

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 21st Floor
San Francisco, California 94105**

NOTICE OF PROPOSED ACTION

DATE: April 2, 2010

REGULATION FILE REG-2010-00001

Standards and Training for Estimating Replacement Value on Homeowners' Insurance

SUBJECT OF PROPOSED RULEMAKING

The Insurance Commissioner proposes to adopt the regulation described below after considering comments from the public. The Commissioner proposes the following changes to Chapter 5 of Title 10 of the California Code of Regulations: (1) the addition of new Section 2188.65 to Article 6.5 of Subchapter 1; (2) the amendment of Section 2190.2 of Article 7 of Subchapter 1; (3) the amendment of Section 2190.3 of Article 7 of Subchapter 1; and (4) the addition of new Article 1.3: Valuation of Homes to Subchapter 7.5.

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 agents and brokers who sell homeowner'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 construction costs; and (5) establish record keeping requirements.

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: Monday, May 17, 2010 at 10:00 a.m.

Location: Department of Insurance Hearing Room
300 South Spring Street
Los Angeles, CA 90013

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 May 17, 2010. Please direct all written comments to the following contact person:

Michael Tancredi, Senior Staff Counsel
California Department of Insurance
300 South Spring St., 12th Floor
Los Angeles, CA 90013
Telephone: (213) 346-6637

Questions regarding procedure, comments, or the substance of the proposed action should be addressed to the above contact person. In the event the contact person is unavailable, inquiries regarding the proposed action may be directed to the following backup contact person:

George Teekell, Senior Staff Counsel
California Department of Insurance
45 Fremont Street, 21st Floor
San Francisco, CA 94105
Telephone: (415) 538-4390

DEADLINE FOR WRITTEN COMMENTS

All written materials must be received by the Insurance Commissioner, addressed to the contact person at his address listed above, no later than 5:00 p.m. on May 17, 2010. Any written materials received after that time may not be considered.

COMMENTS TRANSMITTED BY E-MAIL OR FACSIMILE

The Commissioner will accept written comments transmitted by e-mail provided they are sent to the following e-mail address: tancredim@insurance.ca.gov. The Commissioner will also accept written comments transmitted by facsimile provided they are directed to the attention of Michael Tancredi and sent to the following facsimile number: (213) 897- 9241. **Comments sent to other e-mail addresses or other facsimile numbers will not be accepted. Comments sent by e-mail or facsimile are subject to the deadline set forth above for written comments.**

AUTHORITY AND REFERENCE

The proposed regulations will implement, interpret and make specific the provisions of Insurance Code sections 35, 730, 735.5, 790.03, 790.04, 1625, 1625.5, 1631, 1633, 1749.1, 1749.3, 1749.31, 1749.85, 1760.5, 1763, 1764.1, 2051.5, and 10087.

The authority for these regulations are set forth in Insurance Code sections 35, 730, 790.03, 790.04, 790.10, 1631, 1633, 1727, 1749.7, 1749.85, 1763, 1768, 1861.05, and 2051.5.

INFORMATIVE DIGEST

SUMMARY OF EXISTING LAW AND POLICY STATEMENT OVERVIEW

Insurance Code section 1749.85 provides:

- (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 replacement value shall be calculated in accordance with the regulation.

The policy underlying the proposed action is to assure that homeowners receive from Department licensees more accurate replacement value estimates regarding their insured structures. 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. Since 2003, California has experienced significant wildfires in 2007 and 2008 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 too low, causing underinsurance issues to arise during efforts to rebuild or replace their residences.

The significance of the replacement value being 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 kinds¹ of insurance coverage on their home: 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

¹ In conjunction with the coverage options referenced, homeowners may request Building Code Upgrade-Ordinance and Law Coverage which pays up to limits specified in the policy and additional costs required to bring the dwelling up to code.

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.

The necessity of having an accurate estimated replacement value that is updated regularly is paramount. The use by agents, brokers and insurers of replacement value estimation software that does not take into consideration factors including costs to replace the foundation of the structure, debris removal and demolition expenses, overhead and profit, engineering reports, and architect's plans is one source of the underinsurance problem.

The regulation clarifies the terms "replacement value" and "replacement cost" to create a more consistent, comprehensive and accurate replacement cost calculation; sets forth training standards for agents and brokers who sell homeowner's insurance; requires that licensees follow certain standards when using replacement cost calculators; and establishes record-keeping requirements. The regulations also impose certain requirements on other kinds of construction costs estimates.

Further, Insurance Code section 790 et seq., the Unfair Practices Act, provides that certain acts are defined as unfair and deceptive. The regulation makes it clear that when setting, recommending or communicating about a policy limit on a homeowners' insurance policy to characterize using the word "replace" or "replacement" any estimate of construction costs not comporting with the applicable provision of the regulation will constitute 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.

EFFECT OF PROPOSED ACTION

The proposed regulations provide specific definitions applicable to the regulation and to Insurance Code Section 1749.85. They provide the recommended curricula required under Insurance Code 1749.85. The proposed regulations will establish the course requirements and the training on specific subjects, including how to estimate replacement cost and construction costs, necessary for those seeking to sell dwelling fire or homeowners' insurance.

The proposed regulations establish new record keeping requirements for those licensees who calculate estimated replacement cost and construction costs.

The proposed regulations provide standards for real estate appraisers who want to estimate replacement value for homeowner insurance policy purposes.

The proposed regulations provide standards to be used when a licensee estimates replacement cost and construction costs. These standards require that certain components and features be considered in estimating replacement cost or constructions costs,

mandating that cost calculators factor in the costs of each feature and component. They require that licensees advise consumers if all of the features and components that are defined to make up a replacement cost estimate are not used in the calculation. If all of the components are not considered, the licensee may not call the calculation an estimated replacement cost. The regulations impose various restrictions on and requirements for construction cost estimates, including those not qualifying as a replacement cost estimate, as defined. Further, the regulations require that licensees should regularly evaluate their methods for estimating replacement cost and construction costs to ensure that these estimates are up-to-date.

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 the adoption of the proposed regulations may have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states. The types of businesses that may be affected are real estate appraisers, insurers and insurance agents, insurance brokers and vendors of home valuation software. The Commissioner has not considered proposed alternatives that would lessen any adverse economic impact on business and invites you to submit proposals. Submissions may include the following considerations:

- (i) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to businesses.
- (ii) Consolidation or simplification of compliance and reporting requirements for businesses.
- (iii) The use of performance standards rather than prescriptive standards.
- (iv) Exemption or partial exemption from the regulatory requirements for businesses.

POTENTIAL COST IMPACT ON PRIVATE PERSONS OR BUSINESSES

The cost of the course that insurance producers may need to pay may result in a minor economic impact. However, licensing courses are already required, notwithstanding these regulations, so the cost impact could be neutral.

The agent's time from work to take a classroom course may also be an economic impact. Again, though, this could be neutral. The Department has six homeowners' insurance valuation courses available for agents to complete for continuing education credit. Three courses are contact (classroom) and three are non-contact (either Internet or textbook). This means that the insurance producer has an option and may not need to take time from work to complete the course.

There might be a minor economic impact to licensees regarding the record keeping requirements, although licensees currently have record keeping requirements and the addition of another category of documentation to be retained would involve little, if any cost. Additionally, when construction costs estimates are provided rather than replacement cost estimates, the licensee may incur a cost associated with identifying and explaining the components that have been left out of the estimate. Such cost may be incurred in changing information on a licensee website, for example, or when providing this information in writing.

There may be a slight economic impact on insurance producers who are required to take into consideration components and features in estimating replacement cost. This may be related to assuring that whatever cost calculators they use include these components.

There might be an economic impact for real estate appraisers who may wish to offer services providing estimating replacement cost for insurance purposes as they will have to update their calculations and calculation software, if applicable, to assure inclusion of the components and features required for the estimate.

The regulations require that when insurers require that certain replacement cost and construction costs tools and sources be used by insurance producers, that the insurers establish procedures for using the tools and sources, and that they train the insurance producers on these procedures. The training could lead to an appreciable economic cost. However, under most circumstances, currently, insurers provide such training on the use of replacement cost and construction costs estimators and in this regard the economic impact may be neutral.

It is possible that there could be a premium increase because replacement cost estimates are required to include debris removal and foundation replacement estimates, components not necessarily included currently. However, given the fact that any premium increase is anticipated to be extremely minor, it should have no significant impact on homeowner premium costs.

EFFECT ON JOBS AND BUSINESSES IN CALIFORNIA

The proposed regulations will not eliminate jobs within the State of California. They may create jobs for those real estate appraisers who wish to offer their services to the insurance industry by estimating the replacement cost of residential dwellings in connection with a homeowners' insurance policies.

The proposed regulations will not eliminate existing businesses within the State of California. They may create new businesses for those real estate appraisers who wish to offer their services to the insurance industry by estimating the replacement cost of residential dwellings in connection with homeowners' insurance policies

The proposed regulations may lead to the expansion of businesses within the State of California as to those entities offering replacement cost and construction costs software to producers and insurers. The proposed regulations require that specific components and features be considered in any estimate that is called a "replacement cost" estimate, and inclusion of those features, and the marketing of the cost calculators that comply with the regulations, will provide the opportunity for business expansion.

FINDING OF NECESSITY

The Commissioner finds that it is necessary for the welfare of the people of the state that the regulations apply to businesses.

IMPACT ON HOUSING COSTS

The proposed regulations 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 this action is proposed or would be as effective as and less burdensome to affected private persons than the proposed action. The Commissioner invites public comment on alternatives to the regulation.

IMPACT ON SMALL BUSINESS

The Commissioner has determined that the proposed amendments will affect small businesses to the extent that it affects insurance agents, brokers and real estate appraisers that may qualify as small businesses. 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 is no existing federal regulation or statute comparable to the proposed regulations.

TEXT OF REGULATIONS AND STATEMENTS OF REASONS

As noted above, 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 45 Fremont Street, 21st Floor, San Francisco, California 94105, between the hours of 9:00 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 right hand 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 'PROPOSED REGULATIONS ' screen appears, you may choose to find the documents either by conducting a search or by browsing for them by name.

To browse, click on the 'Currently Proposed Regulations' link. A list of the names of regulations for which documents are posted will appear. Find in the list the 'Standards and Training for Estimating Replacement Value' link, and click it. Links to the documents associated with these regulations will then be displayed.

To search, enter "REG-2010-00001" (the Department's regulation file number for these regulations) in the search field. Alternatively, search by keyword ("Homeowners'," for example, or "replacement"). Then, click on the 'Submit' button to display links to the various filing documents.

MODIFIED LANGUAGE

If the regulations adopted by the Department differ from those which have originally been made available but are sufficiently related to the action proposed, they will be available to the public for at least 15 days prior to the date of adoption. Interested persons should request a copy of these regulations prior to adoption from the contact person listed above.