

DEPARTMENT OF INSURANCE**Legal Division, Rate Enforcement Bureau**45 Fremont Street, 21st Floor
San Francisco, CA 94105

**NOTICE OF PROPOSED EMERGENCY ACTION
AND FINDING OF EMERGENCY
PURSUANT TO CALIFORNIA INSURANCE CODE SECTION 12921.7**

REG-2007-00046

April 21, 2008

PRIOR APPROVAL REGULATIONS

California Insurance Commissioner Steve Poizner (the "Commissioner") hereby provides notice, pursuant to California Insurance Code section 12921.7 that he will propose to the Office of Administrative Law ("OAL") the adoption of emergency amendments to the Prior Approval Regulations, referenced in Title 10, Chapter 5, Subchapter 4.8, Article 2, Sections 2642.6, 2642.7, and Article 4 Sections 2644.2, 2644.3, 2644.6, 2644.7, 2644.8, 2644.11, 2644.12, 2644.17, 2644.19, 2644.20, 2644.21, 2644.23, 2644.25 and 2644.27 of the California Code of Regulations, on an emergency basis pursuant to California Government Code section 11346.1(b).

This Notice contains a description of the facts demonstrating the existence of an emergency and the necessity for the regulations, along with a copy of the text of the emergency regulations.

This Notice is provided to every person, group, and association who has previously filed a request for notice of regulatory action with the Commissioner. Copies of the Notice and studies are available at the Department of Insurance, 45 Fremont Street, 21st Floor, San Francisco, California, 94105 and on the Department's web site at www.insurance.ca.gov.

The proposed regulation will be submitted to the OAL together with the rulemaking file not less than five (5) working days after the mailing of this Notice, as required by California Insurance Code section 12921.7. Questions regarding this Notice should be directed to:

California Department of Insurance
Legal Division
Attn: Lara Sweat, Senior Staff Counsel
45 Fremont Street, 21st Floor
San Francisco, California 94105
(415) 538-4192

The Commissioner hereby finds that an emergency exists, and that the following amendments to the Prior Approval Regulations, referenced in Title 10, Chapter 5, Subchapter 4.8, Article 2, Sections 2642.6, 2642.7, 2642.8 and Article 4 Sections 2644.2, 2644.3, 2644.6, 2644.7, 2644.8, 2644.11, 2644.12, 2644.17, 2644.19, 2644.20, 2644.21, 2644.23, 2644.25 and 2644.27 of the

California Code of Regulations, are necessary for the immediate preservation of the public peace, health and safety, or general welfare.

INFORMATIVE DIGEST / POLICY STATEMENT OVERVIEW

Existing law, Proposition 103 (Insurance Code sections 1861.01 *et seq.*), an initiative approved by the California voters on November 8, 1988, establishes a system of prior approval rate regulation for property-casualty insurance lines (except those listed in Insurance Code section 1851). In 1991 the Department adopted regulations which provided a formula to determine whether a rate was excessive or inadequate. These regulations were upheld in *20th Century Insurance Company v. Garamendi* (1994) 8 Cal.4th 216 recognizing that the Department's use of a general formula could help reduce the task of reviewing rate applications to a "manageable size." Each section of these regulations is part of the comprehensive formula used to determine rates. All the sections work together to help determine an appropriate insurance rate, that is, one that is neither excessive nor inadequate.

DESCRIPTION OF PROBLEM AND NECESSITY FOR REGULATION

In 2006, the Department made comprehensive revisions to the prior approval regulations (RH05042749) which were effective in April 2007 (the "2007 revisions"). The 2007 revisions included significant changes to the prior approval regulations including existing variances and the creation of new variances. A variance will allow deviation from the prior approval regulations for certain specified reasons such as lack of data or solvency issues. Variances are crucial to the ratemaking process because they can recognize and allow for the uniqueness of an insurer's experience data by line and program.

The 2007 revisions were intended to simplify the prior approval process and to provide some flexibility in certain situations as warranted by the variances.

Since the 2007 revisions have been in effect, certain issues were identified both by the Department and insurers with regard to the administration of the variances. After these issues were identified, the Department invested considerable time and effort in the development of standards and benchmarks and other revisions to the prior approval regulations which were not able to be addressed in the 2007 revisions.

The goal of this rulemaking is to make necessary changes to the variances and other associated prior approval regulations.

JUSTIFICATION FOR ADOPTION AS EMERGENCY REGULATIONS

Regulations were created as a means to determine whether a rate is excessive or inadequate. The use of regulations for this process was upheld in *20th Century* where the court recognized that regulations providing for a general formula were an appropriate method for managing the number of rate applications. In order for the Department to be able to review the large number of rate application it receives each year, rules of general application must be in place, thus a regulation.

This rulemaking is necessary to resolve the issues with the variances as well as to address other issues that arose after the 2007 revisions.

Since the revisions went into effect in April 2007, the Department and insurers began to notice certain issues with the administration of the variances. As it became clear that administering the variances was problematic, the Department began to develop amendments to the regulations as well as to other sections of the prior approval regulations that were not able to be addressed during the 2007 revisions or that arose as a result of the 2007 revisions. However, due to the highly technical nature of the prior approval regulations and variances, there was no way to craft a “quick fix.” The proposed regulation changes are a result of several months of study, discussion and refinement as each part of the regulatory scheme is part of a comprehensive formula used to determine rates. The components all work together to complete the calculation for a maximum and minimum permitted earned premium and determine the appropriate rate. Every section is a necessary component in a formulaic regulatory scheme designed to keep the job of rate regulation manageable.

The Department has moved quickly to resolve the issues with the 2007 revisions and regulations and therefore these revisions need to be put into place as soon as possible. The Department has identified a significant decrease in rate applications in 2007. Insurance is multi billion dollar industry, affecting almost every citizen of the state. It is necessary to have an appropriate, properly functioning mechanism for determination of rates.

These regulations need to be enacted on an emergency basis in order to have a fully functioning regulatory scheme. Pursuant to CCR section 2632.11(c)(1), private passenger automobile insurers must fully comply with the 2006 amendments to the automobile rating factor regulations (the “ARFs”) by July 14 of 2008. Insurers are also required to file rate applications with the class plan.

If these regulations are not enacted on an emergency basis, changes to rates, specifically prior passenger automobile rates, will occur in two parts, the first with the ARF filing and then further changes pursuant to these revisions as the ARF deadline is earlier than the regular rulemaking process deadline. In order to harmonize both regulatory schemes, these amendments must be implemented before the ARF deadline. Accordingly, the Commissioner must utilize the emergency regulations procedures; otherwise the coverage and rate changes to be implemented via the ARF filings will not occur in harmony with rate changes resulting from these revisions.

The only way to immediately protect the public’s interest in this case is if the regulations are adopted on an emergency basis. Requiring insurers to file two rate filings, one right after another, would cause tremendous confusion in the marketplace. As a result insurers will face difficulties implementing their rating plans and insureds may be displaced as insurers implement one rating plan in order to comply with the ARF deadline and then another rating plan to comply with revisions to the prior approval regulations.

California case law supports the Commissioner’s decision to promulgate emergency regulations in this instance. In *Schenley Affiliated Brands Corp. v. Kirby* (Cal. Ct. App. 1971) 21 Cal. App.3d 177 the court held that an agency did not abuse its discretion in promulgating emergency regulations where other regulations were about to go into effect and additional regulations were needed in order to achieve a fully operational regulatory scheme.

Lastly the amendments are necessary prior to the ARF filing deadline to allow the Department to handle the large number of filings anticipated. Currently only about twenty percent of private passenger automobile insurers have complied with the ARF deadline which means an influx of filings which the Department will have to review within the statutorily prescribed time frame of 60 days. Without these revisions in place, it will be difficult for the Department to properly review the large number of private passenger automobile filings within the designated time frame. The revised regulations provide clarity with better defined benchmarks and will make the development and submission of the ARF filings less cumbersome and time consuming for both insurers and the Department.

AUTHORITY UNDER WHICH REGULATIONS ARE PROPOSED

These regulations are specifically authorized by California Insurance Code sections 1861.01 and 1861.05. These regulations would implement, interpret or make specific Insurance Code sections 1861.01 and 1861.05.

Because this proposed rulemaking action concerns ratemaking, California Government Code section 11340.9(g) applies.

COMPARABLE FEDERAL LAW

There are no comparable existing federal regulations or statutes.

LOCAL MANDATE DETERMINATION

The Insurance Commissioner has initially determined that the proposal will not result in any new program mandates on local agencies or school districts.

COST OR SAVINGS TO STATE OR LOCAL AGENCIES / SCHOOL DISTRICTS / FEDERAL FUNDING

The Insurance Commissioner has initially determined that the proposal will not result in any cost or significant savings to any state agency or to any local agency or school district for which Part 7 (commencing with section 17500) of Division 4 of the Government Code would require reimbursement, or in other nondiscretionary costs or savings to local agencies. Nor will the proposal affect federal funding to the state.

TECHNICAL STUDIES OR REPORTS RELIED UPON

CDI study “Calculation of Leverage Factors [Earned Premium to Average Surplus], Data from the 2007 Edition of AM Best’s Aggregates and Averages [Rounded to the Nearest Million].”

CDI Study “Underserved Community Earned Exposures for Private Passenger Auto and Homeowner s Insurance.”

CDI study “Calculation of Average Insurer Line Concentration.”

