeping. And there could be -- there's an issue with regard to unreasonable record keeping that Joe may explain and may refer to -- keeping records of policies -- or excuse me -- of quotes that are not actually sold. Now, the Government Code. We know that regulations must be consistent and not in conflict with the statute. They must be reasonably necessary to effectuate the statute's purpose. Okay. Now, the Commissioner must have authority and reference for the regulations. The authority for the regulations -- and I'm going to refer now to the standards. This is the .183. You've got .180-183. Specifically, I'm going to deal with .183,which I think is the real key component of these regulations. And those are the new standards that<br>will be -- that are attempting to be proposed on producers. The statute is 1749.85. I implore you to look at the legislative history on this statute if you have not already done so. The statute was initially enacted through Jackie Spear in -- through Sections (a) and (b), which authorize the Curriculum Committee to make | summarized those written comments, the Department incorporates fully herein its response to the Agents and Brokers Association of California written comments. |

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| | recommendations on instruction. That is (a). They wanted agents and brokers to have more instruction on replacement value. That's good, necessary. Legislature caused that. Spear wanted that, and that would help with the health problems with the basic fire situation that we have had. The statute also, as originally enacted in 2005, I think it was, indicated those individuals that could not estimate, could not make estimates of the replacement value of a structure or explain levels of coverages. They do that by -- the statute does thatby saying any person who is not an insurer, underwriter, actuary, a property and casualty agent, blah, blah, blah, cannot estimate. Okay. Now, that's what it said. A year later, the appraisers -- yes, we're getting to that; that's really the keyword of the whole rig. The appraisers felt that they were left out for some reason, of the people or the individuals that could make these type of estimates. And so what they did was they came to the Legislature and said that if the Department establishes standards -- this is part of the legislative history. This is from the Senate Rules Committee analysis of SB1847. And it's the provision that enables appraisers to do estimates of replacement cost under a policy of fire insurance upon realization by the Government Relation Subcommittee of the Appraisal Institute that its members were no longer authorized to estimate replacement cost due to the passage of the bill which contained (a) and (b). And that they needed something in here that allowed them to do that. And so the licensed appraisers -- and then<br>that term was then put into (c) and (d). And so (c)<br>was the sections are not being construed to preclude<br>licensed appraisers, contractors and architects from<br>estimating replacement value. And then (d) goes if the Department, by adopting the regulation -- and this is the key one, obviously, is this is (d) accepting 49185 -- if the Department wants to adopt a regulation establishing standards for calculating of estimates of replacement values of the | |

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| | structure by appraisers, the word agents and brokers, contractors, architects, blah, blah, blah, that is not in the statute. What is in the statute is giving you authority to regulate the appraiser. And then this makes it clear that the real estate appraiser's estimate must be calculated pursuant to a regulation if you adopt it. Okay. So what you're stuck with is that you're dealing with a regulation that really would apply to a real estate appraiser, not an agent or a broker. They did not, in this statute, go that far to require or to permit the Department to adopt regulations dealing with replacement value as applicable to an agent and broker. It only went so far as to establish the Curriculum Committee to be able to enact and education requirement to educate agents and brokers about that. So with that, we have certainly a contention that goes to the heart and core of the regulation. The other issue, again -- and I think this was mentioned, but let me just make it very clear what the -- how this works. The provision -- I don't know if it's .183 or 4. The provisions considers a misleading statement in violation of 790.03. And then I think that it -- any estimate not conforming to (a) through (e) of .183 is considered a misleading statement. Okay. So what we have is the regulation has created a new category of an unfair or deceptive practice. The DOI has no authority to create new violations of 790.03, except for a procedure in 790.06. And that's an order to show cause hearing. Other than that -- and then that would be applicable to the specific -- to the specific licensee that the order to show cause – or non licensee, I guess it could be either -- that the order to show cause is brought against. In order to have new acts as declare as an unfair practice in 790.03 that's a legislative. That's within the realm of the Legislature to be adopted. So if there's a 790.03 issue, again, the Department should go to the Legislature and have the Legislature determine that this should be an unfair practice. Okay. I'm going to submit -- I will submit | |

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| | written testimony on this. It will further amplify the legal argument on that. As I said, I wanted to bring Joe Jimenez, the who is here, who is president of the association, and also and insurance agent/broker, and will be dealing with this regulation himself. And so, in fact, on behalf of constituents and his own organization, he has a couple comments.<br>JOE JIMENEZ: Thank you. I appreciate the time and the opportunity. First, I guess I'm the only person in the room who is not an attorney. Bob is doing a really good here. I'm an insurance agent. I've been an insurance agent for 25 years now. And I'm a president of a newly formed trade insurance association called Insurance Agents and Brokers Association of California. We are a nonprofit trade association, which focuses on legislation regulatory matters on behalf of our member producers. This association was started by two former presidents of the Alliance of Insurance Agents and Brokers, who were also appointed to the Insurance Commissioner's Agents and Brokers Advisory Committee. Basically, IABAC was born to enable producers to have information on legal expertise and regulatory matters. But as Bob already went through the technical aspect of the whole thing, I want to give you the real sense from my insurance agents. And what I see here, we oppose these regulations on the legal grounds just stated because we feel they place onerous and unnecessary requirements of producers. The daily provisional requirements will have a lot of certification requirements. It will carry three hours continuing education -- sorry. I lost my thought here -- for some homeowners evaluations.<br>The record keeping on unsold policies seems to be one that is completely unnecessary. And also creates standards, as Bob just said, makes the provision responsible on the information on the estimate that we give to the clients. And we obviously rely on third-party evaluations that makes the producer responsible or liable. It doesn't seem right.<br>So that is basically what I wanted to say. That as an insurance | |

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| | producer, we don't feel this is necessary, and we will only create more problems; and therefore, we oppose them. | |
| **Insurance Trade Association, Alliance of Insurance Agents and Brokers, Association of California Insurance Companies, Insurance Agents and Brokers Association of California, National Association of Mutual Insurance Companies, Pacific Association of Domestic Insurance Companies, Personal Insurance Federation of California, Western Insurance Agents** | On behalf of the attached list of property and casualty insurer producer trade associations (the "trade associations"), we are requesting that you reconsider and withdraw the proposed Replacement Estimate Regulations (the "Regulations"). At the CDI hearing held on May 17, 2010, witness testimony was presented by trade associations opposing the Regulations. Following the hearing, a meeting was held in Sacramento during which the trade associations approved this request on the basis that proposed standards and penalties contained in Section 2695.183 are overreaching and inappropriate. This letter sets forth the trades' reasoning for their request. On behalf of all of the trade associations joining in this request, we respectfully request that you withdraw the § 2695.183 standards at this time. The Regulations may then focus on reasonable training and record-keeping requirements which can be monitored for their effectiveness. This letter sets forth the trades' reasoning for their request. (1) 1. The Regulations, which create new standards for producers, dictate what must be included in replacement value estimates and require producers to verify the information even if the estimate is produced by another source. Producers must verify the sources and methods used to estimate replacement costs and that they are kept current. Many smaller producers are not in the best position to determine homeowner cost estimates in each geographic area of the state which they sell homeowners insurance. Further, using other sources to provide the estimates will be costly to producers/insurers and the penalties and threat of civil litigation will likely reduce the number of insurers and producers using estimates in the future. The result would be to have the homeowner assume personal responsibility to determine the amount of insurance needed for replacement in the event of a total loss. (2) 2. The Regulations overreach by requiring producers or insurers, who | **Response to Insurance Trade Association, Alliance of Insurance Agents and Brokers, Association of California Insurance Companies, Insurance Agents and Brokers Association of California, National Association of Mutual Insurance Companies, Pacific Association of Domestic Insurance Companies, Personal Insurance Federation of California, Western Insurance Agents Association June 17, 2010 written comments**:<br>(1) Section 2695.183 (e) is clear and not onerous. It simply provides that a licensee who estimates replacement cost shall no less frequently than annually take reasonable steps to verify that the sources and methods used to estimate replacement cost are kept current. So as to make even more clear the obligation, the proposed section has been amended as to read: "The licensee shall no less frequently than annually take reasonable steps to verify that the sources and methods used to generate the estimate of replacement cost are kept current to reflect changes in the costs of reconstruction and rebuilding, including change in labor, building materials, and supplies, based upon the geographic location of the insured structure. The estimate of replacement cost shall be created using such reasonably current sources and methods." This is something one would assume a licensee would be doing even if there was not a regulation requiring it. What good would an estimate be if it was based on faulty and out of date data? Certainly, it is not unreasonable to require that one who provides an estimated replacement cost consider the geographical region involved. A flat low land street structure versus a mountainside home, for example. Additionally, the concern about liability regarding smaller producers is misplaced as well. Section 2695.183 (k) provides that when an insurer requires that a broker-agent utilize a specific source or tool to create an estimate of replacement cost, the insurer must prescribe written procedures and shall train the |

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| **Association June 17, 2010 written comments** | typically use another more credible source to provide the estimate, to in effect guarantee the estimate under the requirement to verify that the sources and methods used to produce the estimate are kept current. (3) 3. Onerous new CIC § 790.03 penalties are created by the Regulations (up to $10,000 each violation) if the producer does not conform to the newly established standards. The insurer would be subject to these violations if the insurer prescribes procedures relative to the estimates to be followed by the producer. This creates additional liability on insurers and producers resulting in high penalties if an estimate does not include the correct cost for any "item" for a particular geographical area used to create the estimate. (4) 4. The Regulations create unintended negative consequences on homeowner consumers. Because of the potential liability created, many producers and insurers could cease using estimates. Homeowners would then be forced to select their own policy limits without recommendations from producers and insurers who will likely revert to the use of a disclaimer that the policy limit was selected by the homeowner without recommendation by the producer or insurer.(5) 5. For those that will use a third party source to create the estimate, there will be recurring costs to the producer and insurer to maintain updated statistical building costs information for each geographical area which could include different statistical costs within the same city for items making up the estimate. That cost plus the cost of compliance with the Regulations will be passed on to the consumer as an added cost for the insurance.<br>The Regulations reflect an excessive response to a problem that affects few consumers. The added protection to consumers through the mandatory disclosure statements and homeowners bill of rights as contained in § 10101.1 of the Code and as currently being amended through AB 2022 (Gaines) is sufficient consumer protection at this time. The CDI can monitor future consumer complaints after the training | broker-agent. Further, the amended subsection states that: "the insurer, and not the broker-agent, shall be responsible for any noncompliance with the provisions subdivisions (a) through (e) of this Section 2695.183, unless that noncompliance results from failure by the broker-agent to follow the insurer's prescribed written procedures when using the source or tool."<br>(2) This regulation requires that licensees verify the validity of the tools they are using to estimate replacement cost. The regulation does not state that they may not use third party vendors. However, if they do use the vendors, they are required to verify that the sources and methods are kept current. Again, this is not an onerous requirement but, rather, one which any reasonable licensee should follow even in the absence of a regulation, given that an estimate based upon stale data would be an unreasonable action on the part of the licensee. The proposed regulations prohibit neither reliance on third party estimates nor the use of divergent methods of producing estimates. Third party estimates that are prepared on behalf of a licensee cannot be used by the licensee as a means of escaping responsibility for making a misleading statement, however, nor can estimates of replacement value omit consideration of cost elements known to be part of what would be required in order to replace the structure in question in the event of a total loss, no matter which method of producing these estimates is used.<br>(3) Not a single commenter has called into question the fact that each of the elements listed in Subdivision (a) of Section 2695.183 may be required to be paid for in the event of a total loss, because each in fact could be. Thus, to describe as a replacement cost estimate and estimate that does not factor in each of these potential cost elements is inherently a misleading statement which is or should to be known to be misleading. There is nothing new about the prohibition of misleading statements made by licensees. The proposed regulations in this respect do nothing more than identify one particular variety of |

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| | and other consumer protection laws go into effect to determine if additional consumer protection is needed. | misleading statement which licensees know or should know is misleading: to describe as a replacement cost estimate an estimate that fails to consider all of the elements which no one disputes may in fact need to be paid for in the event of a total loss. The regulations impose no substantive requirement to the effect that the estimate must turn out to be accurate. Inaccurate estimates of replacement value, in and of themselves, will not be violations of the proposed regulations unless it turns out that when the licensee estimated replacement cost he failed to consider one or more of the cost elements known to be part of the cost of replacing the structure in question in the event of a total loss. Licensees who thus virtually ensure that the estimate they provide to an applicant or insured will be insufficient to replace the home in the event of a total loss, and yet describe the estimate as a replacement cost estimate, are necessarily making a misleading statement which they know or should know is misleading, and are therefore already committing a prohibited act under the Unfair Practices Act. The regulations will merely state this fact explicitly.<br>(4) There are no negative consequences to consumers. Just the opposite. The proposed regulations are necessary to ensure that replacement cost estimates at least have a chance of being accurate. The regulations merely set forth the various components of a dwelling that may need to be replaced in the event of a total loss. The proposed regulations do not require that all such estimates be accurate. The regulations do, however, proceed from the basis that it is a misleading statement to communicate an estimate of replacement cost estimate when it is incomplete and omits consideration of certain components of a dwelling known to require replacement in the event of a total loss. In other words, calling something a replacement cost estimate when what is being estimated is necessarily something less than what it could take to replace the structure is a misleading statement. Not a single commenter has called into question this basic premise. |

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| | | (5) This regulation requires that licensees verify the validity of the tools they are using to estimate replacement cost. Again, the regulation does not state that they may not use third party vendors. However, if they do use the vendors, they are required to verify that the sources and methods are kept current. Again, this is not an onerous requirement but, rather, one which any reasonable licensee should follow even in the absence of a regulation, given that an estimate based upon stale data would not be reasonable conduct on the part of the licensee. There is no evidence presented that would reflect an increased cost to consumers, or that the licensees are not already verifying that current data is used. The regulations are not an excessive response to problem that only affects a few. Rather, the Rulemaking File, referenced herein, establishes that when considering total losses, particularly in light of the wildfire destruction in recent years, the issues surrounding estimated replacement cost are paramount. The references to the Homeowner Bill of Rights and disclosure statements relate to insurance policies. These regulations relate to estimating replacement cost and what must be taken into account in making those estimates. |
| **Automobile Club of Southern California (AAA) May 17, 2010 written comments** | On behalf of the Automobile Club of Southern California and our affiliated Interinsurance Exchange of the Auto Club (collectively, "Auto Club"), I would like to offer the following comments on this proposed regulation. The Auto Club is a member of the Association of California Insurance Companies (ACIC) and is in general agreement with the comments provided by that organization on this proposal. We have two additional recommendations to offer.<br>(1) 1.The ninety days provided in Section 2188.65(b) is not an adequate period of time in which to develop materials and a curriculum, secure approval from the Department and complete all training of personnel. We propose that 180 days be allowed for this purpose.<br>(2) 2. Section 2695.183 (h) provides that a copy of the | **Response to Automobile Club of Southern California (AAA) May 17, 2010 written comments**:<br>(1) In consideration of this comment and others, proposed Section 2188.65(b) is amended to provide for a 180 day, rather than the originally noticed 90 day, time frame.<br>(2) In consideration of this comment and others, Section 2695.183 (h) [now "g" under the amended proposed regulations] has been amended to provide that if the transaction is conducted over the telephone, a copy of the estimate shall be mailed to the insured no later than three business days after the applicant agrees to purchase the coverage. |

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| | estimate must be provided to the applicant or insured at the time that the policy limit is set. For transactions other than those conducted in person (e.g., by telephone or over the internet), we request that the regulation allow three business days in which to mail the estimate. This is the amount of this currently provided for an insurer to send a residential property disclosure. | |
| **Insurance Agents and Brokers of the West May 17, 2010 written comments** | On behalf of the Insurance Brokers and Agents of the West, I am writing to express our qualified support for the above-referenced contemplated regulations, but also to strongly encourage the California Department of Insurance to make additional revisions, which I will describe below, prior to adoption of these proposals. IBA West is a trade association representing independent insurance agents and brokers. Our membership—comprised of more than 600 California agencies and brokerages, and tens of thousands of individual broker-agents—would be directly, and potentially very adversely, affected by the sweeping new duties these contemplated regulations would impose. At the outset, allow me to express our appreciation to the Department of Insurance, and to Insurance Commissioner Steve Poizner, for your collective desire to address the pernicious issue of underinsurance in homeowners' insurance. While many previous Commissioners have paid lip service to this problem, Commissioner Poizner is to be commended for this attempt to use his regulatory powers to effect solutions. As a matter of public policy, we share the Commissioner's desire to ensure that California homeowners better understand how the replacement cost of their insured property and contents is calculated, and to make fully informed decisions regarding replacement cost when they select policy coverage limits. Before commenting on the "solutions" the Department has suggested, however, we believe it is essential to understand the complex and varied reasons for the existence of the "problem" of underinsurance. First, economic incentive. | **Response to Insurance Agents and Brokers of the West May 17, 2010 written comments:**<br>(1) The Department concurs and thanks the Insurance Agents and Brokers of the West for this comment and its introductory statement.<br>(2) In consideration of the comment, proposed Section 2695.183 (k) has been amended to state that the procedures referenced are to be "complete written procedures."<br>(3) The regulations require that certain documents be maintained by a licensee who provides an estimate. The word "provide" is appropriate and does not establish any legal duty other than to maintain the records. The word "provide" is defined by Mirriam-Webster Online as "to supply or make available (something wanted or needed)." However, in an effort to make clearer the obligations on licensees concerning the document requirements, proposed Section 2695.182 is amended as follows: "(a) In the event an estimate of replacement cost is provided or communicated by a licensee to an applicant or insured in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis, the licensee shall document and maintain in the applicant's or insured's file the following information:<br>(1) The status of the person preparing the estimate of replacement value, as the insurer underwriter or actuary or other person identified by the insurer, a broker-agent, a contractor, an architect, a real estate appraiser, or other person or entity permitted to make such an estimate by Insurance Code |

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| | Both insurers and homeowners have an economic incentive to underestimate replacement costs. Simply put, the lower the replacement cost valuation, the lower the premium. And the lower the premium, the more likely an insurer is to sell its policies in a highly competitive marketplace, and the more money a homeowner can save. Insurers and homeowners alike understand that total losses are very rare—a fact that makes this line of insurance generally very profitable for insurers, and also generally insulates all parties from the consequences of underestimating total replacement cost. Until or unless someone devices an altogether new pricing model in homeowners' insurance, this economic incentive to underestimate replacement cost will likely always be a significant cause of underinsurance. As an observation and not as a criticism, we note that nothing in the contemplated regulations appears to address this fundamental cause of the problem. Second, impossibility of objective calculation. Even in cases where the insurer and homeowner both want in good faith to determine the most accurate possible estimation of replacement cost, fact is that no single formula or set of calculations yet devised can produce a replacement cost figure that will prove accurate in all cases. There are simply too many variations (even in tract housing) in quality and nature of construction and fixtures, scope and extent of contents, unique building code requirements, slope, effects of supply and demand in the marketplace (even in the absence of "demand surge"), etc,…, to develop a single calculation that guarantees replacement cost has been accurately projected for a given home. The state of the art is certainly more advanced than it has ever been, and it is not unreasonable to expect that further improvements will continue to be made, but it is probably not realistic to expect that such modeling will EVER produce a replacement cost calculation that is 100-percent accurate. To our reading, nothing in the contemplated regulations addresses this fundamental cause of the problem, although we support | section 1749.85;<br>(2) The name, job title, address, telephone number, and license number, if applicable, of the person preparing the estimate of replacement value;<br>(3) The source from which or method by which the estimate of replacement cost prepared, to include any replacement cost calculator, contractor's estimate, architectural report, real estate appraisal, or other source or method; and<br>(4) A copy of any reports, inspection reports, contractor's estimates, or other documents used to prepare the estimate of replacement value.<br>(b) In the event the estimate of replacement cost is provided by a licensee to an applicant or insured, in connection with an application for or renewal of a policy that provides coverage on a replacement cost basis, the licensee shall maintain in the insured's file the records specified in subdivision (a) of this Section 2695.182 for the entire term of the insurance policy or the duration of coverage, whichever terminates later in time, and for five years thereafter. In the event the estimate of replacement cost is provided by a licensee to an applicant to whom an insurance policy is never issued, subdivision (a) of this Section 2695.182 shall not apply.<br>(c) Notwithstanding any other provision of this Section 2695.182, this section shall impose no duty upon a broker-agent to obtain from the insurer and maintain any information or document that in the absence of this section would not come into the possession of the broker-agent in the ordinary course of business."<br>(4) While the Department has not adopted all of the language suggested in the comment, in consideration of the comment, Noticed Section 2695.183 (g) [now "f" under the amended regulations] is amended to include the requested text: "Except as provided in subdivision (k) of this Section 2695.183." Subdivision (k) reads: "When an insurer identifies one or more specific sources or tools that a broker agent must use to create |

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| | the adoption of minimum standards for making such calculations. Third, lack of information. Insurers, insurance broker-agents, third-party vendors who develop and sell replacement cost calculators, and consumers each have particular areas of presumed expertise—which, for the most part, do not overlap: Consumers are in a substantially better position than insurers or broker-agents to know what they own, and to know the value of what they own. It is for this reason that California case law long ago recognized the principle that the primary legal duty to select coverage limits falls upon the applicant for, or buyer of, insurance coverage. Insurers are in a substantially better position than consumers or broker-agents to know what risks they desire to underwrite in their contracts and how they intend to adjust claims, and the third-party vendors they pay to obtain replacement cost calculators, are in the best position to know what factors should be included in such calculations in order to achieve the best estimation ; indeed, we are not aware of any circumstance in which an insurer does not *mandate* one methodology or another for broker-agents to use in offering its policies for sale. However, in point of fact, only a local residential building contractor or appraiser is likely to have the detailed experience, information and expertise necessary to express an informed opinion on potential rebuilding costs in the event of a total loss in any specific area. Insurance brokers and agents are in a better position than consumer s or insurers to explain to consumers the differences between and among the various types of insurance coverages available to residential property owners, and to assist the consumer in selecting the type of policy that best suits the consumer's needs. The Department is to be commended for legislation it is sponsoring this year in the California Legislature to reform the "Petris Disclosures" (required by Insurance Code Section 10102), but even if enacted, the relative complexity and variety of coverage terms and conditions can leave even sophisticated and intelligent | an estimate of replacement cost,<br>(1) the insurer shall prescribe complete written procedures to be followed by broker-agents when they use the sources or tools,<br>(2) the insurer shall provide the broker-agent with the training ~~or~~ and written training materials necessary to properly utilize the sources or tools according to the insurer's prescribed procedures, and<br>(3) the insurer, and not the broker-agent, shall be responsible for any noncompliance with this Section 2695.183 that results from the failure of the estimate to satisfy the requirements of subdivisions (a) through (e), unless that noncompliance results from failure by the broker-agent to follow the insurer's prescribed written procedures when using the source or tool."<br>(5) In consideration of this and other comments, proposed Section 2188.65(b) has been amended to provide the 180 days suggested. Further subdivision (q) has been added to proposed Section 2695.183 to establish the effective date of the regulation insofar as its applicability to estimating replacement value as follows: "This article shall apply only to estimates of replacement value that are prepared, communicated or used by a licensee on or after the day that is one hundred eighty (180) calendar days after filing with the Secretary of State." |

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| | consumers confused. In these regulations, CDI has developed several intriguing proposals aimed at expanding consumer awareness and information, which we support. However, it is imperative for the Department to keep these relative areas of expertise in mind as it considers imposing new duties upon insurers and their vendors, producers, or consumers.<br>(1) No party to an insurance transaction should be held liable for decisions that fall outside their area of assumed responsibility or expertise, especially where the party in question has NOT accepted a legal duty to so act.<br>Consistent with that principle, we applaud the Department for the following provision, within proposed Section 2695.183(k): "When an insurer requires that a broker-agent utilize a specific source or tool to create an estimate of replacement cost or construction costs, (1) the insurer shall prescribe procedures to be followed by broker-agents when they use the source or tool, (2) the insurer shall provide the broker-agent with the training or training materials necessary to properly utilize the source or tool according to the insurer's prescribed procedures, and (3) the insurer, and not the broker-agent, shall be responsible for any noncompliance with the provisions subdivisions (a) through (f) of this Section 2695.183, unless that noncompliance results from failure by the broker-agent to follow the insurer's prescribed procedures when using the source or tool." We also strongly support, and thank the Department for incorporating into the proposed regulations, Section 2695.183(m): "No provision of this article shall be construed as requiring a licensee to estimate replacement cost to set, or recommend to an applicant or insured, a policy limit on a homeowners' insurance policy. No provision of this article shall be construed as requiring a licensee to advise the applicant or insured as to the sufficiency of such an estimate." However, in order to eliminate ambiguity and to resolve a significant internal inconsistency, we would respectfully urge the Department to make three additional changes, all of which | |

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| | are technical rather than substantive in nature, yet essential, in our opinion, not only to comply with the minimum standards of the California Administrative Procedures Act for the promulgation of lawful regulations, but also to ensure that the regulations are not misconstrued. (2) First, we strongly urge the Commissioner: to amend proposed Section 2695.183(k)(1) by requiring insurers to "… prescribe written procedures to be followed by broker-agents…"; to amend subsection (k)(2) to require insurers to "provide the broker-agent with the training ~~or~~ and written training materials…"; and to amend subsection (k)(3) to hold broker-agents accountable if they fail "… to follow the insurer's prescribed written procedures …." the obvious purpose of the changes recommended above is to ensure that the insurer has clearly communicated objective standards to the broker-agent—and that the CDI (or other trier of fact) is thus in a better position to evaluate compliance with these requirements.<br>(3) Second, we are concerned that proposed Section 2695.182 ("Documentation of Person Making Estimate") could be misconstrued to impose legal duties on broker-agents they do not wish, and are not qualified, to assume, and to provide information to applicants or insureds that is outside their knowledge. Specifically, subsection (a) of that section applies to any licensee who has "provided" … "any estimate of replacement cost or estimate of construction costs…."<br>The word, "provided," is not defined. It could be construed to mean either the act of making the calculation, or the mere act of conveying the calculation made by another. In almost every case, the insurer or a vender selected by the insurer will be performing the former role, and in almost every case, the broker-agent will be performing the latter role.<br>This failure to define precisely what is, and is not, meant by "providing" the estimate is no mere semantic. By stating, as part of the disclosure required by the section, that she has "provided" the replacement cost estimate to the consumer— | |

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| | merely because she followed procedures and used a methodology mandated by her insurer—she is arguably representing and warranting an independent evaluation or determination that, in fact, she has not undertaken and is in no position to undertake. We urge CDI to revise proposed Section 2695.182 to require insurers to make the disclosures required by that section, at least in any case where an insurer requires use of a particular source, tool or methodology, and to better recognize that the broker-agent's only role, in the vast majority of cases, is to convey the results of the calculations produced by the insurer's methodology—and that disclosure by the broker-agent should be limited to the functions actually performed and legal duties actually assumed by the broker-agent. We would also recommend that the disclosure requirements in Section 2695.182 be expressly added by reference to the provisions of Section 2695.183(k)(3) that make "the insurer, and not the broker-agent" responsible for non-compliance, except as noted in the current regulatory proposal. (4) Here is our third and final technical amendment on this subject: We would respectfully urge CDI to likewise add a reference to Subsection (g) of 2695.183 to the provisions of Section 2695.183(k). Subsection (g), as proposed, now provides, in part: "The provisions of this article are binding upon licensees, notwithstanding the fact that information, data, or statistical methods used or relied upon by a licensee to estimate replacement cost may be obtained through a third party source." To be clear: If a broker-agent wishes to voluntarily assume the responsibility for selecting the replacement cost valuation, or even expressing a professional opinion on its adequacy, then of course that licensee could be—and already IS—potentially liable in the event the estimate is materially wrong. But in cases where a broker-agent is merely using the tools mandated by an insurer, we believe it is not reasonable or fair to make broker-agents responsible to ensure that every aspect of the insurer's | |

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| | methodology conforms to the many requirements of these regulations—and we believe that is precisely how subsection (g) could be read.<br>In summary, we believe proposed Section 2695.183(k) should be amended as follows to read:<br>"When an insurer requires that a broker-agent utilize a specific source or tool to create an estimate of replacement cost or construction costs, (1) the insurer shall prescribe written procedures to be followed by broker-agents when they use the source or tool, (2) the insurer shall provide the broker-agent with the training ~~or~~ and written training materials necessary to properly utilize the source or tool according to the insurer's prescribed procedures, and (3) the insurer, and not the broker-agent, shall be responsible for any noncompliance with the provisions subdivisions (a) through ~~(f)~~ (g) of this Section 2695.183, and Section 2695.182, unless that noncompliance results from failure by the broker-agent to follow the insurer's prescribed written procedures when using the source or tool."<br>(5) Finally, we offer two very important recommendations regarding implementation. Proposed Section 2188.65(b), which is based on preexisting California Insurance Code Section 1749.85, requires all broker-agents who solicit dwelling or homeowners' insurance to complete a three-hour continuing education requirement within 90 days after these regulations take effect. Additional time is needed. We recommend at least six months after the anticipated effective date of the regulations, and we would recommend that the CDI amend this provision by adding a date-specific (rather than tying the effective date to a future approval date that broker-agents would not readily understand or be able to easily ascertain), or making the regulations effective on the later of either x-day or six months after adoption. | |
| **Insurance Agents and Brokers of the** | Good morning distinguished panel. For the record, my name is Steve Young. I have the privilege of representing and appearing today for the independent insurance agents and the | **Response to Insurance Agents and Brokers of the West testimony given at May 17, 2010 Public Hearing in Los Angeles, CA:** Mr. Young testified on behalf of Agents and |

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| **West testimony given at May 17, 2010 Public Hearing in Los Angeles, CA** | insurance brokers of California who are members of IBA West. And we're here to thank the Department, first, for a great number of changes that you have made from the pre-notice discussion draft that we last gathered in February to discuss here. I'll talk more about that in just a second.<br>And pleased to support the adoption of the regulations with a couple of changes which I'll outline briefly. Number one, I just wanted to say, on the record, that we very much appreciate the effort that the Department is making to try to address this problem. We all recognize that there are a lot of<br>different reasons for underinsurance and consumer education and with the information to them, I think is a key departmental, and plainly not the solution to every reason for the underinsurance problem. But it is key factor, and we support the Department's efforts to both formulate specific<br>concrete objective standards for what should be and should not be in these calculations. We definitely thank you for that. And I would like to especially like to thank the<br>Department for adding in Section 2695.183(k) provisions that essentially recognize that he who selects or determines replacement cost estimations -- estimated figures, he should be liable for. And to the extent that an agent or broker as the sales intermediary is simply using the methodology or tools that the insurer has mandated, the agent/broker should not be liable. And that's both common sense, but that is also consistent with California law and law of every other state regarding who is liable for these decisions. And we'd also like to thank and applaud the Department for adding Subsection (m) of that same section 2695.183, which makes it clear that<br>nothing in these regulations is intended to convey a legal duty on the part of an agent/broker or any other person, any other licensee to actually make this determination in lieu of a consumer or policyholder decision. We think those are very, very beneficial changes; so thank you for that.<br>Probably wouldn't be earning my salary today if we didn't have a | Brokers of the West. As Mr. Young mentioned, written comments were provided to the Department and those written comments have been presented in this Final Statement of Reasons, along with the Department's responses to the comments. In this regard, as Mr. Young did not provide any different comments than those presented in the written comments, but rather, summarized those written comments, the Department incorporates fully herein its response to the Agents and Brokers of the West written comments. |

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| | few suggestions for additional changes; so let me run those just briefly. Number one, in 2695.183(k) there is a provision there that requires insurers to proscribe the procedures that their broker/agents are to follow. We believe that regulations should be amended to specify that these procedures should be put in writing. It's very important, we believe, for the Department of Insurance to be able to evaluate compliance of these (inaudible) equally important<br>for agents and brokers to have a clear documented list of the roles that they're expected to follow. So we would recommend conforming changes to (k)(2) and (k)(3), as well, to make sure these procedures are not oral, they are in writing. We are concerned secondly, that there continues to be some language within the regulations that is internally inconsistent with respect to what it means to provide a replacement cost estimate.<br>I'm focusing specifically on Subsection (a) now of Section 2695.182. This is the section that sets forth the various documentation requirements. And it says that this section, Subsection (a) of 2695.182, applies to any licensee who has<br>provided, quote-unquote, any estimate of replacement<br>cost or estimate of construction cost. The problem that we see with the word provided is not found here. It could be given two very significantly different interpretations. The first is merely conveying an analysis or a calculation that has been obtained from using a software program. Or it could mean actually making that determination themselves So in order to be unambiguous and to be internally consistent we the provisions we just discussed in .183(k), we believe, really, about two or three different options here One is to try to define what you mean by providing in this instance. But the other option would be to simply amend .183(k) which currently essentially provides -- I don't want to call it immunity, but it shelters an agent or broker who I simply using the insurer's methodologies, only from complying with Subsections (a) through (f) of 26935.183.<br>And one solution to this ambiguity and the internal inconsistency | |

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| | would be to also reference .183(k) or add a reference in .183(k) to this documentation requirement in 2695.182. And we will be providing written testimony<br>to give specific language and it elaborate in a little more detail our concerns here and why we believe it was essential to make this change in order to conform with the administrative procedures. It's not a substantive (inaudible) but it's highly technical one to be internally consistent.<br>Last point I'll make in my oral comments is just to second the comments of the ACIC regarding the time for complying with the continuing education requirement. And we actually have two suggestions for you there. Number one, we agree that a minimum of 180 days is a more appropriate timeline for every licensee of the Department who is selling or transacting homeowners insurance to obtain the mandatory CE. But the other suggestion we would make because agents and brokers, in many instances, will be reading these regulations themselves, trying to figure out what's required to comply -- I mean, because they won't necessarily know when the regulations are actually and finally improved, if at all, by the Office of Administrative Law. We recommend, you know, suggesting, you know, an alternative statement of, you know, either six months after approval, or you know -- I'm just going to use -- throw a date out of March 1, of 2011, whichever is later, or language to that effect.<br>I'd be happy to answer any questions if the panel has any. And I really think that Commissioner Poizner and this Department deserves a great deal of credit for very hard work and the amount of thought you've put into this. And to the extent, as we believe, there is substantial lack of information and lack of understanding about what the placement cost calculation is, and what factors do and do not go into it, we think these regulations are a very substantial step forward to helping to solve this problem. | |
| **Jose Solario and Ron Calderon –** | August 27, 2010<br>RE: Homeowners' Insurance<br>Dear Mr. Poziner [sic]: | **Response to Jose Solario and Ron Calderon – State Assembly Member, State Senator August 27, 2010 written comments:** |

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| **State Assembly Member, State Senator August 27, 2010 written comments** | Thank you for taking time in our recent discussions to outline your views about the need for additional regulations affecting homeowners' insurance. As the Chairs of the Legislative Committees with jurisdiction over insurance law, we believe this dialogue furthers the Legislature's ongoing responsibility for oversight of Department of Insurance (CDI) activities.<br>We heard clearly your belief that homeowners' insurance policyholders and applicants would benefit from additional information to aid their selection of policy limits. (1) We certainly agree that an informed, intelligent decision about policy limits is important, and that an intelligent conversation between a consumer and a well-trained insurer employee or agent can be a key component in that decision. As you consider regulations on this topic, (for example, proposed CDI regulation 2010-00001) we look forward to establishing a common view of the Legislature's prior agreements and enactments in this area of law. (2) In your regulation's current iteration, we are concerned the structure of the proposed regulation might actually *discourage the very conversations that we agree ought to occur*. Specifically, the regulation's "trigger" for imposition of its primary requirements would be the use, in a insuring transaction, of the words "replace" or "replacement". We're concerned that under such a regime, insurers or agents might simply try to avoid using these terms in an effort to avoid the requirements of the regulation; Indeed CDI staff has, as we understand it, suggested to the industry that avoiding the use of these terms is all an insurer need do to avoid the regulation if it deems the requirements too onerous. That seems an anti-consumer outcome. We believe that any intelligent conversation about coverage limits for a homeowner's policy *should* include the words "replace" and "replacement." (3) As lawmakers, we do recognize that the devastating October 1991 fires in the Oakland hills dramatically changed the type of homeowners' insurance coverage available for consumers in California. Prior to the | (1) The Department concurs that an informed, intelligent decision regarding policy limits is important and that intelligent communications between well trained insurer employees (and agents and brokers) and consumers is a key component in that decision. The proposed regulations allow for clear and understandable communications regarding the meaning of estimated replacement cost estimates. The consumer and the licensee will communicate knowing what the term "replacement cost estimate" means and what it does not mean. It will end confusion and enable licensees to better engage their customers and provide the opportunity for consumers to make informed decisions regarding their insurance needs. The proposed regulations take into consideration fully the Legislature's enactments in the area of homeowners' insurance.<br>(2) The Department rejects the proposition that the regulations discourage a conversation about replacement cost. In fact, the regulations provide clarity when the term replacement cost is used. Simply, the proposed regulations require that when a licensee communicates a replacement cost estimate to a consumer, that the replacement cost estimate will include consideration of certain factors and components. In this way, both the licensee and the consumer will know, without any ambiguity, what the estimate of replacement cost includes. The regulations do not require that the estimate be entirely accurate, or that it guarantees the amount estimated will be sufficient to rebuild the house. In light of this comment, and others, the proposed regulations have been amended to make this concept even more apparent. In this regard, Section 2695.183 (j) has been amended so as to define more narrowly and specifically the obligation to provide an estimate that comports with 2695.183 (a) through (e) [these subdivisions specify with particularity those features and components to be considered when estimating replacement value] as follows:<br>"To communicate an estimate of replacement value not comporting with subdivisions (a) through (e) of this |

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| | fires, it was common for carriers to offer coverage guaranteeing a complete reconstruction following a total fire loss, regardless of coverage limits purchased. This type of coverage was not without controversy, particularly when homeowners alleged that agents urged the purchase to "too much" insurance and purposely "over-insured" them. Since the Oakland fires, guaranteed replacement cost policies have become in increasingly rare. More common in today's marketplace are homeowners' insurance policies with a specified maximum dollar policy limit which the applicant selects after considering his or her needs. Under such a "limited" replacement cost policy, if the costs to reconstruct a home to pre-loss condition exceed the policy limit, the insurance contract requires the carrier to pay the policy limit, but no more. Many insurers also offered "extended replacement" policies, which still provided coverage above the stated policy limits, but which also contained a firm maximum, usually stated as a percentage of the basic coverage limits. In the aftermath of the Oakland Hills Fire, the Legislature carefully considered the confusion that a policyholder may experience when shopping for a "limited" or "extended" or "guaranteed" replacement cost policy. After extensive deliberation, the Legislature adopted standardized language that describes the various options that carriers must use when offering homeowners' insurance. (See Insurance Code Section 10102.) Policies promising a complete reconstruction without regard to policy limits are now known as "guaranteed replacement cost" policies; policies promising reconstruction up to, but not exceeding, policy limits are now known as "limited replacement cost" policies. In our discussions, you indicated a belief, based upon observations at town hall meetings and complaints received by CDI staff, that confusion remains among policyholders about the difference between guaranteed and limited replacement cost policies. You also expressed a desire that insurers and agents be a source of | Section 2695.183 to an applicant or insured in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis constitutes making a statement with respect to the business of insurance which is misleading and which by the exercise of reasonable care should be known to be misleading, pursuant to Insurance Code section 790.03." Further, in consideration of this comment and others, that that the proposed regulations are in conflict with California statutory law and somehow would limit a licensees communication about the California Residential Property Insurance Disclosure, the proposed regulations have been amended to add Section 2695.183 (n) as follows: "No provision of this article shall limit or preclude a licensee from providing and explaining the California Residential Property Insurance Disclosure, as cited in Insurance Code section 10102, explaining the various forms of replacement cost coverage available to an applicant or insured, or explaining how replacement cost basis policies operate to pay claims."<br>(3) The Department agrees that since the availability of guaranteed replacement cost policies is limited, it is of paramount importance that confusion regarding "replacement cost" be addressed. These proposed regulations do just that. They make clear what the term "replacement cost" and "replacement value" estimate mean. It should be noted, as well, that the proposed regulations do not define insurance policies. They do not provide information concerning what is meant by limited, extended or guaranteed replacement cost policies. This is left to the disclosures mandated by the Legislature through Insurance Code Section 10101 et. seq. As referenced in the comment, the effort to address confusion regarding the types of insurance policies available on the homeowner insurance market and their meaning, the Department sponsored and the Legislature passed AB 2022 (Gaines). The proposed regulations address the meaning of estimates of replacement cost, not the |

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| | credible information on these matters and not add to marketplace confusion. To address these concerns, with our strong backing, the Legislature has just passed without a "no" vote your sponsored legislation, AB 2022 (Gaines), to improve the standardized form. (4) With respect to your pending rulemaking, you have advised us that you believe current law authorizes the CDI to promulgate regulations requiring 1) insurance producers to obtain training regarding replacement cost issues, 2) carriers to keep additional records that would aid CDI examinations and 3) carriers/producers to provide consistent and comprehensive information when choosing to provide non-binding estimates of replacement cost. As part of the Legislature's oversight role, we look forward to reviewing the results of this rulemaking to ensure it is both good policy and consistent with your statutory authority – which we regard as quite specific. (5) Initial drafts of the proposed rule have raised questions about the CDI's purpose and authority. We appreciate the assurances you have given us that the CDI does not intend to alter the balance achieved under current law to allow both guaranteed and limited replacement cost policies in the marketplace. (6) Further, we appreciate and agree with your view that CDI rules should respect the current law which 1) allows agents and insurers to offer non-binding estimates of replacement cost without triggering guaranteed replacement cost liability and 2) respects the role of applicants and policyholders in selecting their own policy limits and costs, consistent with the ruling in Everett v. State Farm, 162 Cal.App.4th 649 (2008). As you consider how to finalize the proposed rule, it is important to ensure that knowledgeable decisions are made up front and clear understandings are reached between consumers and insurers or agents so that a limited replacement cost policy does not become unwittingly transformed into a guaranteed replacement cost policy, and consumers are not unwittingly sold insurance that they do not need. (7) Specifically, as we | definition or meaning of insurance policies.<br>(4) The Department clearly has the authority to promulgate the proposed regulations under Sections 35, 730, 790.03, 790.04, 790.10, 1631, 1633, 1727, 1749.7, 1749.85, 1763, 1768, 1861.05 and 2051.5 of the Insurance Code.<br>(5) The Department in promulgating the regulations, as the comment states, has no intention of altering the balance achieved under current law so as to permit both guaranteed and limited replacement cost polices in the marketplace.<br>(6) Nowhere in the proposed regulations is there any requirement, obligation, mandate, or inference that would prohibit licensees from offering non-binding estimates of replacement cost without triggering guaranteed replacement cost liability. Similarly, the proposed regulations do nothing to alter the role of applicants and policyholders in selecting their own policy limits. As noted above, the proposed regulations apply to estimates of replacement cost, not the definition or meaning of insurance policies. In response to comments that the noticed regulations prevented an applicant or insured from obtaining his or her own estimate of replacement cost, the regulations have been amended to add Section 2695.183 (o) as follows:<br>"No provision of this article shall limit or preclude an applicant or insured from obtaining his or her own estimate of replacement cost from an entity permitted to make such an estimate by Insurance Code section 1749.85."<br>(7) The comment re-states the concerns referenced in comment (2). Again, the Department rejects the proposition that the regulations discourage a conversation about replacement cost. Rather, the regulations provide clarity when the term replacement cost is used. Simply, the proposed regulations require that when a licensee communicates a replacement cost estimate to a consumer, that the replacement cost estimate will include consideration of certain factors and components. In this way, both the licensee and the consumer will know, without |

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| | discussed above, proposed section 2695.183(j) would appear to trigger increased regulation and possible sanction upon the mere use of the words "replace" or "replacement" during a transaction. This approach could inappropriately jeopardize the viability of a limited replacement cost market, which empowers<br>individual homeowners to control their insurance costs and thereby acts as a safeguard against both predatory sales of inflated coverage on the one hand, and sales of inadequate coverage on the other. (8) Further, this approach could wrongly incentivize agents and insurers to pressure the purchase of ever higher policy limits based on a fear that post-fire policy proceeds insufficient to permit a complete reconstruction would result in mandated extra-contractual liability. Neither under-, not over-insurance is a good result. We understand and respect your statement that this is not your intent for the regulations. We are relying on your assurance that the final rule will address our concerns in this area.<br>(9) We also appreciate your clear statement that it is your intent that proposed section 2695.183 work to ensure that applicants receive consistent and comprehensive information when selecting their policy limits. We are inclined to support your view that applicants would be in a better position to select their initial policy limits if the law posed no obstacle, legal or practical, to the readiness of agents and carriers to offer high quality, non-binding reconstruction cost estimates. This does appear to be service that state law should encourage. We look forward to your attempt to develop a rule that would specify the minimum structural components, including foundation type, which must be factored into a licensee's non-binding estimate of reconstruction costs that it may choose to provide to an applicant. Ensuring that up front estimates are fair, reasonable, understood and well-documented by both parties is the better way to avoid post-claim disputes. (10) Because questions have been raised about the extent of the CDI's | any ambiguity, what the estimate of replacement cost includes. The regulations do not require that the estimate be entirely accurate, or that it guarantees the amount estimated will be sufficient to rebuild the house. In light of this comment, and others, the proposed regulations have been amended to make this concept even more apparent. In this regard, Section 2695.183 (j) has been amended so as to define more narrowly and specifically the obligation to provide an estimate that comports with 2695.183 (a) through (e) [these subdivisions specify with particularity those features and components to be considered when estimating replacement value] as follows: "To communicate an estimate of replacement value not comporting with subdivisions (a) through (e) of this Section 2695.183 to an applicant or insured in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis constitutes making a statement with respect to the business of insurance which is misleading and which by the exercise of reasonable care should be known to be misleading, pursuant to Insurance Code section 790.03." Further, in consideration of this comment and others, that that the proposed regulations are in conflict with California statutory law and somehow would limit a licensees communication about the California Residential Property Insurance Disclosure, the proposed regulations have been amended to add Section 2695.183 (n) as follows: "No provision of this article shall limit or preclude a licensee from providing and explaining the California Residential Property Insurance Disclosure, as cited in Insurance Code section 10102, explaining the various forms of replacement cost coverage available to an applicant or insured, or explaining how replacement cost basis policies operate to pay claims."<br>(8) As the comment notes, it is not the intent of the proposed regulations to incentivize licensees to pressure the purchase of higher policy limits on a fear that insufficient policy proceeds |

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| | authority to directly regulate the cost-estimation process, we may consider consulting the Legislative Counsel's office to seek additional guidance on this matter. (11) We also think it very important that, when developing a rule regarding non-binding estimates of replacement cost, that the CDI wisely use its powers under the Unfair Practices Act (Insurance Code section 790) without triggering unnecessary disputes over the extent of CDI power. While the CDI's powers under 790.03 are strong, they are not, of course, unlimited. As the CDI drafts a rule to assist applicants and policyholders, we urge careful consideration of how to improve the current system without jeopardizing the viability of a limited replacement cost system which allows applicants and policyholders to manage their coverage limits and costs. (12) As the CDI moves to finalize its rule, we will continue to seek input from all stakeholders to evaluate how the rule would fit within the existing statutory and case law framework. Interim hearings may be appropriate should critical issues remain unaddressed by the rulemaking, as both a resource available to the CDI and as a basis for the formulation of legislation in 2011, should it be necessary. Thank you for your leadership and collaboration on this important matter. We invite you to reply to this letter with a confirmation of our mutual understanding with respect to the development of the law in this area and your intentions to develop further clarity that will avoid post-claim disputes in the future. Sincerely,<br>JOSE SOLORIO<br>RON CALDERON<br>State Assembly member<br>State Senator | would result in "mandated extra contractual liability." Initially, again, the proposed regulations do not require that the estimated replacement cost estimate by necessarily accurate in estimating the replacement value, only that the specifically referenced components and factors in reaching the estimate be considered. Secondly, nothing in the proposed regulations support the proposition that because an estimated replacement cost estimate may not be sufficient to rebuild a home mandates "extra-contractual liability." Notwithstanding this, based upon this comment and others, the proposed amended regulation, Section 2695.183 (m) has been amended to state as follows: "No provision of this article shall be construed as requiring a licensee to estimate replacement cost or to set, or recommend a policy limit to an applicant or insured. No provision of this article shall be construed as requiring a licensee to advise the applicant or insured as to the sufficiency of an estimate of replacement cost." Further, in response to this comment and others, that the regulations in some manner interfere with licensees' rights in determine their own eligibility guidelines in writing homeowners' insurance policies, the regulations have been amended to add Section 2695.183 (p) as follows: "For purposes of this subdivision (p), "minimum amount of insurance" shall mean the lowest amount of insurance that an insurer requires to be purchased in order for the insurer to underwrite the coverage on a particular property, based upon an insurer's eligibility guidelines, underwriting practices and/or actuarial analysis. An insurer may communicate to an applicant or insured that an applicant or insured must purchase a minimum amount of insurance that does not comport with subdivisions (a) through (e) of this Section 2695.183; however, if the minimum amount of insurance that is communicated is based in whole or in part on an estimate of the replacement value, the estimate of replacement value shall also be provided to the applicant or insured and shall comply with all applicable provisions of this article. Nothing in this article shall limit or |

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| | | preclude an insurer from agreeing to provide coverage for a policy limit that is greater than or less than an estimate of replacement cost provided pursuant to this article. “<br>(9) The Department agrees. The proposed regulations meet these goals. Specifically, as to the comment that the Department develop a rule that would specify the minimum structural components, including foundation type, the proposed regulations include these specifications. Further, based upon this comment and others, the Department has revised the proposed regulations to make clearer the structural components and factors to be considered in preparing an estimate of replacement cost. Proposed Section 2695.183 (a)(1) through (5) has been amended as follows: “(1) Cost of labor, building materials and supplies; (2) Overhead and profit; (3) Cost of demolition and debris removal;-(4) Cost of permits and architect’s plans; and (5) Consideration of components and features of the insured structure, including, at least the following: (A) Type of foundation; (B) Type of frame; (C) Roofing materials and type of roof; (D) Siding materials and type of siding; (E) Whether the structure is located on a slope; (F) The square footage of the living space; (G) Geographic location of property; (H) Number of stories and any nonstandard wall heights; (I) Materials used in, and generic types of, interior features and finishes, such as, where applicable, the type of heating and air conditioning system, walls, flooring, ceiling, fireplaces, kitchen, and bath(s); (J) Age of the structure or the year it was built;. and (K) Size and type of attached garage.”<br>(10) As referenced in response to comment (4) the Department has authority to promulgate the proposed regulations pursuant to Sections 35, 730, 790.03, 790.04, 790.10, 1631, 1633, 1727, 1749.7, 1749.85, 1763, 1768, 1861.05 and 2051.5 of the Insurance Code.<br>(11) The Department understands the importance of the comment and the proposed regulations do, in fact, represent a |

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| | | conservative, well reasoned approach to assisting consumers in making insurance decisions, while at the same time, setting forth clear and reasonable requirements for licensees in estimating replacement cost. The proposed regulations will not create unnecessary disputes over the extent of the Department's power under Section 790.03. The regulations state simply that if a licensee communicates that an estimate is an estimate of replacement cost, that is take into consideration the components and factors necessary to achieve a complete estimate, components and factors that are stated in specific, clear and easily understood language. The rulemaking authority is clear, as well. For example, Section 790.10 states: "The commissioner shall, from time to time as conditions warrant, after notice and public hearing, promulgate reasonable rules and regulations, and amendments and additions thereto, as are necessary to administer this article."<br>(12) The Department has received a number of comments, as referenced in this document, and has provided responses to each. Further, the Department has incorporated many of the suggestions and addressed most, if not all, of the concerns expressed in the comments, pursuant to the 15 Day Notice and the revised text of regulations accompanying it. |
| **Robert G. (Bob) Taylor November 3, 2010 written comments** | I have been an insurance broker for over 30 years. I applaud the new proposed regulations, however, they only deal with the underinsurance problem. In my area, Stanislaus, San Joaquin, Tuolumne and Merced Counties. We have been battling with the insurance carriers on over insurance issues, without any success. (1) For example, a client of mine purchased a small duplex. I received replacement cost estimates from three general contractors, in our area, that build this type of structure. All three came in at about $ 110 to $120 per square foot plus $25,000 to $50,000 for debris removal and site work. Seven different insurance companies said they used the Marshall Swift replacement cost estimating system. All estimated that this little, standard construction, duplex was | **Response to Robert G. (Bob) Taylor**<br>**November 3, 2010 written comments:**<br>(1) The proposed regulations provide that an applicant for homeowner's insurance may obtain his or her own estimate of replacement cost. Proposed Section 2695.183 (o) states**:** "No provision of this article shall limit or preclude an applicant or insured from obtaining his or her own estimate of replacement cost from an entity permitted to make such an estimate by Insurance Code section 1749.85. " In this regard, the applicant in the example provided in the comment would have the option of using his or her own estimate of replacement cost provided that the entity making the estimate is permitted to do so by Insurance Code section 1749.85. With respect to the carriers |

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| | $250 per square foot. They forced my client to purchase $ 350,000 of insurance on this building when the actual replacement cost is $ 200,000. This is not an isolated case. It is with all our homeowners and dwelling fire clients. (2) They are paying 20 to 30 percent more than they should for their policies. I think this issue should also be addressed along with the underinsurance problem. The regulations should address the total replacement cost problem.<br>Any help or assistance you can give us in this area would be greatly appreciated by my clients and the citizens of our great state.<br>Thank you!<br>Robert G. (Bob) Taylor | decision to use Marshall Swift, the regulations do not seek to regulate an insurer's use of an outside vendor or other source to generate an estimate of replacement value, only to set forth standards no matter what source is created by or on behalf of the licensee.<br>(2) The regulations provide a definition of estimate of replacement cost and describe how the estimate is to be determined when communicating it to an applicant or insured. In this regard, the regulations seek to provide clarity and understanding to insurance applicants, insureds and licensees, alike, in communicating about estimates of replacement cost. |
| **Wawanesa Insurance November 12, 2010 written comments** | Hi Joel,<br>I apologize for not attending the hearings on this important regulation.<br>(1) It is our hope that consideration be given to granting up to two years to implement. If we did something like the 2006 auto rate regs where a carrier had 2 years to comply, it would make things smoother and easier for the vendors, industry , the DOI and consumer. IT shops these days have a lot on their plate.<br>(2) Consider an exemption to the regs for a carrier that provides a minimum extended replacement cost i.e. for 200% of ERC or GRC. Why ? The ITV is out dated the next day. In a Cat situation no matter how good job of ITV, the demand surge for contractors and materials may still result in under-insurance.<br>This is another way to tackle an underinsurance issue with better coverage.<br>(3) Another issue is the 3 days to provide the consumer with a copy of the valuation. Unless there is a compelling reason, suggest consideration to allow up to 30 days.<br>David | **Response to Wawanesa Insurance November 12, 2010 written comments:**<br>(1) The regulations become effective 180 days after they are filed with the Secretary of State pursuant to proposed Section 2695.183 (q): "This article shall apply only to estimates of replacement value that are prepared, communicated or used by a licensee on or after the day that is one hundred eighty (180) calendar days after filing with the Secretary of State." The Department believes it is in the best interest of consumers and licensees that the regulations be implemented as soon as is practical given the significance of assuring that broker-agents receive training on estimating replacement cost, and that licensees communicating estimates for replacement cost do so in accordance with the proposed regulations. In this regard, the Department believes that the 180 day implementation time frame is sufficient to permit licenses and vendors to take steps that are reasonably necessary to comply with the proposed regulations.<br>(2) The regulations provide that an insurer may offer a minimum amount of insurance. Proposed Section 2695.183 (p) states: "For purposes of this subdivision (p), "minimum amount of insurance" shall mean the lowest amount of insurance that an |

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| | | insurer requires to be purchased in order for the insurer to underwrite the coverage on a particular property, based upon an insurer's eligibility guidelines, underwriting practices and/or actuarial analysis. An insurer may communicate to an applicant or insured that an applicant or insured must purchase a minimum amount of insurance that does not comport with subdivisions (a) through (e) of this Section 2695.183; however, if the minimum amount of insurance that is communicated is based in whole or in part on an estimate of replacement value, the estimate of replacement value shall also be provided to the applicant or insured and shall comply with all applicable provisions of this article. Nothing in this article shall limit or preclude an insurer from agreeing to provide coverage for a policy limit that is greater than or less than an estimate of replacement cost provided pursuant to this article." The proposed regulations do not characterize this as an "exemption" as described in the comment, however, they do provide that an insurer may state to an applicant or to an insured at renewal that it, the insurer, will only sell the insurance policy if the applicant or insured purchases the minimum amount of insurance set by the insurer. Further, the provision provides that an insurer need not base the minimum amount of insurance on a replacement cost estimate and therefore, need not comply with the requirement that certain features and components be considered in estimating replacement cost. Only if the minimum amount of insurance is based on an estimate of replacement cost must the insurer comply with the regulations in this regard.<br>(3) Proposed Section 2695.193 (g) (1) provides in relevant part that: "…In the event the estimate of replacement cost is communicated by telephone to an insured, the copy of the estimate shall be mailed to the insured no later than three business days after the time of the telephone conversation. In the event the estimate of replacement cost is communicated by telephone to an applicant, the copy of the estimate shall be mailed to the applicant no later than three business days after |

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| | | the applicant agrees to purchase the coverage." The three day time frame is not onerous and permits the insured the opportunity to review the estimate of replacement cost in a timely fashion after the telephone conversation. A thirty day time frame, as suggested in the comment, would allow too much time to elapse between the conversation and receipt of the estimate. A meaningful, timely discussion or analysis, if needed, concerning the estimate of replacement cost, would be less likely. If an applicant asks for an estimate over the phone and does not agree to purchase the policy, the estimate need not be sent to the applicant at all. Only if the applicant decides to purchase the policy is the licensee obligated to mail a copy of the estimate to the applicant within three business days after the applicant agrees to purchase the policy. Again, this is neither onerous nor unreasonable and provides the applicants who become insureds the opportunity for a timely opportunity to review the estimate. |
| **California Association of Independent Insurance Adjusters November 8, 2010 written comments** | Dear Mr. Tancredi:<br>You may recall that we spoke shortly after the May 17, 2010, public hearing on the originally proposed text of the above referenced proposed regulations. (1) Specifically, I inquired as to whether or not Article 1.3 Section 2695.180 and all subsequent subsections of the proposed regulations would apply to Independent Insurance Adjusters. As I pointed out in our conversation, the Definition of "Licensee" as set forth in Section 2695.180 (d) (1) and (3) would lead one to conclude that any reference to a "Licensee" would pertain to Independent Insurance Adjusters throughout all subsequent sections of the proposed regulations.<br>At the time we spoke, you expressed your understanding that these regulations were intended to apply only to agents and brokers, but you stated that you would send out an e-mail to the co-drafters of the legislation to verify your understanding. You also stated that you would get back to me if you received any information to the contrary. | **Response to California Association of Independent Insurance Adjusters November 8, 2010 written comments:**<br>(1) The proposed regulations apply to those defined as licensees under Section 2695.180 (d):<br>"Licensee" means (1) any person or entity that holds a license or certificate of authority issued by the Department of Insurance; (2) a broker-agent; or (3) any other entity for whom the Insurance Commissioner's consent is required before transacting business in the State of California or with California residents." Independent insurance adjusters are licensees as defined in the section; as are broker-agents and insurers, however, the regulations apply to those licensees who communicate an estimate of replacement cost in connection with an application for or renewal of a Homeowners' insurance policy that provides coverage on a replacement cost basis. It is the understanding of the Department that independent insurance adjusters investigate and adjust insurance claims; they are not involved, typically, in communicating an estimate of |

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| | As a member of the Curriculum Board, I was recently provided a link to the material that was added to the originally noticed text in response to the comments received at the public hearing. This information prompted me to write to you to re-confirm that these regulations are not applicable to Independent Adjusters, particularly since will modify California Code of Regulations, Title 10, Chapter 5, and Subchapter 7.5.<br>From my reading of the amended text, it appears that the insertion of the phrase "in connection with an application for or renewal of a Homeowners' insurance policy that provides coverage on a replacement cost basis" in all relevant sections of the text does confirm your original position that the entirety of Article 1.3 "Valuation of Homes" is not applicable to Independent Insurance Adjusters.<br>Would you please contact me at your earliest to let me know if you have obtained any information that would cause you to believe that these proposed regulations do apply to Independent Adjusters? Thank you for your kind attention to this matter.<br>Yours truly,<br>Helen DalCin<br>California Association of Independent Insurance Adjusters | replacement cost to an applicant for insurance or insured, in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis. If an independent insurance adjuster was involved in this defined activity, then, of course, the regulations would apply to his or her actions; otherwise, they would not. |
| **Personal Insurance Federation of California (PIFC) November 12, 2010 written comments** | Dear Mr. Tancredi:<br>The Personal Insurance Federation of California ("PIFC") appreciates the opportunity to submit comments to the California Department of Insurance ("the Department") in response to the Modifications to the Amended Text of the Standards and Training for Estimating Replacement Value on Homeowners' Insurance Regulation ("amended regulation").<br>PIFC member companies provide home, auto, flood and earthquake insurance for millions of Californians. Our member companies, State Farm, Farmers, Liberty Mutual Group, Progressive, Allstate and Mercury, write more than 60 percent of the home and auto insurance sold in this state. In addition, | **Response to Personal Insurance Federation of California (PIFC) November 12, 2010 written comments:**<br>(1) In its May 17, 2010 written comments PIFC previously argued that the Department did not have authority to promulgate the proposed regulations. The Department incorporates its response to those comments, noted specifically, above (6.1).<br>(2) The comment asserts that estimate of replacement value and estimate of replacement cost are "commonly used terms" and that the Department has no regulatory authority to define them. These are commonly used terms, perhaps, but not commonly understood terms. As the Rulemaking File establishes, based |

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| | the National Association of Mutual Insurance Companies (NAMIC) is an associate member.<br>For nearly a year, PIFC has participated in discussions regarding a proposed regulation concerning standards and training for estimating replacement cost as it relates to the purchase of homeowners' insurance. We applauded the successful effort to revise the California Residential Property Insurance Disclosure form and have consistently expressed our support for improved training standards as authorized specifically by statute. We have provided formal and informal comments and attempted to provide the Department with information as to the practical impacts of the amended regulation on both the consumer and the insurance professional. We have also expressed our concern that the Department, while pursuing a worthy goal of creating "…a more consistent, comprehensive and accurate replacement cost calculation," has exceeded its statutory authority and has failed to comply with provisions of the Administrative Procedure Act ("APA").<br>PIFC incorporates, by reference, our letter dated May 17, 2010, detailing questions and concerns with the original proposed regulation, most of which remain. In our comments below, we will attempt to emphasize the amended language and focus our concerns to those provisions.<br>***THE AMENDED REGULATION DOES NOT MEET THE REQUIREMENTS OF GOVERNMENT CODE SECTION 11349.1.***<br>**Authority**<br>(1) The authority of an administrative agency to adopt regulations is limited by the enabling legislation. *(Bearden v. U.S. Borax, Inc., (2006) 138 Cal.App.4th 429)*. To be valid, an administrative regulation must be within the scope of authority conferred by the enabling statute or statutes. *(Terhune v. Superior Court (1998) 65 Cal.App.4th 864)*. Agencies do not have discretion to promulgate regulations that are inconsistent | upon consumer complaints and the numerous articles written concerning underinsurance, confusion over the meaning of an estimate of replacement cost is major contributing factor to underinsurance. The regulations state simply that if a licensee communicates that an estimate is an estimate of replacement cost, that it is take into consideration the components and factors necessary to achieve a complete estimate, components and factors that are stated in specific, clear and easily understood language. The rulemaking authority is clear, as well. Section 790.10 states: "The commissioner shall, from time to time as conditions warrant, after notice and public hearing, promulgate reasonable rules and regulations, and amendments and additions thereto, as are necessary to administer this article." The comment argues, without foundation, that Section 790.10 is limited to adopting regulations to implement the existing list of unfair business practices set forth in Section 790.03 and "that it is not available to expand the list of unfair business practices as the amended regulation does." In fact, the regulations do not expand the scope of Ins. Code 790.03. Insurance Code section 790(b) identifies as a prohibited act the making of misleading statements with respect to the business of insurance that should be known to be misleading. For a licensee to communicate an estimate of replacement cost where not all the components that may need to be replaced, or other necessary costs, are included in the estimate is just such a misleading statement.<br>(3) The act in question here is communicating an estimate to an applicant or insured when what is being estimated is not complete and does not contain all of the cost elements of what it would reasonably take to replace the home. The procedure detailed in Insurance Code Section 790.06 is not available here, since the prohibited act in question is in fact defined in Insurance Code Section 790.03, where that prohibited act is defined in the broadest possible terms: "*any* assertion, representation or statement with respect to the business of |

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| | with the governing statute, or that alter or amend the statute or enlarge its scope. *(Slocum v. State Board of Education (2005) 134 Cal.App.4th 429).*<br>(2) There is no authority provided by the cited statutes for the Department to create an entirely new definition for commonly used terms as proposed in Section 2695.180(e), *as amended*. This new definition is then referenced throughout Section 2695.183, *as amended*, and serves as the basis for further requirements, prohibitions and even penalties, including the creation of a new violation of Insurance Code Section 790.03 under Section 2695.183(j), *as amended*.<br>Section 790.10, cited by the Department as authority, is limited to adopting regulations to implement the existing list of unfair business practices set forth in Section 790.03. It is not available to expand the list of unfair business practices as the amended regulation does. (3) Section 790.06 sets out the exclusive process for the Department to add to the list of acts that constitute unfair business practices. The Department asserts that the regulation is authorized because it is implementing a provision in Section 790.03, making a misleading statement about the business of insurance (Section 2695.183(j)). (4) PIFC does not concede that providing information, that assists an applicant or insured to estimate the cost of replacing the structure to be insured, is a statement about the business of insurance. (5) Even making that assumption, it does not follow that such information is misleading if it is not calculated solely in accordance with the extensive dictates of this regulation. For example, information provided by a contractor, knowledgeable about local building costs, could form a valid basis for an estimate of replacement cost that is not misleading. Certainly, an estimate of replacement cost could be provided without setting out the factors that went into the estimate or attaching cost to separate components that make up the overall estimate.<br>(6) Also, an estimate is exactly that – it is an estimate. An | insurance … which is untrue, deceptive, or misleading, and which is known, or which by the exercise of reasonable care should be known, to be untrue, deceptive, or misleading." Insurance Code Section 790.03 (b) (emphasis added). Thus, the definition of the prohibited act sweeps in the whole gamut of misleading statements, including misleading statements with respect to estimates of replacement costs. Accordingly, Insurance Code Section 790.06 does not apply.<br>(4) It cannot be credibly argued that an estimate of replacement cost communicated to an applicant or insured in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis is not a statement about the business of insurance.<br>(5) In cases where the applicant or insured chooses to provide his or her own estimate, the comment ignores proposed Section 2695.183 (o) which states: "No provision of this article shall limit or preclude an applicant or insured from obtaining his or her own estimate of replacement cost from an entity permitted to make such an estimate by Insurance Code section 1749.85." In cases where the licensee obtains an estimate of replacement cost from a contractor, these regulations would hold to the basic premise that leaving out certain components or aggregating the estimate to include the components in the final value, but specifically not identifying and costing out those components is expressly or inherently misleading. This is true since there would be not mechanism for the consumer or the regulator to verify whether the licensee has completely omitted consideration of those components or has merely aggregated those costs into the total value. Consumer confusion would still exist in that case.<br>(6) The comment ignores proposed Section 2695.183 (m): "No provision of this article shall be construed as requiring a licensee to estimate replacement cost or to set, or recommend a policy limit to an applicant or insured. No provision of this article shall be construed as requiring a licensee to advise the |

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| | estimate does not require the mathematical precision that the Department is mandating by this amended regulation to prevent it from being misleading. An estimate provided with the explanation that it is only an estimate and that the applicant or insured is to determine the amount of insurance needed to replace the structure is, by definition, non-misleading.<br>The effect of the proposed regulation is to set out totally new standards and restrictions on communication, making the failure to comply with an additional definition of an unfair business practice. As noted above, the Department cannot do that under the authority contained in Section 790.10 or any other provision of law. Certainly, the regulation exceeds the scope of authority contained in Section 790.03, dealing with misleading statements concerning the business of insurance.<br>(7) An agency has no authority to promulgate a regulation that is inconsistent with controlling law. *(Communities for a Better Environment v. California Resources Agency (2002) 103 Cal.App.4th 98).* No legal basis exists for the Department to restrict insurance companies from obtaining and/or communicating an estimate of replacement cost, activities that are critical and essential to underwriting decisions, as the *amended regulation* proposes in Section 2695.183.<br>"The Insurance Code provides no express authority for regulating the underwriting of homeowners' insurance, nor can such expansive authority be implied. Unlike automobile insurance, homeowners' insurance is subject to only a few restrictions, all clearly set forth in the Insurance Code. Reading the Insurance Code to give the Commissioner broad authority to regulate underwriting beyond these specific provisions is inconsistent with the legislative scheme as a whole." *(AIA v. Garamendi).* The Department remains bound by this decision. The only statutes that restrict an insurance company's underwriting decisions with respect to homeowners' insurance are Insurance Code Sections 676 and 791.12. Other sections set out the basis for canceling a policy | applicant or insured as to the sufficiency of an estimate of replacement cost." There is not a requirement of mathematical precision. Instead, the proposed regulations establish a simple, easily understood principle. If a licensee chooses to communicate that an estimate is an estimate of replacement cost, that it is to take into consideration the components and factors necessary to achieve a complete estimate, components and factors that are stated in specific, clear and easily understood language. If a licensee fails to meet this criteria, and chooses to communicate an incomplete estimate, then, and only then, is the statement considered misleading.<br>(7) The comment asserts that the Department cannot adopt regulations that have an impact upon homeowners' insurance underwriting practices. To support this position, the comment cites *AIA v. Garamendi*, a de-published case. A de-published opinion may not be cited or relied upon by a party in any other action unless, pursuant to California Rule of Court 8.1115, when it is relevant under the doctrines of law of the case, res judicata, or collateral estoppel; none of which are applicable here. The proposed regulations do not represent litigation with PIFC or any other party in the AIA v. Garamendi case. Further, even assuming that *AIA v. Garamendi* could be cited, the arguments raised by are misplaced. The regulations do not have an impact on underwriting practices. The regulations do not specify, require or otherwise mandate how insurers underwrite homeowner policies. Insofar as the comment references Section 2695.183, this section requires that if the licensee states that it has calculated an estimate of "replacement cost," it will include those components listed in the regulation, simply. The comment offers that the proposed regulations act to impose "restrictions on estimating replacement cost – a fundamental component of any underwriting decision." The comment ignores proposed Section 2595.183 (m): "No provision of this article shall be construed as requiring a licensee to estimate replacement cost or to set or recommend a policy limit to an applicant or insured. |

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| | (Sections 675, 675.5, 676), or prohibit when a policy may be non-renewed (Sections 675, 676.9, 676.10, 676.1) or prohibit discriminatory practices (Sections 679.7-679.73). **These restrictions are exclusive**. The Department has no authority to expand these restrictions to include restrictions on estimating replacement cost—a fundamental component of any underwriting decision. (8) The underwriting process will almost always necessitate the calculation of an estimated replacement cost to determine: (1) a minimum amount of insurance a company may offer based upon its internal guidelines and (2) the basic coverage amount upon which an extended coverage amount may be offered.<br>Any attempt to regulate the estimating process fundamentally includes the regulation of underwriting. Section 2695.183(p), *as amended*, proposes to specifically regulate the communication of a "minimum amount of insurance" in conflict with controlling statutory and case law.<br>Most insurance companies offer extended coverage that is usually some percentage above the basic coverage amount. Extended coverage provides a cushion for the unexpected, rapid increases in construction costs, upgrades, additions and other changes that did not trigger the insured to increase the basic coverage. Extended coverage is based on a basic coverage amount that is equal to or greater than the estimated replacement cost. In fact, extended coverage cannot be provided unless the basic coverage is at least as great as the estimated replacement cost of the property.<br>Hence, to even discuss extended coverage, the insurance company has to obtain an estimate of the replacement cost and communicate that amount to the insurance applicant.<br>Estimating and communicating the replacement cost is integral to making an underwriting decision, that is, whether extended coverage can be provided or not. Section 2695.183, *as amended*, prohibits an insurance company specifically from obtaining, estimating, or communicating a replacement cost | No provision of this article shall be construed as requiring a licensee to advise the applicant or insured as to the sufficiency of an estimate of replacement cost." In spite of the protestations that the proposed regulations act to impose restrictions on how an insurer underwrites its insurance business, the regulations explicitly do not impose any such limitations or restrictions.<br>(8) In this comment, PIFC seems to be acknowledging, or at least inferring an understanding, that the proposed regulations do not directly impact underwriting practices. Instead, the comment turns to an argument that the regulations indirectly impact insurance underwriting because an insurer necessarily must calculate an estimate of replacement cost to determine either or a minimum amount of insurance and or a coverage amount upon which an extended coverage may be offered. While the comment references proposed Section 2695.183 (p), it acts to mischaracterize it. In fact, it provides clearly that the insurer is left free to underwrite as it sees fit.<br>Section 2695.183 (p): "For purposes of this subdivision (p), "minimum amount of insurance" shall mean the lowest amount of insurance that an insurer requires to be purchased in order for the insurer to underwrite the coverage on a particular property, based upon an insurer's eligibility guidelines, underwriting practices and/or actuarial analysis. An insurer may communicate to an applicant or insured that an applicant or insured must purchase a minimum amount of insurance that does not comport with subdivisions (a) through (e) of this Section 2695.183; however, if the minimum amount of insurance that is communicated is based in whole or in part on an estimate of replacement value, the estimate of replacement value shall also be provided to the applicant or insured and shall comply with all applicable provisions of this article. Nothing in this article shall limit or preclude an insurer from agreeing to provide coverage for a policy limit that is greater than or less than an estimate of replacement cost provided pursuant to this article." The plain meaning is that an insurer |

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| | unless it complies with subdivisions (a) through (e). As such, it directly regulates underwriting.<br>(9) PIFC does recognize the authority of the Department, under Insurance Code Section 1749.85, to promulgate regulations related to the curriculum and training of broker-agents on "proper methods of estimating replacement value of structures…" However, nothing in that statute, or contained within the legislation's history, can be read to allow the Department the authority to promulgate regulations applicable to broker-agents for any purpose other than to establish a training curriculum. Section 2695.183, *as amended*, attempts to regulate well beyond curriculum by specifying standards and requiring and prohibiting certain forms of communication between the licensee and the consumer.<br>(10) In addition, the amended regulation appears to conflict with established California law reflecting the responsibility of the insured to set policy limits. "It is up to the insured to determine whether he or she has sufficient coverage for his or her needs." *(Everett v. State Farm General Insurance Co. (2008) 162 Cal.App.4th 649).* The court in *Everett* also affirmed that Insurance Code Sections 10101 and 10102 do not require an insurer to set policy limits that equal the cost to replace the property, nor is an insurer duty bound to set policy limits for insureds. The amended regulation will have the impact of shifting the responsibility for establishing policy limits from the insured to the insurer, contrary to current law.<br>(11) **Clarity**<br>The amended regulation is fraught with ambiguity and fails to meet the clarity standard as defined under the APA Section 11349 (c). "Clarity means written or displayed so that the meaning of the regulations will be easily understood by those persons directly affected by them." An ambiguous regulation that does not comply with the rulemaking procedures of the Administrative Procedure Act (APA) is void. *(Capen v. Shewry (2007) 65 Cal.Rptr.3d 890).* | may determine its minimum amount of insurance without considering each component and feature necessary for an "estimate of replacement cost." If the minimum amount of insurance is based in whole or part on an "estimate of replacement cost" then the insurer must comply with the regulation and consider the expenses associated with each component and feature listed in the regulations. Again, the regulation is not mandating that a minimum amount of insurance be based in whole or part on an estimate of replacement cost. PIFC then argues that, in reality, the only way to determine a minimum amount of insurance is to consider an estimate of replacement cost, and that further, an insurer must determine it to offer an extended replacement cost policy. Assuming this is so, the last sentence of subdivision (o) provides an insurer the opportunity to offer whatever coverage it wants, notwithstanding the proposed regulation's requirements for estimating replacement cost. It reads: "…Nothing in this article shall limit or preclude an insurer from agreeing to provide coverage for a policy limit that is greater than or less than an estimate of replacement cost provided pursuant to this article." Further, this comment emphasizes the greater and more urgent need for a consistent and complete estimate of replacement cost. If insurers use, or intend to use, estimates of replacement cost to derive a minimum amount of insurance or to evaluate extended coverage, then the starting premise must be a complete estimate of replacement cost. To do otherwise, puts both the insurer and consumer at a disadvantage from the start.<br>(9) The Department does not rely on the language of Insurance Code Section 1749.85 alone as reference and authority to promulgate proposed Section 2695.183 with respect to broker-agents. The amended text of regulations cites as authority the following: Sections 730, 790.03, 790.04, 790.10, 1749.7, 1749.85, 1861.05, and 2051.5, Insurance Code.<br>(10) PIFC offered a similar comment (10) in May 2010 and the |

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| | PIFC and our member companies have spent months in discussions and exchange of information with the Department and yet still the experts within these companies have no clear understanding of the requirements of this amended regulation. Comments and questions related to clarity are provided within the specific section comments below.<br>(12) **Consistency**<br>Consistency is defined in Government Code Section 11349 (d) as "being in harmony with, and not in conflict with or contradictory to, existing statutes, court decisions, or other provisions of law. An agency has no authority to promulgate a regulation that is inconsistent with controlling law *(Communities for a Better Environment v. California Resources Agency (2002) 103 Cal.App.4th 98*), nor with the governing statute. *(Pulaski v. California Occupational Safety and Health Standards Board (1999) 75 Cal.App.4th 98).*<br>As discussed above, Section 2695.183, *as amended*, is in conflict with *AIA v. Garamendi* in its attempt to regulate underwriting. This section is also inconsistent with Section 1749.85, which applies to ***training curriculum for broker-agents*** (subdivision (a)) and places a requirement on ***real estate appraisers to calculate an estimate of replacement value in accordance with regulations***, if adopted by the Department (subdivision (d)). The amended regulation goes far beyond training and curriculum by mandating a specific set of requirements for estimating replacement cost for licensees (including broker-agents) in clear conflict with statutory law.<br>(13) **Necessity**<br>Finally, the Department has failed with the amended regulation to satisfy the "Necessity" standard. The record of the rulemaking proceeding fails to "demonstrate by substantial evidence the need for a regulation to effectuate the purpose of the statute, court decision, or other provision of law that the regulation implements, interprets or makes specific, taking into account the totality of the record." For purposes of this | Department incorporates fully its response thereto. The restating of this comment by PIFC gives no credence to the proposed amended Section 2695.183 (m) : "No provision of the article shall be construed as requiring a licensee to estimate replacement cost or to set, or recommend a policy limit to an applicant or insured. No provision of this article shall be construed as requiring a licensee to advise the applicant or insured as to the sufficiency of an estimate of replacement subdivisions (n), (o) and (p) to Section 2695.183 as follows:<br>"(n) No provision of this article shall limit or preclude a licensee from providing and explaining the California Residential Property Insurance Disclosure, as cited in Insurance Code section 10102, explaining the various forms of replacement cost coverage available to an applicant or insured, or explaining how replacement cost basis policies operate to pay claims.<br>(o) No provision of this article shall limit or preclude an applicant or insured from obtaining his or her own estimate of replacement cost from an entity permitted to make such an estimate by Insurance Code section 1749.85.<br>(p) For purposes of this subdivision (p), "minimum amount of insurance" shall mean the lowest amount of insurance that an insurer requires to be purchased in order for the insurer to underwrite the coverage on a particular property, based upon an insurer's eligibility guidelines, underwriting practices and/or actuarial analysis. An insurer may communicate to an applicant or insured that an applicant or insured must purchase a minimum amount of insurance that does not comport with subdivisions (a) through (e) of this Section 2695.183; however, if the minimum amount of insurance that is communicated is based in whole or in part on an estimate of replacement value, the estimate of replacement value shall also be provided to the applicant or insured and shall comply with all applicable provisions of this article. Nothing in this article shall limit or preclude an insurer from agreeing to provide coverage for a |

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| | standard, evidence includes, but is not limited to, facts, studies and expert opinions. (APA Section 11349 (a)). Nothing in the Initial Statement of Reasons or any new information provided in the recent Notice, evidences any need for this regulation.<br>The Department added several "documents" to the rulemaking file. Nothing in the file constitutes studies or expert opinions - the majority are newspaper articles, which can hardly be classified as "expert opinions." The "survey" was conducted by a bias group and offers no scientific methodology or conclusions that could possibly be the basis for the regulation. The Department has not offered any information, other than limited, anecdotal, to justify the need for the amended regulation – no studies and no facts.<br>Certainly the Department has provided no explanation for why the precise detailed mandates of the amended regulation are necessary to implement Section 790.03. That is, why each and every provision is required to avoid providing an estimate of replacement cost that is misleading. Nothing less is required by the APA.<br>In promulgating the amended regulation, the Department has failed to meet the requirements of the California Administrative Procedure Act.<br>***SPECIFIC COMMENTS AND QUESTIONS AS TO THE AMENDED REGULATION***<br>(14) **Is the Amended Regulation Intended to Apply to Manufactured Homes?**<br>Because of the nature of the type of construction, manufactured homes are generally not reconstructed but replaced following a total loss. Consequently, the reconstruction value estimation process for manufactured homes is significantly different as compared with site-built homes. Specifically, replacement value estimators for manufactured homes generally do not provide for provisions for cost of foundation or architect's plans/engineering reports/permits, whether the structure is located on a slope, the | policy limit that is greater than or less than an estimate of replacement cost provided pursuant to this article."<br>(11) This is a general comment and does not reference any particular section of the proposed regulation.<br>(12) This is a general statement that rehashes the same comments made in (1) through (10) and the Department incorporates fully its responses thereto.<br>(13) A substantially similar comment (6) was made by PIFC in May 2010 and the Department incorporates fully its response thereto. The comment made here, in November 2010, gives little credence to the Rulemaking file. It refers only in passing to the additional documents added to the file since the original notice. PIFC does take the time though, to declare, without explanation or clarity, that the survey included in the Rulemaking File, [2007 Wildfire Insurance Claim Status Survey/United Policyholders], was "conducted by a bias group. It claims it "offers no scientific methodology or conclusions that could possibly be the basis for the regulation…" PIFC ignores the findings of the survey, which establish that underinsurance is a serious issue and that an understanding of an estimates of replacement cost remains illusive. The Rulemaking file includes more than fifty separate consumer complaints and their files related to underinsurance and replacement cost; testimony at an investigative hearing held by the insurance commissioner on the same issues; declaration and summaries of market conduct examinations on these issues. Further, as noted previously, pursuant to the 15 Day Notice, the following has been added to the rulemaking file, further evidencing the need for the regulations: MBS report and website information on replacement cost issues; multiple media reports throughout several years reporting on the underinsurance problem from the Orange County Register; the North County Times; Sign On, the Union Tribune, the New York Times, The Insurance Journal, CNN Money, the Associated Press, the Malibu Times, the Ventura County Star, |

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| | type of frame, or nonstandard wall heights.<br>Since estimating programs are not generally available for manufactured homes that incorporate all of the provisions required by Section 2695.183 and because the training required for manufactured homes is significantly different than site-built homes, it would seem appropriate to exempt manufactured homes from the proposed regulation.<br>We raised this issue during the previous comment period and there has been some indication that the intent is that the amended regulation does ***not*** apply to manufactured homes, but as written, there is a lack of clarity. Would the Department please indicate its intention and clarify the language?<br>(15) **Section 2695.180 (e), as amended**<br>This section broadly defines the terms "estimate of replacement cost" and "estimate of replacement value" as "any estimate, statement, calculation, approximation or opinion, whether expressed orally or in writing, regarding the projected replacement value of a particular structure or structures."<br>The definition is so broad as to encompass almost any conversation that would take place between a licensee and a customer, thereby triggering all of the requirements in Section 2695.183 and resulting in a myriad of unintended consequences and downstream regulatory ramifications. It could very well lead to consumer confusion because its breadth could be interpreted to be akin to market value, which would be completely inaccurate. Specifically, the proposed definition of "estimate of replacement cost" is subsequently referenced in many other sections of the amended regulation and makes it impractical and infeasible for a licensee to ensure compliance with the amended regulation:<br>2190.3(f): Requirement to maintain records and copies of the estimate of<br>replacement cost;<br>2695.183(e): Requirement for a licensee, no less frequently than annually, to take reasonable steps to | the Los Angeles Times, Kiplinger, Claims, KCOY 12, the Napa Valley Register, the Sacramento Bee. It is clear that the regulations are necessary.<br>(14) PIFC made this comment in May 2010 (2) and in consideration of it, the proposed regulations were amended so that they not apply to manufactured homes. The Department has amended proposed Section 2188.65(a) (1) and Section 2695.180 (a) to read as follows: ""Homeowners' insurance policy" shall have the same meaning as "policy of residential property insurance" as defined in subdivision (a) of Insurance Code section 10104." Language in the originally noticed regulations applying the regulations to mobile homes has been removed.<br>(15) Proposed Section 2695.180 (e) is as follows: ""Estimate of replacement value" shall have the same meaning as "estimate of replacement cost" and means any estimate, statement, calculation, approximation or opinion, whether expressed orally or in writing, *regarding the projected replacement value of a particular structure or structures*."(emphasis added) Certainly, the context of the communication being related to the "projected replacement value of a particular structure or structures" alone, acts to inform the definition. The comment cites the proposed sections where the definition of "estimate of replacement cost" is used. Again, though, PIFC does not quote the sections. Each section includes specific language surrounding and limiting the circumstances in which obligations arise that are designed to and do prevent the "myriad of unintended consequences" PIFC cavalierly predicts. The comment provides a "hypothetical" to support the argument of unintended consequences related to oral discussions. However, the comment misreads the proposed regulations. An oral communication of an estimated replacement cost is permissible, and even anticipated, as the proposed regulations consider transactions conducted telephonically, for instance. The regulations do not prohibit, as |

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| | ensure that sources and methods used to generate the estimate of replacement cost are kept current;<br>2695.183(g)(1): Requirement to provide a copy of the estimate of replacement cost to the applicant or insured at the time the estimate is communicated;<br>2695.183(g)(2): Requirement that the estimate of replacement cost itemize the projected cost for each element of Section 2695.183(a)(1)-(a)(4);<br>2695.183(h): Requirement to provide a copy of the revised estimate of replacement cost if the estimate has been revised; and<br>2695.183(i): Requirement to maintain a record of the information used to generate the estimate of replacement cost and a copy of the estimate of replacement cost in the file for the prescribed period of time.<br>Because the scope of the definition for "estimate of replacement cost" has been expanded to include oral approximations or opinions, it is not possible for a licensee to generate a printed or an electronic copy of any additional adjustments outside of the software provided that would support the revised oral "estimate", as required by Section 2695.183(g)(1) which is a consequence of a private conversation between the agent and applicant.<br>Also, because the licensee would not be aware of specific details exchanged in any private conversations, it is not possible to maintain a record of the information used to generate this revised "estimate of replacement cost," as required by Section 2695.183(i) and Section 2190.3(f).<br>Since an adjustment which occurs outside a licensee's system-generated estimating process (i.e., based on information from an oral conversation) is not captured, it would not be possible to itemize the elements listed in Section 2695.183(a)(1) - (a)(4) to support the revised oral estimate, as required by Section 2695.183(g)(2). Next, since the licensee does not have | the comment suggests, a licensee from generating a printed or an electronic copy of any additional adjustments outside of the software that would support a revised oral estimate which is a consequence of a private conversation between the agent and applicant. The comment that a licensee would not be aware of specific details exchanged in any private conversations and would then not be able to maintain a record of the information used to generate this revised estimate of replacement cost fails to consider proposed Section 2695.182 (c). Proposed Section 2695.182 (c): "Notwithstanding any other provision of this Section 2695.182, this section shall impose no duty upon a broker-agent to obtain from the insurer and maintain any information or document that in the absence of this section would not come into the possession of the broker-agent in the ordinary course of business."<br>(16) 2695.183(e) requires that licensees "…shall no less frequently than annually take reasonable steps to verify that the sources and methods used to generate the estimate of replacement cost are kept current to reflect changes in the costs of reconstruction and rebuilding, including changes in labor, building materials, and supplies, based upon the geographic location of the insured structure. The estimate of replacement cost shall be created using such reasonably current sources and methods." If the sources and methods are based upon oral, private conversations, it is not only practical, but required that a licensee take reasonable steps to verify that the information is kept current. If PIFC is arguing that it would be advisable to use outdated, stale information upon which to base replacement cost estimates, then such comment supports the need for regulation in this area..<br>(17) The changes made to proposed section 2695.183 satisfy fully the requirement of the APA Section 11346.8(c). The changes are (1) nonsubstantial or solely grammatical or (2) sufficiently related to the original text that the public was adequately placed on notice that the change could result from |

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| | any record of any oral adjustments, it is not possible for the licensee to maintain a physical or electronic copy of the revised estimate of replacement cost in the file as required by Section 2190.3(f) and Section 2695.183(h).<br>(16) Finally, it is not practical for an insurer to "take reasonable steps" to ensure that personal information or experience base that is discussed in private, oral conversations, be annually updated (as required by Section 2695.183(e)).<br>**Section 2695.183, as amended**<br>(17) Several substantive changes have been made to this Section which raise the question of whether the amended regulation satisfies the requirement of the APA Section 11346.8(c): The change must be either: (1) nonsubstantial or solely grammatical or (2) sufficiently related to the original text that the public was adequately placed on notice that the change could result from the originally proposed regulatory action. (18) The term "communicate" which is actually used throughout the amended regulation, lacks clarity. The change in the first sentence of the amended regulation from a prohibition on a licensee to "estimate a replacement cost" (unless the specified standards are met), to the amended language which now states that no licensee shall "communicate" an estimate (unless the specified standards are met) is unclear. Because the term "estimate of replacement cost" is defined so broadly in Section 2695.180(e), the intent of this amendment needs to be clarified.<br>(19) Other substantive amendments include the addition of the language, still in the first sentence, "…in connection with an application for or renewal of…" Would the Department please clarify the phrase "in connection with"? The inclusion of renewals within the requirement creates a new and substantial burden on insurers, essentially shifting the responsibility of determining coverage from the insured to the insurer – in direct violation of the *Everett* decision. It creates a situation where simply by sending the renewal notice the requirements | the originally proposed regulatory action. To go back to the beginning, originally proposed regulations, were premised on, and remain premised on a simple and easily understood concept. If you, as a licensee, communicate an estimate of replacement cost, you (the licensee) and the consumer (be it someone who is applying to buy an insurance policy, or to one who is a policyholder already) will understand it to be the same thing. It will include a consideration of the expenses associated with those components and features simply and straightforwardly listed in the propose regulations. There will be no surprises. The estimate, itself, may be wrong. An estimate that does not include all of the factors and components that is called an "estimate of replacement cost" is misleading.<br>(18) "Communicate" was added to the regulation so as to clarify that estimates of replacement cost subject to the regulations are those that are in fact communicated to applicants and insureds.<br>(19) The phrase "…in connection with an application for or renewal of…" has been added, again, to clarify and make certain that the regulations apply only to communications of estimates of replacement cost in an insurance transaction regarding an application for or renewal of a homeowner insurance policy. For instance, the regulations do not apply to one who may be estimating how much it will cost to rebuild a home-replacement cost in the context of an insurance adjuster, after a loss, who is estimating the cost to rebuild the home after it has been destroyed. Proposed Section 2695.183 (h) makes clear the obligations of a licensee on renewal of a policy as follows: "…If an estimate of replacement cost is updated or revised by, or on behalf of, the licensee and the revised estimate of replacement cost is communicated to the …insured in connection with …renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis, the licensee shall provide a copy of the revised or updated estimate of replacement cost to the applicant as provided in paragraph |

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| | of complying with the standards (a) through (e) would apply or place the insurer at risk for being found to have violated Section 790.03 (per subdivision (j)). Can the Department explain what is intended? Does the Department intend to change existing law to force insurers to determine coverage upon renewals, even if a customer does not want this? Currently, the applicant/insured has full responsibility for providing all information necessary for a non-binding estimate of coverage. The broker-agent may assist the applicant/insured by utilizing that information to estimate replacement cost, sharing that information, but relying on the applicant/insured to determine the coverage amount best for them. Does the Department intend that the amended regulation will require a change in this practice? Current practice also includes situations where an applicant/insured provides a contractor or other estimate of replacement cost prepared by a third party. Would that "communication" trigger all of the requirements of this section and put the broker-agent in the position of having to verify that estimate by attempting to comply with subdivisions (a) through (e)?<br>(20) **Section 2695.183(g)(2), as amended**<br>The requirement to itemize the projected costs will necessitate changes to the business practices of most companies and include modifications to vendor systems and company systems requiring substantial cost and time to achieve the ability to comply. We also raise the concern of how the itemized figures may be used *after the fact* during the claims process, which could be years removed from the initial estimate, in a circumstance where no subsequent estimate was prepared and policy limits go unchanged because the consumer did not increase their limits– which, given the burden on the licensee if they choose to prepare an estimate, not preparing subsequent estimates may become a more common practice. The responsibility to obtain sufficient insurance is on the insured – | (g)(1) of this Section 2695.183, or to the insured simultaneously with the renewal offer, as the case may be. This subdivision (h) shall not apply when the update or revision to the estimate of replacement cost or the policy limit results solely from the application of an inflationary provision in a policy or an inflation factor. This subdivision (h) shall not obligate a licensee to recalculate an estimate of replacement cost on an annual basis." Neither this provision, nor any provision in the proposed regulations, by their express language, or inferentially, shift the responsibility of determining coverage from the insured to the insurer.<br>(20) Proposed Section 2695.183(g)(2) simply requires that an estimate of replacement cost communicated to an applicant for insurance or an insured "must itemize the projected cost for each element specified in paragraphs (a)(1) through (a)(4), and shall identify the assumptions made for each of the components and features listed in paragraph (a)(5), of this Section 2695.183." The detail required by this proposed section is what all current vendors of estimates of replacement cost provide now, with many providing mush greater detail. Also, some insurers also provide this required level of detail or more. Therefore, there is no support that significant or costly changes would be necessary to implement these regulations. Further, this proposed section does not created any obligation by the insurer to guaranty the sufficiency of an estimate, as specifically stated in proposed section 2695.183(m), "No provision of this article shall be construed as requiring a licensee to advise the applicant or insured as to the sufficiency of an estimate of replacement cost". Lastly, these regulations do not impose any liability on insurers for an insured's failure to update their policies.<br>(21) PIFC raised this argument in its May 2010 written comments and the response to those comments, particularly comment (6.1) is incorporated fully herein. Additionally, PIFC has raised similar arguments in comments (2), (3) and (4) and |

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| | but they often do not update their policies, in spite of being encouraged to do so routinely by their agent or company.<br>(21) **Section 2695.183(j), as amended**<br>This subdivision expands the prohibitions under Insurance Code Section 790.03. This may not be done by regulation, rather an expansion of this type must be passed by the legislature or in accordance with Section 790.06. The Department has no authority to expand the list of unfair business practices by regulation. "If, in adopting an administrative regulation under this section, a state agency does not confine itself to a reasonable interpretation of the statute, the legislative area has been invaded and courts are obligated to strike down an administrative rule which attempts to add to or subtract from the statute." (*Macomber v. State Social Welfare Bd. (1959) 175 Cal.App.2d 614).* "Agencies do not have discretion to promulgate regulations that are inconsistent with the governing statute, or that alter or amend the statute ***or enlarge its scope***." (*Sabatasso v. Superior Court (2008) 167 Cal.App.4th 791). Emphasis added.*<br>PIFC has continually expressed our concern that this provision could create a litigation path for industrious lawyers. The amended regulation is a compilation of overly prescriptive requirements which also lack clarity and even conflict. Compliance will be difficult and disagreements about what was "communicated' (the regulation includes all oral communication as well) will take place at the time of claim, perhaps years removed from the initial estimate. process. The amended regulation, and specifically this provision, are fraught with litigation traps.<br>(22) **Section 2695.183(n)**<br>This subdivision states that no provision of this article shall "limit or preclude" a licensee from "providing and explaining" the required California Residential Property Insurance Disclosure, nor from "explaining the various forms of replacement cost coverage" nor from "explaining how | the Department incorporates its responses to those comments. Section 790.10 states: "The commissioner shall, from time to time as conditions warrant, after notice and public hearing, promulgate reasonable rules and regulations, and amendments and additions thereto, as are necessary to administer this article." The regulations do not expand the scope of Ins. Code 790.03. Insurance Code section 790(b) identifies as a prohibited act the making of misleading statements with respect to the business of insurance which should be known to be misleading. For a licensee to communicate an estimate of replacement cost where not all the components that may need to be replaced, or other necessary costs, are included in the estimate is just such a misleading statement. As stated above in response to PIFC's earlier comments, the act in question is calling something a replacement value estimate when what is being estimated is something short of what it would take to replace the home. The procedure detailed in Insurance Code Section 790.06 is not available here, since the prohibited act in question is in fact defined in Insurance Code Section 790.03, where that prohibited act is defined in the broadest possible terms: "*any* assertion, representation or statement with respect to the business of insurance … which is untrue, deceptive, or misleading, and which is known, or which by the exercise of reasonable care should be known, to be untrue, deceptive, or misleading." Insurance Code Section 790.03 (b) (emphasis added). Thus, the definition of the prohibited act sweeps in the whole gamut of misleading statements, including misleading statements with respect to estimates of replacement cost. Accordingly, Insurance Code Section 790.06 does not apply.<br>(22) The Department disagrees with PIFC's interpretation that proposed Section 2695.183(n) is unclear. It reads in full: "No provision of this article shall limit or preclude a licensee from providing and explaining the California Residential Property Insurance Disclosure, as cited in Insurance Code section 10102, explaining the various forms of replacement cost |

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| | replacement cost basis policies operate." However, this language does not provide any exemption or protection for "communication" as is provided in subdivision (l) and given the broad definition of 2695.180(e), this provision does not appear to offer any protection for the licensee in discussing the required disclosure forms.<br>(23) **Section 2695.183(o)**<br>This subdivision, while allowing the applicant to obtain his or her own estimate, does not explain how that estimate may be used in any communication with the licensee, nor whether the act of accepting an estimate provided by an applicant will trigger the requirements on the licensee under this Section and subject a licensee to the definition in Section 2695.180(e), triggering potential liability under Section 2695.183(j).<br>(24) **Section 2695.183(p)**<br>Comments with respect to the legal authority of the Department to regulate the calculation and communication of the "minimum amount of insurance" requirement a company may have as a part of their underwriting guidelines was discussed above.<br>This entire subdivision is confusing. It appears to conflict with subdivision (l) which states that "Section 2695.183 applies to *all communications* by a licensee, verbal or written, with the *sole exception* of internal communications….that concern the insurer's underwriting decisions and that never come to the attention of the applicant or insured." How can the insurer not communicate issues relating to minimum amount of insurance and how can the internal process not fall under the broad definition of an estimate of replacement cost? The first part of subdivision (p) seems to be an exception allowing communication, yet the second part of subdivision (p) seems to be a trap depending upon what words or phrases are used, particularly given that most internal processes will include some sort of estimate. Insurers need clear guidance on how to comply with this provision. | coverage available to an applicant or insured, or explaining how replacement cost basis policies operate to pay claims." This proposed regulation does in fact permit licensees to "explain" the cited disclosures and other information, so it does protect licensees who "communicate" these same disclosures and other information.<br>(23) The Department rejects the comment that the 2695.18 (o) is unclear or needs further explanation. It states: "No provision of this article shall limit or preclude an applicant or insured from obtaining his or her own estimate of replacement cost from an entity permitted to make such an estimate by Insurance Code section 1749.85." This proposed section does not place responsibility on the licensee for any estimate provided by an applicant or insured, nor does it trigger completeness and other standards required by these regulations. These standards only apply to estimate of replacement cost prepared by, for, or on behalf of the licensee, not those independently obtained from the applicant or insured.<br>(24) The Department rejects the comment that Proposed Section 2695.183(p) is confusing and that it is in conflict with other subdivisions or that it creates a trap. PIFC provides no explanation for its contentions. The language is clear and concise and easily understandable. There is no obvious or inherent conflict with any other subdivision. The allegation that there is some sort of trap through some sort of underlying meaning, is again, presented by PIFC without foundation. Proposed Section 2695.183(p) reads:<br>"For purposes of this subdivision (p), "minimum amount of insurance" shall mean the lowest amount of insurance that an insurer requires to be purchased in order for the insurer to underwrite the coverage on a particular property, based upon an insurer's eligibility guidelines, underwriting practices and/or actuarial analysis. An insurer may communicate to an applicant or insured that an applicant or insured must purchase a minimum amount of insurance that does not comport with |

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| | (25) **Section 2695.183(q)**<br>This provision regarding an extended implementation date is appreciated, though 180 days is likely not sufficient time to make the vendor and system changes necessary to comply with the provisions of the amended regulation.<br>With all due respect for the impact to any homeowner who has inadequate insurance at a time of loss – due to any number of reasons – the number of insureds in that situation are few compared to the overall insured homeowner population and even to those who suffer a loss. Yet, this proposal would disrupt the relationship and responsibilities of everyone who applies for and purchases homeowners' insurance. (26) The Department still has produced no evidence that its stated goal will be achieved or that regulating the estimating process to the point of dictating the words and phrases used in a conversation will have any measurable effect on reducing the number of homeowners who find or believe themselves to be without adequate coverage at the time of a claim.<br>(27) PIFC supports improved and additional training requirements for broker-agents. We supported the Department's efforts to improve the disclosure process and increase consumer knowledge to allow better decisions for adequate coverage (AB 2022 (Gaines)). We also support the Department's efforts to better educate homeowners on the importance of choosing adequate coverage limits. We look forward to continuing to work with the Department on ways to decrease the likelihood of insureds having inadequate coverage. (28) The proposed regulation Section 2695.183, however, will not achieve that goal, nor do we believe the Department has the authority to promulgate this regulation. We respectfully request that the Department withdraw this section from the amended regulation.<br>As we have for the past year, PIFC stands ready to work with the Department, but we must adamantly oppose this amended regulation. | subdivisions (a) through (e) of this Section 2695.183; however, if the minimum amount of insurance that is communicated is based in whole or in part on an estimate of replacement value, the estimate of replacement value shall also be provided to the applicant or insured and shall comply with all applicable provisions of this article. Nothing in this article shall limit or preclude an insurer from agreeing to provide coverage for a policy limit that is greater than or less than an estimate of replacement cost provided pursuant to this article." This subdivision has been discussed in depth in response to PIFC comment (10).<br>(25) The regulations become effective 180 days after they are filed with the Secretary of State pursuant to proposed Section 2695.183 (q): "This article shall apply only to estimates of replacement value that are prepared, communicated or used by a licensee on or after the day that is one hundred eighty (180) calendar days after filing with the Secretary of State." The Department believes it is in the best interest of consumers and licensees that the regulations be implemented as soon as is practical given the significance of assuring that broker-agents receive training on estimating replacement cost, and that licensees communicating estimates for replacement cost do so in accordance with the proposed regulations. In this regard, the Department believes that the 180 day implementation time frame is sufficient to permit licenses and vendors to take steps that are reasonably necessary to comply with the proposed regulations.<br>(26) The Department disagrees with this comment, and incorporates fully all of the responses provided to all of the comments by PIFC, and all others, as well as the evidence in the Rulemaking file, in support of its stated goal regarding this proposed regulation.<br>(27) The Department thanks PIFC for this comment.<br>(28) The Department disagrees with this comment and will not be withdrawing the proposed Section 2695.183 from the |

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| | Thank you for your time and consideration. Please feel free to contact PIFC's General Counsel, Kimberley Dellinger Dunn via email at kdellingerdunn@pifc.org or by phone at 916-442-6646 or PIFC's Legislative Advocate, Ermelinda Ruiz via email at eruiz@pifc.org or by phone at the number listed above, if you have any questions about PIFC's written comments. | proposed regulation. |
| **Association of California Insurance Companies (ACIC) November 12, 2010 written comments** | The Association of California Insurance Companies (ACIC) objects to the October 27, 2010 revision of the proposed regulations relating to the estimation of replacement value for homeowners insurance because the regulations fail to comply with the standards of necessity and authority. In addition, the regulations would impose uniform requirements on insurers that are costly and arbitrary.<br>(1) Necessity<br>Government Code Section 11349.1 provides that a regulation adopted by a state agency must be necessary. "Necessity" means that the rulemaking proceeding must demonstrate substantial evidence that there is a need for the regulation.<br>In its October 27, 2010 notice of the changed text of the regulations, the Department of Insurance gives notice that documents have been added to the rulemaking file.<br>The addition of the documents to the rulemaking file appears to be a response to testimony put forth by ACIC and others at the May 17, 2010 hearing on the proposed regulations. That testimony pointed out that the department provided no evidence, facts or expert opinions to justify the proposed regulations' standards for developing replacement cost estimates.<br>(2) The documents that were added to the rulemaking file fail to provide any proof that these regulations are necessary.<br>The documents do not demonstrate that the replacement estimating that insurers provide to their customers have resulted in instances of underinsurance for homeowners. Nor do the documents provide any evidence that the uniform estimation formulas mandated by the proposed regulations are necessary.<br>Many of the documents added to the rulemaking file have no | **Response to Association of California Insurance Companies (ACIC) November 12, 2010 written comments:**<br>(1) The Rulemaking file at the time of the originally noticed proposed regulations was more than sufficient to establish necessity. The documents added to the file in accordance with the 15 Day Notice only act to further demonstrate that the regulations are necessary. The Department rejects the comment that the Department added to the Rulemaking file as a result of testimony at the public hearing on May 17, 2010 that there was no justification for the proposed regulations. This is clear, as neither AIAC, nor anyone else, has attacked the information in the original rulemaking file, which included but was not limited to more than fifty separate consumer complaints and their files related to underinsurance and replacement cost; testimony at an investigative hearing held by the insurance commissioner on the same issues after the 2003 wildfires; declaration and summaries of market conduct examinations of insurance companies on issues of underinsurance and estimated replacement cost. In fact, neither AIAC, nor anyone else, has even asked to review the Rulemaking file, at any time, before or after the 15 Day Notice.<br>(2) The comment states that many of the documents (referring to the news articles) added to the rulemaking file are not relevant. This is a misleading comment, for all of the articles in the rulemaking file are related directly and indirectly to rebuilding homes after a fire, and the insurance component in that equation. While some of the articles do not have as their subject the underinsurance and replacement cost estimate issues directly, many of them do, and the comment fails to reference |

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| | relevance to replacement cost estimates; the information relates to assistance provided by FEMA and the Small Business Administration, fraudulent contractors, assistance offered to farms affected by wildfires and insurance covering county governments. Other documents note that underinsurance is not the result of estimates provided by insurers, but instead stems from a homeowner's lack of diligence or the conscious choice to purchase inadequate coverage. (3)The November 13, 2007 *New York Times* article included in the rulemaking file states, "Insurance industry officials say many homeowners contribute to the problem of insufficient coverage. In seeking to keep premiums low, the officials said, homeowners often do not inform their insurers about renovations, opt out of adequate coverage or fail to update their policies." (4) The December 4, 2007 *North County Times* staff opinion observes, "The problem of underinsurance which so often surfaces after a disaster, occurs because people forget to let their insurers know about improvements they've made to their home or new purchases that would need to be replaced after a fire, earthquake or theft." (5) And in the December 27, 2007 *North County Times* article which was added to the rulemaking file, Insurance Commissioner Poizner states that insufficient insurance "is bound to happen. People don't keep their insurance companies up-to-date."<br>(6)The department's Informative Digest for the proposed regulations asserts after the 2007 wildfires, homeowners "learned that replacement value estimates made in setting coverage limits for their homes was (sic) too low, causing underinsurance issues to arise during efforts to rebuild or replace their residences." But this assertion is not backed up with facts. After the 2007 wildfires, the department received few complaints about underinsurance and there is no data that links these complaints to insurer replacement estimates. The department's November 9, 2009 press release explains that as a result of the 2007 wildfires, nearly 40,000 insurance claims were filed. The press release notes that the department received only 70 complaints related to | even one of these articles in its comment.<br>(3) The New York Times article includes many statements not mentioned in the AIAC comment. For example:<br>"As Californians recover from another season of devastating wildfires, one of the biggest obstacles is a painfully familiar one. As many as 40 percent of homeowners statewide lack enough insurance to cover their home-replacement costs, according to the California Department of Insurance, and most realize the problem only when it is too late…"<br>"After past disasters, California state officials tried to raise homeowners' awareness of their coverage limits by requiring policies to be written clearly and with disclaimers about what is not covered. But several national studies suggest that many homeowners tend to underestimate risk and do not understand that their policies do not guarantee replacement of their homes. "Most Americans still think that full coverage means full coverage, but insurance companies know otherwise," said Douglas Heller, executive director of the Foundation for Taxpayer and Consumer Rights, an advocacy organization…"<br>"Guaranteed home-replacement policies have become increasingly rare in California since the 1990s, when a series of catastrophic earthquakes and wildfires sent insurers' profits plummeting. Most California policies have limits on construction, although some include inflation riders or extension policies to create buffers beyond the estimated replacement price.."<br>"An analysis by The San Diego Union-Tribune of 2,137 houses that were destroyed in unincorporated areas of San Diego County in the last big wildfires, in 2003, found that only 46 percent had been rebuilt by late last year. In many cases, policyholders said they had not resolved their insurance claims or received enough money to replace their homes, The Union-Tribune reported…"<br>"But John Garamendi, the California lieutenant governor who served two terms as the state's insurance commissioner, has |

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| | underinsurance stemming from the nearly 40,000 claims. The release gives no indication that any of the 70 complaints were justified and provides no facts that show that the complaints were linked to, or arose from, replacement cost estimates provided by their insurance companies. (7)The only seemingly "statistical" study added to the rulemaking file is the United Policyholders survey of 2007 wildfire victims. But the survey is not a valid study. The survey is not based on a scientific sampling of the 40,000 wildfire claims. The survey merits no consideration. It provides no factual foundation for any regulatory activity. The Department of Insurance has provided no evidence that there is a need for the proposed regulations' mandate that insurers must strictly adhere to the uniform standards for replacement cost estimates set forth in the regulations. Until such evidence is established, the proposed regulations fail to meet the "necessity" standard required by the Administrative Procedure Act, and should not be adopted.<br>Authority<br>(8) Proposed Sections 2695.183 sets standards that a licensed insurer would be obliged to follow when the insurer provides an estimate of replacement cost to an applicant or policyholder. The revised version of the section continues to cite Insurance Code Section 1749.85 for its statutory authority. However, none of the four subsections of Section 1749.85 authorize the Department of Insurance to set standards for replacement cost estimates that an insurance licensee communicates to a homeowner. Subsection (a) does give the department the power to adopt regulations governing the curriculum and training of producers on the proper methods for estimating replacement costs, but no more. Subsection (b) explains who may not estimate replacement costs and states that an insurer's underwriter may communicate estimates. Subsection (c) makes clear that licensed appraisers, contractors and architects may estimate a structure's replacement value. Subsection (d) states that if the department adopts a regulation establishing standards for the calculation of estimates | placed much of the blame on the insurance companies. At a news conference earlier this year, Mr. Garamendi said that "lack of clarity in the language" of policies was a main reason that homeowners had insufficient insurance. He also said that, in some cases, insurance agents and insurance companies "were giving bad information to the consumers…" "<br>"Jim Wells, president of Marshall & Swift/Boeckh…, said insurance companies had improved the models they used to estimate replacement costs. But many of the companies, Mr. Wells said, did not take the next step and contact homeowners who held policies written with older, less accurate information. "Sometimes the insurance companies believe their agents have that responsibility," Mr. Wells said. "Sometimes it is an expense they're not ready to bear even though it pays for itself in higher premiums. Sometimes it's just not the way they did business in the past, and sometimes they think it's the policyholders' responsibility and not theirs.""<br>(4) It should be noted, as well, that the same article pointed out that Commissioner Poizner stressed that "while it was his job to make sure insurance companies met their legal obligations to policyholders, it was also the responsibility of homeowners to make sure insurance companies have all the information they need to provide adequate and speedy service." The proposed regulations will assure that the companies receive and process "all of the information" needed to estimate replacement cost.<br>(5) The article points out as well that: "…Karen Reimus of Scripps Ranch advises policyholders not to take their insurance company's recommendation at face value. Reimus lost her home in the Cedar fire of 2003 and has since become an outspoken advocate for homeowners. Reimus said her experience and that of those she's advised is that insurance companies tend to suggest a coverage amount that's insufficient in the event of a total loss…"<br>Further, the comment neglects to mention even one of the following articles, and the quotes from them, all of which speak |

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| | by real estate appraisers, appraisers must follow the standards. Nothing in Section 1749.85 authorizes the department to set standards for estimates that insurers communicate to applicants and policyholders. Thus, proposed Section 2695.183 is not authorized by Insurance Code Section 1749.85.<br>(8)The revision to subdivision (j) of proposed Section 2695.183 states that an insurer that communicates an estimate of replacement value that does not comport with subdivisions (a) through (e) is guilty of making a misleading statement under Insurance Code Section 790.03. There is no authority for the adoption of subdivision (j).<br>Section 790.03 defines unfair insurance practices. The Department of Insurance does not have the authority to expand the practices defined in Section 790.03 through the adoption of a regulation. Instead, the department is required to proceed against an insurer pursuant to Insurance Code 790.06 which relates to situations when "any person engaged in the business of insurance is engaging in this state in any method of competition or in any act or practice in the conduct of the business that is not defined in Section 790.03." Subdivision (j) of Section 2695.183 invalidly attempts to expand Insurance Code Section 790.03. There is no authority for the adoption of subdivision (j).<br>Arbitrary<br>(9) Subdivision (a) of proposed Section 2695.183 would require every estimate of replacement cost to include the dollar costs for specified components and consideration of a long list of other components and features. ACIC believes that this formula for an estimate reflects a calculating tool developed by Marshall & Swift/Boeckh (MSB) but which has been modified by that company.<br>The department's choice of this now outmoded estimating tool is arbitrary. The department has provided no explanation why this particular estimating formula is superior to all other calculating tools that are available to insurers. This formula for listing the costs for specified components has been introduced in the | to the significance of the underinsurance issue:<br>Union Tribune article: *Fighting off Fraud After the Disaster*, November 3, 2007: "Two weeks before the 2003 fire, the one-story home they had bought a decade earlier for $120,000 was appraised at $349,000. But the couple's home was underinsured, and in the end the insurance company gave them $147,000 to rebuild."<br>Union Tribune article: *Burned-out Homeowners Begin Insurance Process*, November 29, 2007<br>"Months after the 2003 fires, the state's insurance industry found itself at the center of an embarrassing firestorm over underinsurance complaints. Hundreds of homeowners said they learned only after the fires that their insurance policies undervalued the cost of rebuilding their homes, sometimes by hundreds of thousands of dollars…<br>The controversy drew the wrath of then-Insurance Commissioner John Garamendi, who berated insurance underwriters and agents for not doing enough to ensure that homeowners regularly updated their policies…<br>Dozens of homeowners ended up filing lawsuits against their insurers, and some of those cases remain unsettled more than three years later…<br>Still, about 58 percent of all U.S. homes were underinsured by an average 21 percent in 2006, according to Marshall & Swift/Boeckh …<br>"I really don't think that the industry has made the kind of fundamental changes that need to be made so that this doesn't keep happening," said Amy Bach, executive director of United Policyholders, a San Francisco-based consumer advocacy group that is working with wildfire victims in San Diego County…"<br>Union Tribune article: *Homeowners Express Concerns Over Insurance*, November 30, 2007:<br>"Poizner assured the crowd of more than 200 that his agency will hold insurers responsible for policies that were improperly written. "If the insurance company has made a mistake, used |

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| | October 27, 2010 revision to the proposed regulations. This is a substantial change to the original version of the regulations. Before this exclusive formula is mandated for every replacement cost estimate, the department must convene another public hearing to determine whether the estimating formula in subdivision (a) of Section 2695.183 is so clearly superior to every other approach as to warrant exclusion of all other estimating formulas.<br>Since the proposed formula in subdivision (a) is outmoded, it is likely that many insurers are not using the formula today. Adoption of subdivision (a) will require those insurers to make expenditures that conform their systems to the subdivision by adopting outmoded formula.<br>Presumably, MSB modified the estimating formula called for in subdivision (a) because the modification improved the quality of the estimates. By proposing the preservation of the unmodified formula in subdivision (a), the department presumes that it has a superior level of expertise in this specialty.<br>ACIC believes that homeowners are best served when there are a variety of estimating tools and formulas available to insurers. The department's one-size-fits-all estimating approach will not benefit consumers, especially when that approach is arbitrary and outmoded.<br>(10) Proposed Section 2695.183 reflects an unwise public policy. When insurers determine that estimating formulas need improvement so they better serve the needs of consumers, insurers can make those changes. The adoption of Section 2695.183 would cement into law one formula for presenting replacement cost estimates. Today the department thinks this is a good idea. However, if experience shows that the formula is not helping consumers, it will take months of rulemaking to change the mandates in Section 2695.183. During that process, insurers will be prevented from offering their customers better estimates and improved service.<br><u>Application of Regulations</u> | the wrong square footage, ran their computer models wrong, we can hold them accountable," he said…<br>Underinsurance became a major issue in the months after the 2003 fires that burned more than 2,400 homes in the county. Hundreds of homeowners said they learned only after the fires that their insurance policies undervalued the cost of rebuilding, sometimes by hundreds of thousands of dollars…<br>The problem embarrassed the insurance industry, generated numerous lawsuits and prompted then-Insurance Commissioner John Garamendi to hold a series of public hearings on the matter…"<br>CNN Money article: "Underinsurance horror<br>Upon reviewing the Martins' situation, Kehrer concluded that they were underinsured by at least 30 percent to 40 percent. The $785,000 they received to rebuild their home, while close to their policy limit, works out to about $175 a square foot.<br>But, Kehrer says, constructing a custom-built house on a hillside in their neighborhood typically runs $250 to $300 a square foot, based on estimates from local builders. That would put the tab for rebuilding closer to $1.1 million to $1.35 million…"<br>Malibu Times article: State *Insurance Commissioner Talks to Fire Victims*, December 19, 2007: "Residents worried about receiving full value on losses…Most residents in attendance who had lost homes in the fires were concerned about the yawning gap between what they believed was the extent of their coverage and the amount their insurance companies told them to expect…<br>One woman was worried about mitigation issues with her rebuild. "There are homes built in the '40s and '50s that need to be replaced and a new building code goes into effect in January," she said. "Are we responsible for filling that gap?.."<br>Many were concerned that the true value of their homes and personal contents would not be properly paid…<br>One resident voiced a frustration felt by many residents, "The |

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| | (11) Subdivision (q) of proposed Section 2695.183 requires that the standards in the proposed regulations apply to "estimates of replacement value that are prepared, communicated or used by a licensee on or after the day that is one hundred eighty (180) calendar days after filing with the Secretary of State." This time frame is unreasonable.<br>The proposed regulations would require most homeowner insurers to make extensive and expensive system changes. In addition, the companies that provide estimating tools to insurers would have to change their systems to conform to the regulations' estimating approach. This cannot be accomplished in 180 days.<br>And in many cases the 180-day time frame will be shortened. Subdivision (q) triggers the application of the regulations standards when estimates are "used." This means that policies that renew 180 days after the regulations are filed with the Secretary of State must include estimates that conform to the regulations with the renewal notices that are provided 45 days prior to the 180-day implementation date. It usually takes 10 days to prepare and mail the notices. So, in practice, the 180 days will be reduced by 55 days.<br>Setting the impractical 180-day implementation date would not help consumers. If insurers and companies that provide calculating tools are not able to meet the deadline, homeowners will not be able to obtain replacement cost estimates from insurance licensees. That is a harm that should not be imposed on homeowners.<br><u>Clarification</u><br>(12) Subdivision (j) of proposed Section 2695.183 requires all estimates to comport with subdivisions (a) through (e) of Section 2695.183. This conflicts with subdivision (h) of Section 2695.183 which exempts estimates based on inflation factors from compliance with subdivisions (a) through (e). It should be made clear that subdivision (j) does not apply to the estimates covered by the subdivision (h) exemption. | scope of loss estimated by my insurance company doesn't reflect the actual cost of replacing my property," she said…<br>Others complained that insurance companies gave estimated rebuilding costs at $175 per-square-foot…<br>"This is a ridiculous figure," one woman claimed. "We're Malibu. I haven't found a contractor who said he could do anything for less than $300 per-square-foot…"<br>I'm looking at a 60 percent difference between what my insurance company is offering and the minimum bid I've received from contractors," one man said…<br>Ventura County Star article: *Area Wildfires Illustrate Need for Adequate Home Insurance,* January 6, 2008:<br>"The devastating wildfires in Southern California offered a stark reminder: You need to make sure your homeowner's insurance policy will truly protect you and your family if your home is seriously damaged or destroyed…<br>Insurance is no assurance…<br>Don't automatically assume you're protected; according to one national survey, nearly 60 percent of homeowners are seriously underinsured. In the event of a major claim, the survey showed that the underinsured could find that the upper limit of their policy payout is 20 percent less on average than what they would need to rebuild in today's market. So don't be cavalier here. Just because you have a homeowner's insurance policy doesn't mean you have the right one….<br>The difference between the right one and the wrong one could mean tens of thousands of dollars coming out of your pocket because you find out too late that your insurance policy is inadequate…"<br>North County Times article: *Region: Rebuilding Slow in Fire-ravaged Areas*, October 22, 2008:<br>"We haven't seen any plans from about 62 percent of the fire victims -- they haven't submitted anything," said Darren Gretler, the county's building division chief…<br>The rebuilding isn't being stymied by zoning changes or |

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| | | tougher building codes…<br>Instead, the slow pace stems from economic pressures and inadequate insurance, said county officials and one local builder…<br>"The governmental agencies have been very cooperative and made it as easy as they can for people to rebuild," said Mark Connal, sales director for Escondido's Michael Crews Development. "There's been no resistance to rebuilding in the fire-prone areas…<br>"The real problem is most people just can't afford to rebuild the home they lost…<br>The pattern is similar to that experienced in the months following the October 2003 wildfires. Three years after those blazes destroyed 2,137 homes in the unincorporated areas of the county, only 986 had been rebuilt, according to county figures."<br>L.A. Times article: *A Year Later, Victims Say Carriers Misled Them*, October 23, 2008:<br>"…a wildfire sparked evacuations in Southern California on Wednesday morning, victims of a blaze that destroyed 1,600 homes in San Diego County a year ago complained that they were still battling insurance companies to get more money to rebuild…<br>At issue: underinsurance of homes and who is to blame.<br>At a news conference in a fire-vacated lot in the San Diego neighborhood of Rancho Bernardo, residents accused some insurers of misleading them into thinking they had enough coverage to replace homes burned to the ground by the Witch Creek fire in October 2007…"<br>Associated Press report: *Victims of San Diego Fires Criticize Insurers*, October 24, 2008:<br>"But homeowners who lost their homes in the Witch Creek fire last October said at a news conference Wednesday that some insurance companies had misled them before the wildfire about how much coverage they needed to fully rebuild their homes.<br>Karen Hoy, who has only rebuilt the foundation of her 2,100- |

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| | | square-foot Escondido home, said her insurance agent told her in 2004 that she had enough protection to fully rebuild. Now, Hoy says, her insurer is offering her $200,000 less than the full cost to rebuild…<br>United Policyholders, the insurance consumer group that held the news conference, said only 100 of 1,600 homes burned last fall have been rebuilt -- in part because of problems with underinsurance…"<br>L.A. Times article: *Wildfire Victims Burned Again When Coverage Comes Up Short,* November 19, 2008:<br>"According to the California Department of Insurance, nearly 39,000 claims were filed after the wildfires that swept across Southern California last October and November. Just over 30,000 of those claims had been settled as of June 20, leaving almost 9,000 unpaid or disputed…<br>It's not clear how many of those claims involve underinsurance. As of this week, the Department of Insurance had received 90 complaints from policyholders who said their insurance did not adequately cover their losses from last fall's fires. But officials say many underinsurance cases may not result in complaints to regulators… "It's not the vast majority of claims, but it's not insignificant," said state Insurance Commissioner Steve Poizner. "This is a very serious issue."<br>(6) The comment misstates the press release. The release provided information concerning recoveries by the Department of Insurance of more than $27 million from insurance companies for consumers in the aftermath of the Witch Creek fire in San Diego County that killed two people, destroyed 1,650 structures and burned more than 197,000 acres in Oct. 2007. The press release notes: "CDI (California Department of Insurance) was able to recover these funds for consumers that notified the Department of their problems and suspected unfair treatment by their insurer. CDI received 391 consumer complaints since late 2007. Of the 391 complaints received from consumers, 70 have involved underinsurance allegations. |

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| | | CDI recovered more than $4 million for consumers who had complaints stemming from underinsurance issues." Of course, this represents a very high percentage of underinsurance complaints (70) relative to the total number of complaints as a result of the Witch Creek Fire (391). ACIC makes a misleading and untrue comment by representing that the "press release notes that the department received only 70 complaints related to underinsurance stemming from the nearly 40,000 claims." In fact, the 40,000 claim number referenced in the press release is unrelated to the 391 consumer complaints made to the Department regarding the Witch Creek Fire. It refers to the nearly 40,000 insurance claims were filed statewide regarding the "2007 fires," the Witch Creek fire being only one. There is nothing in the press release about the total number of underinsurance related consumer complaints made to the Department of Insurance relative to all of the wildfires in the state in 2007.<br>(7) ACIC criticizes the survey but fails to negate its findings, nor provide any information to the contrary. The United Policyholders Survey 2007 Wildfire Victims reported that: "66% of respondents reported being underinsured. The average amount by which people reported being underinsured was $319,500. 47% of respondents either had not yet settled after two years or their settlement was not enough to rebuild their home."<br>(8) The Department does not rely on the language of Insurance Code Section 1749.85 alone as reference and authority to promulgate proposed Section 2695.183 with respect to broker-agents. The amended text of regulations cites as authority the following: Sections 730, 790.03, 790.04, 790.10, 1749.7, 1749.85, 1861.05, and 2051.5, Insurance Code.<br>(9) The regulations do not mandate that a particular estimate of replacement cost tool be used, only that specific factors and components be considered in estimating the replacement cost. Neither ACIC, nor anyone else commenting on the proposed |

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| | | regulations has argued that these components and features should not be considered in estimating replacement cost. In this regard, the failure to protest may be viewed as acquiescence that the following items should, in fact, be considered when estimating replacement cost, as stated in proposed Section 2695.183 (a):<br>"(1) Cost of labor, building materials and supplies;<br>(2) Overhead and profit;<br>(3) Cost of demolition and debris removal;<br>(4) Cost of permits and architect's plans; and<br>(5) Consideration of components and features of the insured structure, including at least the following:<br>(A) Type of foundation;<br>(B) Type of frame;<br>(C) Roofing materials and type of roof;<br>(D) Siding materials and type of siding;<br>(E) Whether the structure is located on a slope;<br>(F) The square footage of the living space;<br>(G) Geographic location of property;<br>(H) Number of stories and any nonstandard wall heights;<br>(I) Materials used in, and generic types of, interior features and finishes, such as, where applicable, the type of heating and air conditioning system, walls, flooring, ceiling, fireplaces, kitchen, and bath(s);<br>(J) Age of the structure or the year it was built; and<br>(K) Size and type of attached garage."<br>(10) This comment is not supported and is rejected by the Department. The proposed regulations do not prohibit other components and features from being considered now or in the future, only that those listed be among those factored into the estimate of replacement cost. Proposed Section 2695.183 states: "The estimate of replacement cost shall include the expenses that would reasonably be incurred to rebuild the insured structure(s) in its entirety, including at least the following…"<br>(11) The time frame is completely reasonable. The regulations |

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| | | become effective 180 days after they are filed with the Secretary of State pursuant to proposed Section 2695.183 (q): "This article shall apply only to estimates of replacement value that are prepared, communicated or used by a licensee on or after the day that is one hundred eighty (180) calendar days after filing with the Secretary of State." The Department believes it is in the best interest of consumers and licensees that the regulations be implemented as soon as is practical given the significance of assuring that broker-agents receive training on estimating replacement cost, and that licensees communicating estimates of replacement cost do so in accordance with the proposed regulations. In this regard, the 180 day implementation time frame is sufficient to permit licenses and vendors to take steps that are reasonably necessary to comply with the proposed regulations. The comment regarding difficulties providing notice is not supported by any facts.<br>(12) The comment sees a conflict when there is none. Subdivision (j) of proposed Section 2695.183 states that is a misleading statement to communicate an estimate of replacement value not comporting with subdivisions (a) through (e). Subdivision (h) of Section 2695.183 states that if an estimate of replacement cost is updated or revised and communicated, the licensee shall provide a copy of the revised or updated estimate of replacement cost to the applicant as provided. This subdivision (h) shall not apply when the update or revision to the estimate of replacement cost or the policy limit results solely from the application of an inflationary provision in a policy or an inflation factor. Nowhere in subdivisions (a) through (e) is there a requirement that inflationary provisions or inflation factors be included. Subdivision (h) then is written so as to exempt a licensee from having to provide a new copy if the only difference in the later estimate of replacement cost is based upon an inflationary provision or an inflation factor, again, neither of which are considerations for estimating replacement cost under |

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| | | subdivisions (a) through (e). |
| **National Association of Mutual Insurance Companies (NAMIC) and the Pacific Association of Domestic Insurance Companies (PADIC) November 12, 2010 written comments** | Dear Mr. Tancredi:<br>Both the National Association of Mutual Insurance Companies (NAMIC) and the Pacific Association of Domestic Insurance Companies (PADIC) appreciate the opportunity to respond to the October 27, 2010 revised proposed amendments to the regulations concerning Standards and Training for Replacement Value on Homeowners' Insurance.<br>PADIC member companies write approximately $1 billion in property and Casualty premium almost exclusively in California. Because the vast majority of PADIC insurance business is written in California, insurance regulation has a much greater impact on our members and, more importantly, our policyholders than companies who write insurance throughout the country. Approximately one half of the premium written by PADIC is in personal lines, including homeowners insurance.<br>NAMIC is a full-service national trade association with more than 1,400 member companies that underwrite 43 percent ($196 billion) of the property and casualty insurance premium in the United States. NAMIC membership includes four of the seven largest property and casualty insurance carriers in the nation, and every size regional, national and state specific property and casualty insurer, including hundreds of farm | **Response to National Association of Mutual Insurance Companies (NAMIC) and the Pacific Association of Domestic Insurance Companies (PADIC) November 12, 2010 written comments:**<br>(1) In this comment NAMIC and PADIC summarize their May 2010 written comments. The Department in response incorporates fully its responses to those comments referenced above. (1) – (6).<br>(2) This comment argues, as the comments offered in May 2010 (2) and (3) that the Department lacks regulatory authority to promulgate the regulations. The Department incorporates fully its responses to the May 2010 comments (2) and (3). Further, the PADIC and NAMIC suggest that the proposed regulations will unlawfully interfere with protected commercial free speech and are contrary to the interests of the consumer. The Department rejects this characterization. The comment offers no factual support for this proposition, nor does it provide an example of how the proposed regulations will interfere with commercial speech or negatively impact consumers. In fact the proposed regulations will act to foster clear and understandable communication between a licensee and a consumer. They will provide a definition of estimate of replacement cost that can be understood. If a licensee chooses to communicate an estimate |

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| | mutual insurance companies. NAMIC has 106 member insurance carriers writing business in the state of California who write approximately 23% of the property and casualty insurance business in the state.<br>(1) As previously stated in NAMIC's and PADIC's May 11, 2010 written comments, we oppose the implementation of these proposed amendments because: (a) they do not comply with procedural and substantive requirements of the Administrative Procedures Act (APA), Government Code Section 11349.1; (b) the proposed amendments improperly attempt to either add a new prohibition to the California Insurance Code, section 790 et seq., the Unfair Practices Act (Act), or implement the current Act in a way that is inconsistent with the language and intent of a regulation pertaining to deceptive and misleading insurance practices; c) the contemplated regulatory changes improperly subject insurers to Unfair Practices Act liability exposure for merely complying with the insurer's contractual and regulatory duty to communicate with the policyholder about the consumer's insurance options and the terms/conditions of the policy; and d) the proposed amendments are likely to confuse not enlighten insurance consumers as to the issue of properly selecting appropriate homeowners' insurance coverage limits and endorsements.<br>For the sake of brevity, NAMIC and PADIC will not restate, in detail, the concerns previously tendered to the Department of Insurance and will specifically incorporate by reference the arguments made in our May 11, 2010 written comments and oral testimony into this submission.<br>(2) In addition to NAMIC's and PADIC's concern that the proposed revised regulation exceeds the Department of Insurance's regulatory authority, fails to comply with APA Due Process requirements, and is inconsistent with case law on the scope of permissible homeowner's insurance regulations, we are concerned that the revised proposed regulations | of replacement cost it must take into consideration the components listed in estimating it.<br>(3) The Department rejects this general comment. The comment fails to cite a particular proposed section, subsection, subdivision or paragraph to support its statement. The Amended Text of Regulations and the Update of Information Contained in Initial Statement of Reasons are incorporated herein as the Department's response. The amendments made to the original text of reasons are provided in full, with complete explanations as to the rationale for the amended proposed regulations. Further, the Department incorporates fully its responses to each of the comments raised as to specific proposed provisions, both in May 2010 and in November 2010, wherein the Department has pointed out why changes to the original text were made. In this regard, there is no justification or factual basis for the unsupported comment by NAMIC and PADIC.<br>(4) The Department rejects this comment. Proposed Section 2695.182 does not interfere with commercial free speech, but encourages it. Proposed Section 2695.182 (a) (b) and (c) clearly and simply requires a licensee who communicates an estimate of replacement cost in connection with an application for or renewal of a homeowner's insurance policy that provides coverage on a replacement cost basis to maintain certain documents in specific situations. This does not interfere with the communication, it only acts to memorialize it.<br>As well, Proposed Section 2695.183 acts to foster communication between a licensee and an applicant for insurance or an insured by establishing clear and understandable terms related to estimates of replacement cost. The proposed Section requires a licensee who communicates an estimate of replacement cost in connection with an application for or renewal of a homeowner's insurance policy that provides coverage on a replacement cost basis to comply with clear requirements and standards. These requirements and standards provide that an "estimate of replacement cost" shall include the |

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| | unlawfully interfere with an insurer's right to engage in protected commercial free speech and is contrary to the best interest of insurance consumers.<br>(3) NAMIC and PADIC are disheartened by the fact that the Department of Insurance has failed to make any meaningful amendments to the regulation to address insurer concerns with the scope, breadth and legal implications of the proposed regulation. In fact, the revised proposed regulations are even more problematic in some ways than the original proposed regulation.<br>(4) Specifically, in Sections 2695.182 and 183 the revised proposed regulation places restrictions on *all* lawful and appropriate "communications" about estimates of replacement costs between an insurer and the applicant or policyholder. This aspect of the revised proposed regulation is overly broad, unnecessary, and an unreasonably interference with the contractual relationship between the parties in a manner that violates First Amendment Commercial Free Speech Protections.<br>(5) NAMIC and PADIC are also concerned that the revised proposed regulation has expanded the scope of the definition of "replacement value" (Section 2695.180(b)) by including a reference to the cost to "construct" damaged or destroyed structure. The original draft regulation only contemplated the cost to *repair, rebuild or replace* a "completely" damaged or destroyed structure". This change in terminology is concerning, because the cost to "construct" could be significantly different from and exceed in cost what it would take to repair, rebuild or replace a previously existing structure. The word "construct" has a connotative and denotative meaning of erecting a structure that may not have previously existed. Insurance is designed to restore the policyholder's home to its pre-incident condition, not to provide the policyholder with something entirely different. Further, the removal of the qualifier, "completely" to the | expenses that would reasonably be incurred to rebuild the insured structure(s) in its entirety. With the proposed regulations, then, when communications occur between licensees and consumers, there can be no confusion over what is meant by an estimate of replacement cost. Again, this provides for a full and open discussion, not an interference with commercial free speech as is contended in the comment. Proposed Section 2695.183 (j) states: "To communicate an estimate of replacement value not comporting with subdivisions (a) through (e) of this Section 2695.183 to an applicant or insured in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis constitutes making a statement with respect to the business of insurance which is misleading and which by the exercise of reasonable care should be known to be misleading, pursuant to Insurance Code section 790.03." Requiring licensees to identify something as an estimate of replacement cost only when it, is in fact, an estimate of replacement cost, cannot be deemed an interference with commercial free speech. Again the Department offers that it creates a better environment for commercial free speech, one where both licensees and consumers understand the concepts and the context of the discussion. Further, the comment ignores 2695.183 (m) which states: "No provision of this article shall be construed as requiring a licensee to estimate replacement cost or to set, or recommend a policy limit to an applicant or insured. No provision of this article shall be construed as requiring a licensee to advise the applicant or insured as to the sufficiency of an estimate of replacement cost." In this regard, there is nothing in the regulations compelling licensees to "communicate" any advice, if a licensee chooses not to. As well, the comment ignores 2695.183 (n): "No provision of this article shall limit or preclude a licensee from providing and explaining the California Residential Property Insurance Disclosure, as cited in Insurance Code section 10102, |

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| | phrase "damaged or destroyed structure" expands the scope of the regulation to include claims that do not pertain to total losses.<br>(6) We are also concerned that the definition of "estimate of replacement value" (Section 2695.180(e)) is impractical and unworkable. Specifically, the revised proposed regulation includes in the definition of "estimate of replacement value" *all* "statements", even those not relating to an estimate of value, and *all* "approximations or opinions", even those that do not rise to the level of being an actual calculation or formal evaluation of replacement value. This language could expose insurers to legal liability for communications that were not intended to be estimates of value and/or communications that would not reasonably be interpreted by the average applicant or policyholder to be estimates of value. This provision is particular concerning in light of the fact that the regulation specifically applies to *oral* communications by the insurer/licensee to the policyholder or applicant. *Oral* communications are easily misunderstood and misremembered, and create situations rife for "he said-she said" litigation, which is not in the best interest of either party. Moreover, NAMIC and PADIC are concerned that the revised proposed regulation requires an insurer to include in any estimate of replacement cost (which Section 2695.180(e) defines as including any mere statement by an insurer/licensee) a statement "identify[ing] the assumptions made for each of the components and features listed in paragraph (a)(5) . . . ." This provision is entirely unnecessary and excessive, and is in want of clarification. For instance, what is meant by the phrase "identify the assumptions made"?<br>(7) We are also perplexed by the fact that the Department of Insurance has decided to create strict liability for an insurer for the acts of a broker-agent that are not in compliance with Section 2695.183. Specifically, Section 2695.183(k)(3) states that "the insurer, and not the broker-agent, shall be responsible | explaining the various forms of replacement cost coverage available to an applicant or insured, or explaining how replacement cost basis policies operate to pay claims." Certainly, the proposed regulation is not interfering with commercial free speech, just the opposite.<br>(5) Proposed Section 2695.180(b) has been amended from the originally noticed regulations as follows (double underline and double strike through included for purposes of this response) : " "Replacement value" shall have the same meaning as "replacement cost" and is defined as the amount it would cost to repair, construct, rebuild or replace a ~~completely~~ damaged or destroyed structure." The change was made to make clear that the term includes the amount it would cost to "construct" a structure. Mirriam-Webster Online defines "construct" as "to make or form by combining or arranging parts or elements." The comment states: "The word "construct" has a connotative and denotative meaning of erecting a structure that may not have previously existed." The word does not, in fact, have that connotative or denotative meaning. The word "construct" qualifies as "a damaged or destroyed structure" and therefore does not contemplate erecting a structure that may not have previously existed, as the commentator suggests. The word "completely" was removed from the original text of the proposed regulations for clarity. Since the standards set forth in these proposed regulations more specifically address that an estimate of replacement cost shall include all expenses that would reasonably be incurred to rebuild the structure in its "entirety" [Section 2695.180(a)], the terms "replacement value" and "replacement cost" should not be defined so narrowly. To define these terms narrowly using "completely" could result in ambiguity as to when these regulations apply and or are triggered. For example, if the "completely" reference in Section 2695.180(b) in kept, a licensee could attempt to assert that its estimate does not express an opinion of a "complete" estimate, and therefore, does not fall under the definitions of |

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| | for noncompliance with this Section 2695.183 that results from the failure of the estimate (which Section 2695.180(e) defines as including any mere statement by an insurer/licensee) to satisfy the requirements of subdivisions (a) through (c).” In effect, the revised proposed regulation makes the insurer legally liable for a regulatory violation of this regulation by a broker-agent, even in cases where the broker-agent acted outside of the scope of his/her agency relationship with insurer or policyholder/applicant. This radical change to standard agency law is inappropriate and detrimental to the consumer, who should have the right to seek a legal remedy against a broker-agent, who failed to comply with this regulation.<br>(8) In closing, NAMIC and PADIC appreciate being afforded this opportunity to tender the aforementioned comments to the proposed regulation, and respectfully request that the CDI consider the importance of drafting a regulation that does not confuse insurance consumers and/or force insurance companies into having to refuse to assist policyholder’s in their personal evaluation of their homeowner’s insurance coverage limits needs.<br>Thank you for your time and consideration. Please feel free to contact Christian J. Rataj at 303.907.0587 or at crataj@nami.org, or Milo Pearson at 916.225.0618 or milopearson@sbcglobal.net, if you have any questions about NAMIC’s and PADIC’s Written Comments. | “replacement cost” or “estimate of replacement cost” so the entire regulations do not apply to the licensee’s estimates. This would result in a licensee being able to circumvent the regulations and continue to provide misleading and incomplete estimates to consumers. The comment argues that to remove “completely” “expands the scope of the regulation to include claims that do not pertain to total losses.” The regulations do not in any way pertain to claims practices. As noted above, defining “replacement value” so narrowly, using “complete” would allow insurers to do incomplete estimate and circumvent these regulations.<br>(6) Proposed Section 2695.180 (e) is as follows: ““Estimate of replacement value” shall have the same meaning as “estimate of replacement cost” and means any estimate, statement, calculation, approximation or opinion, whether expressed orally or in writing, *regarding the projected replacement value of a particular structure or structures*.”(emphasis added) Certainly, the context of the communication being related to the “projected replacement value of a particular structure or structures” alone, acts to inform the definition. Each section in which the term “estimate of replacement value” or “estimate of replacement cost” is used includes specific language surrounding and limiting the circumstances in which obligations arise. An oral communication of an estimated replacement cost is permissible, and even anticipated, as the proposed regulations consider transactions conducted telephonically, for instance.<br>(7) Proposed Section 2695.183(k)(3) was in substantially the same form when noticed originally in April 2010. NAMIC and PADIC offered no comment concerning it in their May 2010 written comments or testimony. The proposed changes have been made in response to various comments by others, and act to clarify its meaning, not change its substance. Nonetheless, it does not create strict liability for an insurer as the comment suggests. Simply, the provision states that if an insurer tells |

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| | | broker-agents that they must use one or more specific sources or tools to create an estimate of replacement cost, that the insurer must prescribe complete written procedures for the broker-agents to follow. Second, they must train broker-agents and provide written training materials necessary to utilize the sources or tools. Third, the insurer, and not the broker agents, will be responsible for non-compliance with the regulations if the estimate fails to satisfy the requirements of subdivisions (a) through (e) *unless* the noncompliance "results from failure by the broker-agent to follow the insurer's prescribed written procedures when using the source or tool." (emphasis added)<br>(8) The Department rejects the comment's characterization of the proposed regulations. |
| **MSB November 9, 2010 written comments** | Respondent Background<br>Marshall and Swift/Boeckh (MSB) is a California based company that is the largest supplier of residential and commercial property valuation solutions to the property and casualty insurance industry in North America. MSB cost information data, services and technology are at the hub of underwriting and claims departments decisioning (sic) process that strengthen their Insurance to Value (ITV) initiatives of their companies, but as important property claims settlement results and policy management procedures with the ultimate beneficiary the policyholder who is properly insured. MSB enables insurance professionals to generate complete and accurate cost estimates but in a manner that incorporates the consumer in a meaningful way to better protect consumers in the event a loss occurs. Accurate estimating from MSB, proven in the many validation programs we perform serve to protect policyholders from under insurance situations, while simultaneously enabling the insurance provider to determine the appropriate premium required to mitigate the exposure of the risk.<br>Through nearly a decade of partnership with the Department and its commissioners, MSB has worked closely with the department to build "best practices" strategies that lead the industry in | **Response to MSB November 9, 2010 written comments:**<br>(1) The Department concurs and thanks MSB for this comment.<br>(2) Proposed Section 2695.183 (a) (2) requires that an estimate of replacement cost shall include the expenses that would reasonably be incurred to rebuild the structure in its entirety, including expenses associated with "overhead and profit." Further, proposed Section 2695.183 (g) (2) requires that an estimate of replacement cost provided "must itemize the projected cost" for each element specified in paragraphs (a)(1) through (4) [which includes, under paragraph (2), "overhead and profit."] MSB believes that it would be "inappropriate and misleading" to include an individual line item related to overhead and profit. MSB argues that the most accurate and appropriate way to apply overhead and profit is at the "individual component and assembly level, not at the end of the estimate as an applied global percent factor." The Department believes that MSB may have misread the proposed regulation. The regulations do not require that overhead and profit be applied as a global percent factor. The overhead and profit may be calculated at the "individual component and assembly level" as MSB would prefer, however, that total expense must then be separately itemized and reflected as proscribed under proposed |

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| | establishing common, consumer oriented valuation procedures that have also been emulated by Insurance Departments and carriers across the United States. As the Department will recall, it published a position on best practices that MSB alone implemented for the industry with the following general conditions:<br>- Gather property characteristics appropriately.<br>- Use a reasonable ITV tool<br>- Risk specific valuations<br>- No short cut methods<br>- No quality judgments<br>- Minimum of 12 data elements + open-ended question<br>- Confirm basis of initial valuation with homeowner<br>- Reaffirm periodically with homeowner<br>- Recalculate annually<br>- Empower homeowners to validate themselves (www.accucoverage.com)<br>- Concurrence that the MSB RCT estimating system complies with these guidelines was voiced by the Department following the hearings on the 2003 Southern California wildfires, as well as consumer advocates who published that …"the results in the detailed questionnaire RCT approach is within spitting distance of the actual loss." (George Kehrer, Consumer Activist).<br><br>Central to the valuation methodology is then the building cost information and total component approach of MSB that also follows closely the outline for displaying estimated values described in the proposal from the Department since collaboration has certainly occurred.<br>Comments Regarding Proposed Regulations<br>ITV Estimate Output Format<br>As in the past, it has been our distinct pleasure to work with the | regulation Section 2695.183 (a) (2) and (g) (2). This is necessary so that the applicant or insured will have the opportunity to see, separately, the amount being estimated for overhead and profit, rather than having to guess, or make his or her own analysis as to how much of the estimated replacement cost is associated with overhead and profit. |

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| | Department on this very important regulation. At this time of this writing, MSB is actively working with the Department to secure certification for our newly created broker-agent training program. This program was developed specifically to meet the requirements of the regulations new section 2188.65. We are confident that certification will be granted by the Department, allowing us to participate proactively in the fulfillment of this requirement for insurance professionals across the state.<br>(1) Section 2695.183 is also a great interest to MSB as it seeks to formalize the details that underlie the best practices listed above. In (a) the regulation explicitly lists expenses that need to be included in the replacement cost estimate. We agree with the Department that all these possible expenses need to be taken into consideration when generating a replacement cost estimate. Omitting any of these expense categories might result in an underinsurance situation. The list of expense categories is again referenced in (g) (2) where the regulation appears to mandate that the underlying costs associated with the following expense categories be individually represented within the estimate.<br><br>- (a) (1) cost of labor, building material and supplies;<br>- (a) (2) overhead and profit;<br>- (a) (3) cost of demolition and debris removal;<br>- (a) (4) cost of permits and architect's plans<br><br>(2) While all of these expense categories are represented in MSB's calculated replacement estimate, and are documented as such on our standard reports, we feel that it would be inappropriate and misleading to include an individual line item related to (a) (2) overhead and profit. From our eighty-plus years of construction and building experience, we have learned that the most accurate and appropriate way to apply sub-contractor and general-contractor overhead and profit is at the individual component and assembly level, not at the end of the estimate as an applied global percent factor. This is the methodology | |

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| | employed within MSB's estimating solutions. Additionally we would argue that *requiring* individual reporting of the expenses in (g) (2) will provide no substantive benefit for the consumer, and will likely serve as a distraction from the important role they play in verifying the property characteristic being used to generate the replacement estimate. Underinsurance is, more often than not, a reflection of poorly collected and verified property characteristics. It is for these reasons that we respectfully request the removal of item (2) (b) from the regulation.<br>We thank you for your consideration in this matter and welcome the opportunity to discuss this, or any other aspect of this regulations, before its final consideration. | |