

### Substantive Changes to Prior Approval Regulations

Regulation	Garamendi Regulations (effective April 2007)	Poizner May 2008 “Emergency” Amendments	Poizner November 2008 Proposed Amendments	Rate Impact
<p><b>Limits on Projection of Future Payouts on Current Claims (§§ 2644.6, 2644.27(f)(7)<sup>1</sup>)</b></p> <p>Controls how insurance companies project what they will pay out in the future on claims that have already been reported to the insurance company.</p>	<p>Required all insurers to calculate based upon an average of their three most recent years of data. Exceptions to the rule are allowed only under very limited circumstances.</p>	<p>No change.</p>	<p>Allows insurer to use essentially any methodology it chooses to support an exception from the rule.</p>	<p><b>Increased Rates.</b> Allows insurers to inflate their loss and expense projections to increase rates.</p> <p>The CDI recently granted a similar exception to Farmers that increased its homeowners’ premiums by 3.4%, totaling nearly \$30 million annually.</p>
<p><b>Limits on Projection of Future Premiums and Losses (§§ 2644.7, 2644.27(f)(8)<sup>2</sup>)</b></p> <p>This regulation controls how insurance companies project (1) the number and size of future claims and (2) the amount of premiums that they will collect absent a rate change.</p>	<p>Required all insurers to calculate based upon 12 most recent quarters of data. Exceptions to the rule were allowed only under very limited circumstances.</p>	<p>Effectively deregulated this provision. Insurance companies are now allowed to choose between 8, 12, 16, 20, or 24 quarters of data, or to use essentially any methodology it chooses to support an exception from the rule.</p>	<p>No further change.</p>	<p><b>Increased Rates.</b> Allows companies to use whatever approach they desire that results in the highest rates.</p> <p>Because of this amendment alone, Farmers’ pending application for an auto rate change is 4.0% higher than if submitted under the Garamendi regulations, and Mercury has applied for an auto rate <i>increase</i> that would otherwise be a decrease under the Garamendi regulations.</p>

<sup>1</sup> Renumbered as § 2644.27(f)(8) in November 2008 proposed amendments. All section references are to Title 10 of the California Code of Regulations.

<sup>2</sup> Renumbered as § 2644.27(f)(9) in November 2008 proposed amendments.

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<p><b>Control on Insurance Company Expenses (§ 2644.12)</b></p> <p>The regulation rewards efficient companies and penalizes wasteful companies by limiting the amount of expenses that can be passed through to policyholders.</p>	<p>Requires the Commissioner to calculate the industry-wide average expense value by line of insurance. Insurance companies cannot pass through any expenses above that amount.</p>		<p>Increases the amount of expenses that can be passed through and limits the incentives for more efficient companies.</p>	<p><b>Increased Rates.</b> Half of all insurers will be able to charge higher rates. The least efficient insurers could increase rates by 5% or more.</p>
<p><b>Regulation of Profit (§ 2644.16)</b></p> <p>This regulation sets a target maximum after-tax profit.</p>	<p>Sets a maximum rate of return that is indexed to an average of returns on various government bonds, plus an additional 6 percent. As of December 2008, the maximum rate of return that an insurer can build into its rate is 8.47% percent.</p>	<p>Allows the Commissioner to increase the maximum permitted rate of return by an extra 2% based on “financial market conditions.” This change was made without public scrutiny and led insurance companies to request rate increases.</p>	<p>Repeals May 2008 amendment, concluding that the regulation was “unworkable,” and solicits other proposals to allow insurance companies to obtain a higher profit.</p>	<p><b>Increased Rates.</b> Based solely on a 2% increase to the rate of return under the May 2008 amendment, State Farm seeks to increase its auto rates by 3.3%, or nearly \$81 million a year.</p>

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<p><b>Limits Reinsurance Pass-Through (§2644.25)</b></p> <p>Reinsurance is secondary insurance purchased by insurance companies to cover excess losses from a catastrophe. The regulation controls whether reinsurance costs can be passed through to consumers, and if so, how much.</p>	<p>Allowed minimal amounts of reinsurance costs to be passed through to policyholders only for earthquake and medical malpractice insurance lines.</p> <p>Contained strict prohibition on allowing insurers to pass through costs of reinsurance purchased from “unauthorized” reinsurers (those not licensed, accredited, or maintaining an approved U.S. Trust).</p> <p>Required mandatory hearings upon request when 30% of an insurers’ proposed rate is attributable to reinsurance costs to determine the reasonableness of the reinsurance costs, and whether some or all of those costs should be allowed to be passed through to policyholders.</p>	<p>Allows insurance companies to pass through reinsurance from unauthorized reinsurance companies in certain circumstances.</p> <p>Limited the scope of consumer challenges to reinsurance costs passed through to policyholders.</p>	<p>No further change.</p>	<p><b>Increased Rates.</b> Permits dramatic increases in earthquake insurance rates, as much as 40 – 50%. Encourages insurers to buy reinsurance from unregulated companies.</p>

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<p><b>Exception to Ratemaking Formula for Fraud Prevention/Loss Reduction (§ 2644.27(f)(1))</b></p> <p>Allows an insurance company to request an exception from the standard ratemaking formula for exceptional expenditures on fraud prevention and loss reduction.</p>	<p>Commissioner Garamendi provided exceptions ("variances") as "safety valves" to address rare situations when an insurance company could show that the regulations led to an unreasonable rate. This variance compensated those insurers who incurred extraordinary expenditures for fraud prevention and loss reduction, so long as the insurer could demonstrate reductions equal to or greater than the expenditures.</p>	<p>Standardized granting variances for fraud prevention and loss reduction and removed the requirement that insurers prove actual loss reductions.</p>	<p>No further change.</p>	<p><b>Increased Rates.</b> Any insurer with certain fraud prevention/loss reduction expenses can double count them in its rates without showing that their expenditures have actually reduced losses.</p> <p>Before May 2008, no such exception had ever been granted. The Department recently granted such an exception to Farmers, increasing its homeowners' rates. Mercury, Farmers, Auto Club, and Allstate have all requested the variance under the new regulations.</p>

**Proposed Changes to Prior Approval Procedures**

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<p><b>Delayed Implementation of Rate Changes (§ 2644.29)</b></p> <p>Proposition 103 requires that insurance rates are appropriate at all times to protect against price-gouging on one hand, and insolvency on the other. The regulations establish a formula to determine whether a rate is excessive or inadequate.</p> <p>This new proposed regulation will violate the requirement that no rate remain in effect that is excessive or inadequate.</p>	<p>Did not exist.</p>	<p>N/A</p>	<p>Seeks to allow insurers to implement rate changes greater than 15% over a period of time up to two years, rather than immediately as required by the statute.</p>	<p><b>Excessive or Inadequate Rates.</b></p> <p>By not implementing a required <i>decrease</i> immediately, this change would allow insurers to charge rates that the Commissioner has already determined are excessive.</p> <p><u>Example:</u> Commissioner Poizner's highly touted \$500 million in annual rate reductions for Allstate homeowner's and auto lines, which were both decided using the Garamendi regulations, could have been implemented over two years instead of immediately.</p> <p>For rate increases, failure to implement the minimum required rate could leave insurance companies in danger of insolvency.</p>

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<p><b>Change in Regulation of Rate Decreases (§ 2644.51)</b></p> <p>Proposition 103 requires insurance companies seeking to change their rates to file an application with the Commissioner, who must review and approve rates prior to their use. Members of the public have the right to review and challenge the applications through a hearing process.</p> <p>This new proposed regulation would violate the statutory requirement that no rate remain in effect that is excessive or inadequate, and the public participation requirements of Proposition 103.</p>	<p>Did not exist.</p>	<p>N/A</p>	<p>Would eliminate statutory requirement that Department review and Commissioner approve applications seeking a decrease; allows all such applications to be approved without the necessary scrutiny by the Commissioner or the public.</p>	<p><b>Excessive or Inadequate Rates.</b></p> <p>Would allow insurers to continue to charge excessive rates by seeking a smaller decrease than is required by the law. Would also allow insurers to evade solvency protections under Proposition 103. And would allow insurers to destabilize the market and undermine competition by charging inadequate rates.</p> <p><u>Example:</u> This year, Allstate was ordered to lower its auto and homeowners insurance rates by \$250 million each. Had this proposed change been in effect, Allstate could have been allowed to automatically implement decreases of \$110 million and \$80 million respectively without any scrutiny.</p>