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REGIONAL INSURANCE FEDERATION

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE**
300 Capitol Mall, 16th Floor
Sacramento, CA 95814

File No. REG-2008-00028

January 2, 2009

NOTICE OF PROPOSED ACTION AND NOTICE OF PUBLIC HEARING

FREQUENCY AND SEVERITY BANDS MANUAL

SUBJECT OF PROPOSED RULEMAKING

The Insurance Commissioner proposes to adopt the regulations described below after considering comments from the public. Notice is hereby given that the Insurance Commissioner ("Commissioner") proposes to amend Title 10, Chapter 5, Subchapter 4.7, section 2632.9(e) of the California Code of Regulations. The purpose of the regulations, specifically, is to update applicable law in order to incorporate by reference the newest version of the Frequency and Severity Bands Manual. The Frequency and Severity Bands Manual is required to be used, under certain circumstances, when preparing a private passenger automobile class plan in California.

PUBLIC HEARING

The Commissioner will hold a public hearing to provide all interested persons an opportunity to present statements or arguments, either orally or in writing, with respect to this regulation, as follows:

Date and time: Friday, February 20 at 10:00 a.m.

Location: Board Hearing Room
State Board of Equalization
450 N Street, Room 121
Sacramento, CA 95814

The hearing will continue on the date noted above until all testimony has been submitted or 4:00 p.m., whichever is earlier.

PRESENTATION OF WRITTEN COMMENTS; CONTACT PERSONS

All persons are invited to submit written comments on the proposed regulations during the public comment period. The public comment period will end at 5:00 p.m. on February 20, 2009. Please direct all written comments to the following contact person:

Drake Shogun
California Department of Insurance
300 Capitol Mall, 16th Floor
Sacramento, CA 95814
Telephone: (916) 492-3500
ShogunD@insurance.ca.gov

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

Camilo Pizarro
California Department of Insurance
300 Capitol Mall, 16th Floor
Sacramento, CA 95814
Telephone: (916) 492-3500
PizarroC@insurance.ca.gov

COMMENTS TRANSMITTED BY E-MAIL OR FACSIMILE

The Commissioner will accept written comments transmitted by e-mail sent to the following e-mail address: ShogunD@insurance.ca.gov or PizarroC@insurance.ca.gov. The Commissioner will also accept written comments transmitted by facsimile provided they are directed to the attention of the contact person for this proceeding using the following fax number: (916) 327-3482. **Comments sent by e-mail or facsimile are subject to the deadline set forth above for written comments.**

Comments sent to other e-mail addresses or other facsimile numbers will not be accepted.

DEADLINE FOR WRITTEN COMMENTS

All written materials must be received by the Commissioner, in care of the contact person, at the address listed above, by no later than **5:00 p.m. on February 20, 2009**. Any materials received after that time will not be considered.

ACCESS TO HEARING ROOMS

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

ADVOCACY OR WITNESS FEES

Persons or groups representing the interests of consumers may be entitled to reasonable advocacy fees, witness fees, and other reasonable expenses, in accordance with the provisions of Subchapter 4.9, Title 10, California Code of Regulations, in connection with their participation in this matter. Persons interested in inquiring about the appropriate procedures should contact the Office of the Public Advisor at the following address:

California Department of Insurance
Office of the Public Advisor
45 Fremont Street, 21st Floor
San Francisco, CA 94105
(415) 538-4190

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

AUTHORITY AND REFERENCE

The Commissioner proposes to adopt these regulations under the authority of Insurance Code section 1861.02(e). This section specifically authorizes the Commissioner to adopt regulations in order to implement the laws relating to private passenger automobile rates. The proposed regulations are designed to implement, interpret and make specific the manner in which rates and premiums for automobile insurance policies are determined in this State. The Commissioner also proposes to adopt the proposed regulations under the authority of *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216, which recognizes an implied delegation of rulemaking authority for those statutes that give an agency the authority to adopt those rules that are necessary for the due and efficient exercise of a power expressly granted by statute.

The proposed regulations will implement, interpret, and make specific Insurance Code sections 1861.02 and 1861.05.

INFORMATIVE DIGEST

SUMMARY OF EXISTING LAW AND POLICY STATEMENT OVERVIEW

Title 10, California Code of Regulations (“CCR”) sections 2632.5, 2632.8 and 2632.11 were revised in 2006 to implement Insurance Code section 1861.02(a), which requires that automobile insurance rates and premiums be determined by the application of rating factors in a specified

order of importance, or weight. Section 1861.02(a) establishes the order of importance as follows: a driver's driving safety record must be the most important factor, followed by the driver's annual miles driven, followed by the number of years of driving experience for the driver, followed by those other optional factors that the Commissioner adopts through regulation.

Among the optional factors adopted by the Commissioner are the factors of relative claims frequency and relative claims severity. (See CCR § 2632.5, subs. (d) (15) & (16).) The frequency and severity factors permit insurers to assign a given insured vehicle to a particular group, or "band," using either zip code or census tract data. The purpose of grouping zip codes and census tract regions to particular rating bands is to allow the insurer to rate similar risks homogeneously. Prior to the 2006 revisions to the regulations, insurers were permitted to use a maximum of 10 bands for relative claims frequency and a maximum of 10 bands for relative claims severity. As part of the 2006 revisions to the automobile insurance rating factor regulations, the Department expanded these bands from 10 categories each to 20 categories each.

The Department's regulations contemplate that some insurers may lack sufficient credible data to ascertain the most appropriate rating bands for relative claims frequency and relative claims severity. Thus, CCR section 2632.9(d) permits insurers to use an alternative set of data to develop rating bands for relative claims frequency and relative claims severity. This alternative set of data, developed by the Department, is known as the "Frequency and Severity Bands Manual."

Currently, CCR section 2632.9(e) incorporates by reference the Frequency and Severity Bands Manual that was filed with the Secretary of State on July 5, 1996 (the "1996 Manual"). The 1996 Manual was developed for the purpose of demonstrating how losses vary by zip code. The 1996 Manual also estimates frequency and severity of claims for zip codes throughout the state.

The Commissioner recognizes, however, that the 1996 Manual contains data that is more than fifteen years old. Moreover, because the 1996 Manual considers zip codes taken from the 1995 U.S. Postal Service ("USPS") zip code directory, the 1996 Manual does not reflect the revisions to the USPS zip code directory that have taken place over the last decade. Similarly, because the 1996 Manual contemplates 10 rating bands, as opposed to the 20 bands permitted by the 2006 revisions to the automobile rating factor regulations, the utility of the 1996 Manual has diminished.

EFFECT OF PROPOSED ACTION

The purpose of the proposed regulations is to ensure that private passenger automobile insurers will be able to implement the 2006 amendments to the automobile rating factor regulations through the use of updated, credible frequency and severity claims and exposure data that accounts for the fact that insurers may choose to use as many as 20 frequency and 20 severity rating bands.

For these reasons, the Commissioner instructed his staff to develop and publish a new Frequency and Severity Bands Manual that corrects the limitations that exist with respect to the 1996 Manual and aids insurers seeking an alternative credible source for claim frequency and claim

severity data. The proposed regulations seek to incorporate by reference the new Frequency and Severity Bands Manual and affirmatively establish the new Manual as the appropriate data source for use in private passenger automobile insurance class plans.

MANDATES ON LOCAL AGENCIES OR SCHOOL DISTRICTS

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

COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES OR SCHOOL DISTRICTS OR IN FEDERAL FUNDING

The Commissioner has determined that the proposed regulations will result in no cost or savings to any state agency, no cost to any local agency or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of the Government Code, no other nondiscretionary cost or savings imposed on local agencies, and no cost or savings in federal funding to the State.

ECONOMIC IMPACT ON BUSINESS AND THE ABILITY OF CALIFORNIA BUSINESSES TO COMPETE

The Commissioner has made an initial determination that adoption of the proposed regulations will not have a significant impact on reporting requirements, recordkeeping requirements, or other compliance requirements. The Commissioner has made an initial determination that adoption of the proposed regulation will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states, because the proposed regulation simply clarifies and makes specific one computational element of an insurer's optional rating factors. Because automobile insurance is generally written based upon California experience, this regulation does not affect the ability of California insurers to compete with insurers in other states.

The Commissioner has considered various alternatives to the existing and proposed regulation. However, the Commissioner invites comment on proposed alternatives designed to lessen any adverse economic impact on business while ensuring compliance with all applicable legal requirements.

The types of businesses affected by the proposed regulation are insurers transacting automobile insurance in the State of California.

POTENTIAL COST IMPACT ON PRIVATE PERSONS OR BUSINESSES

The Commissioner is not aware of any cost impacts a representative private person or business would necessarily incur in reasonable compliance with the proposed action. Although some insurers may incur additional costs to revise their existing class plans, insurers routinely make and file class plan revisions.

BUSINESS REPORTING REQUIREMENT

The Commissioner finds it is necessary for the health, safety, or welfare of the people of this State that these proposed regulations, which relate to a required report, apply to businesses.

EFFECT ON JOBS AND BUSINESSES IN CALIFORNIA

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

IMPACT ON HOUSING COSTS

The proposed regulation will have no significant effect on housing costs.

ALTERNATIVES

The Commissioner must determine that no reasonable alternative considered by the Commissioner or that has otherwise been identified and brought to the attention of the Commissioner would be more effective in carrying out the purpose for which the regulation is proposed or would be as effective as and less burdensome to affected private persons than the proposed regulation. The Commissioner has considered various alternatives to the proposed regulation and is not aware of a reasonable alternative to the proposed regulation. However, the Commissioner invites public comment on alternatives to the regulation.

IMPACT ON SMALL BUSINESS

The Commissioner has determined that the proposed amendment will affect small businesses to the extent that it affects insurance agents. However, insurance companies, which will also be affected, are by definition not small businesses, pursuant to Paragraph (b)(2) of Government Code section 11342.610.

COMPARABLE FEDERAL LAW

There are no comparable existing federal regulations or statutes.

TECHNICAL STUDIES OR REPORTS RELIED UPON

The Commissioner hereby provides notice that he intends to rely upon the following documents in proposing this rulemaking action:

- California Private Passenger Automobile Frequency and Severity Bands Manual (Amended May 15, 2008).

The Manual listed above, which is hereby incorporated by reference within this regulation, is part of the file for this rulemaking action. Any member of the public may view this document either on the Department's website at www.insurance.ca.gov, or by contacting the contact person listed above and arranging for an appointment to view the rulemaking file.

OTHER STATUTORY REQUIREMENTS

There are no other specific statutory requirements applicable to the proposed regulation.

TEXT OF REGULATIONS AND STATEMENTS OF REASONS

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

The file for this proceeding, which includes a copy of the express terms of the proposed regulations, the statement of reasons, the information upon which the proposed action is based, and any supplemental information, including any reports, documentation and other materials related to the proposed action that is contained in the rulemaking file, is available by appointment for inspection and copying at 300 Capitol Mall, 16th Floor, Sacramento, CA 95814, between the hours of 8:00 a.m. and 4:30 p.m., Monday through Friday.

AUTOMATIC MAILING

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

WEBSITE POSTINGS

Documents concerning this proceeding are available on the Department's website. To access them, go to <http://www.insurance.ca.gov>. Find at the righthand side of the page the heading 'QUICK LINKS.' The third item in this column under this heading is 'For Insurers'; on the drop-down menu for this item, select 'Legal Information.' When the 'INSURERS: LEGAL INFORMATION' screen appears, click the third item in the list of bulleted items near the top of the page: 'Proposed Regulations.' The 'INSURERS: PROPOSED REGULATIONS' screen will be displayed. Select the only available link: 'Search for Proposed Regulations.' Then, when the 'Search or Browse for Documents for Proposed Regulations' screen appears, you may choose to find the documents either by conducting a search or by browsing for them by name.

To search, enter "REG-2008-00028" (the Department's regulation file number for these regulations) in the search field. Alternatively, search using as your search term the California

Insurance Code number of a code section that the regulations implement (for instance, "1861.02"), or search by keyword ("bands manual," for example). Then, click on the 'Submit' button to display links to the various filing documents.

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

AVAILABILITY OF MODIFIED TEXT OF REGULATION

In response to public comment, the Commissioner may determine that changes to the proposal are appropriate. If those changes are sufficiently related to the original text that the public had adequate notice of the proposal, as amended, copies of the amended text will be sent to all persons who testified or presented comments at the public hearing or submitted written comments during the comment period, and to anyone who requested information regarding the proposal. Thereafter, the Commissioner will accept written comments, arguments, evidence and testimony, concerning the changes only, for a period of at least 15 days prior to adoption.

At least 45 days notice will be given if the changes are not 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.

TITLE 10. INVESTMENT
CHAPTER 5. INSURANCE COMMISSIONER
SUBCHAPTER 4.7. PRIVATE PASSENGER AUTOMOBILE RATING FACTORS
ARTICLE 3. RATING FACTORS

10 CCR 2632.9 (2008)

§ 2632.9. Use of Data

(a) An insurer that does not currently have credible data to support any of the categories for any of the rating factors listed in section 2632.5(c) and (d) may use the following for each such factor in their class plans filed within three years of the effective date of these regulations. An insurer may elect to use more than one of the listed data sources, provided each data source is identified as being primary, secondary, or third etc. The primary data source must be used for all rating factors included in that data source. The secondary data source can be used only if the primary data source does not have information on a specific rating factor or as needed to supplement credibility. The secondary data source must be used for all rating factors included in that data source before using a third data source. Similarly, the third data source can only be used if the secondary data source does not have information on a specific rating factor or as needed to supplement credibility, etc.:

(1) their own data, interpolating or otherwise actuarially adjusting the data to fit the categories; or

(2) data from another company; or

(3) data from an advisory organization; or

(4) the indicated relativity from another insurer with a similar book of business; or

(5) data that may be published by the Department; or

(6) approved relativities from another insurer's approved class plan.

(b) For class plans filed more than three years after the effective date of this regulation, an insurer may use only one of the following for every rating factor:

(1) the insurer's own data; or

(2) the insurer's own data and the data from a single alternative source of primary data; or,

(3) data from a single alternative source of primary data, such as an advisory organization; or,

(4) the indicated relativity from the approved plan of another insurer with a similar book of business; or

(5) data that may be published by the Department; or,

(6) data that may be published by the Department and the insurer's own data.

(c) When an insurer uses data from another source (as allowed in 2632.9(a) & (b)) they may use only the raw data before any adjustment factors have been applied (e.g., loss adjustment expenses, trending, loss development, etc.).

(d) If an insurer elects to use the optional factors average relative frequency band and severity band as listed in Section 2632.5(d)(15) and (16), the bands described in Section 2632.9(e) may be used. Use of the data described in section 2632.9(e) shall not be considered a data source for the purposes of section 2632.9(b) and restrict an insurer from selecting one of the options listed there. An insurer may also elect to use their own data for developing the frequency and severity bands. In the event that an insurer lacks credible data at the census tract level, they shall use zip code data. If the insurer's own zip code data is not fully credible, it shall use the claims frequency and severity for the zip code that is published in the manual described in Section 2632.9(e) either:

(1) directly as it is published, or

(2) to credibility adjust their own data. In the case where the manual indicates that the rate published in the manual has been credibility adjusted, an insurer may:

(A) use the credibility adjusted rate in the manual as the complement of credibility, or

(B) combine the unadjusted data published in the manual with its own unadjusted data. If this combined data is still not credible, then an insurer may elect to use as the compliment of credibility either:

1. the rate published in the manual for the CAARP territory that the zip code is a member of, or

2. the rate based on their own data or data from the manual from another grouping of contiguous whole zip codes, selected by the insurer, that is fully credible and contains said zip code.

(e) The frequency and severity rates and possible band assignments for each zip code in California are shown in the manual entitled California Private Passenger Auto Frequency and Severity Bands. Pursuant to the provision of *Section 11344, Government Code*, this regulation is not printed in full herein. The Insurance Commissioner has approved the separate manual designated in this Section. This manual was filed with the Secretary of State of the State of California on July 5, 1996 _____¹, but for the present is separately published, not as part of the California Administrative Code. The manual referenced in this section may be examined on our public website², and at the offices of the Insurance Commissioner in San Francisco, Los Angeles, and Sacramento.

(f) Zip codes not included in the manual described under (e) shall be assigned to bands as follows:

(1) new zip codes that were split off from an old zip code, shall use the band of the former zip code for that area;

(2) new zip codes that combined all or parts of other zip codes shall be assigned to one of the old zip codes that was used to make the new zip code;

(3) all other zip codes not in (e) shall be assigned by the insurer based on the band of any zip code that borders it.

(4) for assignments made under (2) or (3), insurers must choose the same zip code to be used for all band assignments.

AUTHORITY:

Note: Authority cited: *Section 1861.02, Insurance Code*; and *Calfarm Insurance Company v. Deukmejian (1989) 48 Cal.3d 805*. Reference: *Sections 1861.02 and 1861.05, Insurance Code*.

Notes

1. The actual date will be determined when the rulemaking is completed and the revised manual is actually filed with the Secretary of State.
2. To find the revised Bands Manual on the internet, please navigate to the Department of Insurance public website, www.insurance.ca.gov.
Directly under the map of California, find the “NEWS” link.
From that link, click on the “Studies, Reports & Publications” link (the second choice in the drop-down menu).
From that link, click on the “Research Studies” link (fourth choice in the drop-down menu).
At the “Policy Research Studies” page, click on the “Information Related to Class Plan Development” (first link).
Under “NEWS: AUTO CLASS PLAN INFORMATION”, item 3A links to the Title Page, Preface, and Table of Contents for the Manual. Item 3B links to the spreadsheet containing the data for the Manual.