Previous Page

STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 21st Floor
San Francisco, CA 94015

PROPOSED REGULATION TEXT[1]
Prior Approval of Insurance Rates
RH05042749 June 2, 2005
§2642.7. Lines of Insurance.

(a) Wherever in this subchapter insurance is required to be classified by line, the classification shall be into one of the following categories:
(1) Fire
(2) Allied Lines
(3) Farmowners multiple peril
(4) Homeowners multiple peril
(5) Commercial multiple peril
(6) Inland marine
(7) Medical malpractice
(8) Earthquake
(9) Other liability
(10) Private passenger automobile liability
(11) Private passenger automobile physical damage
(12) Commercial automobile liability
(13) Commercial automobile physical damage
(14) Aircraft
(15) Fidelity
(16) Glass
(17) Burglary and theft
(18) Boiler and machinery.
(b) For purposes of this subchapter, mechanical breakdown and similar insurance covering loss caused by the failure or malfunction of a component or system of a motor vehicle, as described in California Insurance Code Section 116(c), shall be classified as private passenger automobile physical damage insurance.
(~~b~~c) Any insurer may disaggregate any of the foregoing lines, except homeowners multiple peril, private passenger automobile liability, and private passenger automobile physical damage, into two subcategories, "commodity" and "specialty."
(~~c~~d) Specialty insurance shall include:
(1) Any single policy having an annual premium over $75,000;
(2) Any policy having a deductible or self-insured retention of $100,000 or more;
(3) Any excess property, excess liability, or umbrella policy, where none of the underlying policies include private passenger automobile liability, private passenger automobile physical damage, or homeowners coverage, or where the underlying policy is written by an unaffiliated insurer and covers at least the first $500,000 in losses;
(4) All policies for

(A) nuclear risks,
(B) pollution legal liability,
(C) product-tampering, product impairment, or product recall,
(D) kidnap and ransom,
(E) political risks,
(F) professional liability or errors and omissions including medical malpractice,

(G) directors' and officers' liability,
(H) boiler and machinery insurance,
(I) fidelity insurance,
(J) mortgage guaranty insurance,
(K) employer liability under the United States Longshoremen's and Harbor Workers' Compensation Act (33 U.S.C. section 901 *et. seq.*), the Jones Act (46 U.S.C. section 688), the Federal Employer Liability Act (45 U.S.C. section 51 *et. seq.*), or any similar statute,
(L) excess employer's liability over workers' compensation insurance; and
(M) Differences in conditions coverage.

(~~d~~e) Commodity insurance shall include all policies in the line that are not defined in this section as specialty.

§2644.4. Projected Losses.

(a) "Projected losses" means the insurer's historic losses per exposure, adjusted by catastrophe adjustment, as prescribed in section 2644.5, by loss development, as prescribed in section 2644.6, and by loss trend, as prescribed in section 2644.7.
(b) Projected losses shall be calculated by applying the loss trend factor separately to data from each accident-year in the recorded period. However, for medical malpractice insurance, where the use of claims-made policies predominates throughout the line, projected losses are more appropriately evaluated on a report-year basis; accordingly, for medical malpractice insurance projected losses shall be calculated on a report-year basis, except where occurrence policies predominate.
(c) Where an insurer elects to disaggregate a line of insurance into commodity and specialty categories pursuant to section 2642.7, the insurer shall, in lieu of the computation of projected losses specified in sections 2644.5 through 2644.7, tender an alternative computation of projected losses for the specialty category, which the Commissioner shall approve if he or she finds the projection to have been made in a sound actuarial manner. Nothing in this section precludes the Commissioner from requiring the additional filing of projected losses computed in the manner specified in sections 2644.5 through 2644.7.
(d) For the earthquake line of business and for the fire following earthquake exposure in other lines, projected losses may be based on complex castastrophe models using geological and structural engineering science and insurance claim expertise. The use of such models shall, at a minimum, conform to the standards of practice as set forth by the Actuarial Standards Board, and the applicant shall have the burden of proving, by a preponderance of the evidence, that the projected losses derived from the model meet all applicable statutory standards.

§2644.16. Rate of Return.

The maximum permitted rate of return means the risk premium, as defined below, plus the return on U.S. Treasury bills for the most recent calendar year.

The Commissioner shall, from time to time, determine, in accordance with section 2646.3, the ~~maximum and minimum permitted after-tax rate of return~~ risk premium for property and casualty insurance ratemaking. The ~~maximum and minimum profit factors~~ risk premium shall represent the ~~range of~~ yield~~s~~ on investments in other enterprises presenting risks to investors comparable to property and casualty insurance~~,~~ minus the return on U.S. Treasury bills. ~~giving~~ The commissioner shall give due consideration to the competing interests of investors and consumers, and taking into account the fact that insurance is imbued with the public interest and that its purchase is sometimes legally required.

§2644.18. Federal Income Tax Factor

(a) "Federal income tax factor" means 1.0 minus the ~~insurer's effective~~ prospective federal income tax rate ~~reported in the most recent year for which historical data are available, giving full account to all tax credits and offsets used or available to the insurer. Where there has been a change in tax laws between the recorded period and the rating period, the effective tax rate shall be calculated using the historical data and the tax rules for the rating period~~.
(b) ~~Where the insurer had a net tax credit, or where the insurer had a net tax liability on a net pretax loss, the effective tax rate shall be zero and~~

~~(1) if the insurer had a net tax credit, the amount of the credit shall be added, as a positive number, to nationwide projected ancillary income;~~

~~(2) if the insurer had a net tax liability, the amount of the liability shall be subtracted from nationwide projected ancillary income.~~

~~(c) Where the insurer's effective tax rate reported in the most recent year for which historical data are available exceeded 34% and the insurer had a net tax liability on a net pretax profit, the effective tax rate shall be 34% and the amount by which the tax liability exceeded 34% shall be subtracted from nationwide ancillary income.~~

The Commissioner shall, from time to time, adopt the prospective federal income tax rate in accordance with section 2646.3. A single prospective federal income tax rate shall apply to all lines of business. It shall take into consideration the multiyear historical federal income tax rate experience of the national insurance industry as a whole, with appropriate adjustments for any significant differences between historical and prospective underwriting and investment results and expectations.

§2644.20. Projected Yield.

"Projected yield" means the ~~insurer's~~ imbedded yield ~~in the most recent year for which investment results have been reported,~~ plus an average of ~~the insurer's~~ realized capital gains over the most recent five years. Imbedded yield shall be calculated as the ~~insurer's~~ net investment income, excluding capital gains, divided by the average of the ~~insurer's~~ start-of-year and year-end surplus and reserves ~~for the most recent year for which investment results have been reported~~.
The Commissioner shall, from time to time, adopt the projected yield in accordance with section 2646.3. A single projected yield shall apply to all lines of business. It shall take into consideration the multiyear historical projected yield experience of the national insurance industry as a whole, with appropriate adjustments for any significant differences between historical and prospective investment and interest rate results and expectations.

§2644.21. Reserves Ratio.

"Reserves ratio" means
(a) the average of the last two years'

(1) industry-wide loss reserves, plus
(2) industry-wide loss adjustment expenses reserves, plus
(3) industry-wide unearned premium reserves

(b) divided by the industry-wide earned premium for the most recent year for which data are available.
There shall be one reserve ratio for each line of business. The industry-wide numbers shall be the sum of all such numbers taken from the California state page of the statutory Annual Statement for all insurers doing business in California. Adjusting and other expense shall be allocated in accordance with section 2643.6.

§2644.23. Credibility Adjustment.

(a) To the extent that the maximum and minimum permitted earned premiums are based upon data that lack credibility, a credibility adjustment shall be made~~, as appropriate, to projected losses, projected allocated loss adjustment expenses, projected loss development, and projected allocated loss adjustment expenses development~~.
(b) The Commissioner shall, from time to time, specify credibility criteria and ~~appropriate sources of substitute data~~ formulas for determining the credibility weight in accordance with section 2646.3.
(c) ~~The credibility adjustment shall consist of adding to the insurer's data sufficient additional data, drawn from an approved source of substitute data, approved in accordance with section 2646.3, to provide a total sample size sufficient to meet the applicable credibility criterion established by the Commissioner.~~ For less than fully credible data, the complement of credibility shall be the annual net trend plus one, raised to the power of the number of years from the effective date of the current rate to the proposed effective date of the proposed rates, minus one. Stated as a formula:
Complement = ((Annual Net Trend+1)^Number of Years) -1
If the number of years from the effective date of the current rate to the proposed effective date of te proposed rates exceeds four, the complement of credibility shall be the annual net trend plus

one, raised to the fourth power, minus one.
(d) The annual net trend is the annual loss trend plus one, divided by the annual premium trend plus one, minus one.
Stated as a formula:
Annual Net Trend = ((Annual Loss Trend +1)/(Annual Premium Trend +1))-1.
(e) The maximum permitted rate change before credibility is the maximum permitted earned premium divided by the trended current rate level earned premium, minus one.
Stated as a formula:
Max Permitted Rate Change = Max Permitted EP/Trended Current Rate Level EP
(f) The credibility-weighted maximum permitted rate change shall be the sum of the product of the maximum permitted rate change before credibility and the credibility weight and the product of the complement of credibility and one minus the credibility weight.
Stated as a formula:
Cred-Wtd Max Permitted Rate Change = (Max Permitted Rate Change x Credibility)+ (Complement x (1 - Credibility))
(g) The minimum permitted rate change before credibility is the minimum permitted earned premium divided by the trended current rate level earned premium, minus one.
Stated as a formula:
Min Permitted Rate Change = Min Permitted EP/Trended Current Rate Level EP
(h) The credibility-weighted minimum permitted rate change shall be the credibility-weighted maximum permitted rate change plus the minimum permitted rate change minus the maximum permitted rate change.
Stated as a formula:
Cred-Wtd Min Permitted Rate Change = Cred-Wtd Max Permitted Rate Change + Min Permitted Rate Change-Max Permitted Rate Change

§2644.24. Reinsurance.

(a) For all lines and sublines except for those listed in the next subparagraph, ratemaking shall be on a direct basis, with no consideration for the cost or benefits of reinsurance.
(b) For earthquake and for facultative reinsurance with attachment points above one million dollars, the maximum permitted earned premium is calculated as follows:

(1) projected losses, as defined in section 2644.4,
(2) plus projected allocated loss adjustment expenses, as defined in section 2644.8,
(3) minus projected reinsurance recoverables, as defined in section 2644.25,
(4) plus projected fixed expenses, as defined in section 2644.9,
(5) minus projected ancillary income, as defined in section 2644.13,

(c) divided by

(1) 1.0,
(2) minus the variable expense factor, as defined in section 2644.14,
(3) minus the maximum profit factor, as defined in section 2644.15,
(4) plus the investment income factor, as defined in section 2644.19.

(d) plus reinsurance premium
(e) divided by

(1) 1.0,
(2) minus the variable expense factor

Stated as a formula:

$$\boxed{max\ permitted\ EP = \frac{losses + ALAE - recoverables + fixedexpenses - ancilincome}{1 - varexp\ factor - profit\ factor + investincfactor} + \frac{reinspremium}{1 - varexp\ factor}}$$

§2642.25. Reinsurance Recoverables.

"Reinsurance recoverables"means all amounts recoverable from reinsurers for paid and unpaid reinsured losses and loss adjustment expenses, including estimated amounts receivable for unsettled claims and claims incurred but not reported as provided under reinsurance agreements.

[1] Additions to existing text are indicated by underline; deletions are indicated by ~~strikethrough.~~

Previous Page | Top of Page

Last Revised - June 02, 2005