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**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE**

45 Fremont Street, 21st Floor
San Francisco, California 94105
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UPDATED INFORMATIVE DIGEST

Policy Statement Overview and Effect of Proposed Action

The Commissioner proposes to make changes to the following sections of Title 10 of the California Code of Regulations. These sections concern the approval of insurance rates.

Due to changes in National Association of Insurance Commissioners (NAIC) reporting requirements and due to experience gained in years of case-by-case rate determinations the Commissioner has determined that the existing regulations must be amended in order to bring the regulations up to date and in compliance with NAIC reporting requirements and other applicable standards. In many instances a change made in one section requires the modification of other sections in order to maintain internal consistency. The overarching goal of this ratemaking is to update the regulations to modern standards while maintaining internal consistency, and enhancing flexibility without sacrificing accuracy, fairness and consistent results.

Section 2642.4 Pure Premium

Existing § 2642.4 defines "pure premium." The initial draft of the proposed regulations amended the current language due to changes in the NAIC reporting requirements, and in response to comments made in the several workshops held before the July 18, 2006, Notice (July 18 Notice) and due to experience gained in many years of case-by-case rate determinations.

Further changes were made to the language in the proposed section in direct response to comments made during the rulemaking phase. In the current proposed regulation the entire section has been deleted. The rationale for this change is the term "pure premium" no longer appears in the regulation therefore there is no need for a definition.

2642.5 Rating Period

Existing § 2642.5 defines "rating period." The initial draft of the proposed regulations amended the current language to eliminate the reference to existing § 2646.3., Generic Determinations. These changes were proposed in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. The rationale for this change is that the Commissioner has determined that generic determinations, as provided for in CCR § 2646.3, are no longer necessary or practical with respect to the rating period. No further change was made to this section.

The rationale for including "rating period" is for purposes of clarity, and to ensure consistency and fairness. A one-year rating period in prospective ratemaking is an historically accepted actuarial standard. The section explicitly places no limits on the number of rate filings that may be made but merely uses a one year period as the period of time which must be accounted for in a rate application. It should be noted the rating period is used only for trend calculation, in the assumption of how often the insurer will change its rates.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

2642.6 Recorded Period

Existing § 2642.6 defines "recorded period." In the initial draft of the proposed regulations the first paragraph was amended. Language referring to existing § 2646.3., Generic Determinations was deleted. These changes were proposed in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. The rationale for this change is that the Commissioner has determined that generic determinations, as provided for in CCR § 2646.3, are no longer necessary or practical with respect to the recorded period. Proposed § 2642.6 subsection (1) has no counterpart in the existing regulations. Additional language was added to the section to provide that additional years of experience may be added where the credibility of that experience is less than the value contained in section 2644.23(g). In that case, additional years, not to exceed ten, may be added. These changes were made in response to comments submitted during the rulemaking process. The rationale for these additional changes was to allow greater flexibility in terms of the number of years of data required to reach credibility.

Proposed § 2642.6 subsection (2) has no counterpart in the existing regulations. Addition language was added to the section to allow for the use of less than three years of data where it can be shown that data is fully credible. These changes were made in response to comments submitted during the rulemaking process. The rationale for these additional changes was to allow greater flexibility in terms of the number of years of data required to reach credibility.

The "recorded period" is merely the time period from which historical data are taken to provide the basis for the proposed rate. The most recent amendments provide for flexibility without sacrificing accuracy, fairness and consistent results.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05.

2642.7 Lines of Insurance

Existing § 2642.7 sets forth the lines of insurance. The initial draft of the proposed regulation was amended to recognize the reclassification, by the NAIC, of some lines of insurance for annual reporting statement purposes.

Existing § 2642.7 was amended, adding subsection (10) products liability. Additionally subsection (16) glass was eliminated. The language in the subsection was further revised in response to comments made during the rulemaking. In subsection five the word "liability" was added. Subsection (6) Commercial multiple peril non-liability was added.

Proposed § 2642.7 subsection (b) has no counterpart in the existing regulations. The new subsection provides that certain types of insurance will be classified as other liability occurrence. The rationale behind this was that mechanical breakdown was not specifically classified and the question of the classification of mechanical breakdown came up in case-by-case determinations. The Commissioner determined that for a number of technical reasons, including comparable leverage and reserve ratios, mechanical breakdown was so similar to other liability occurrence that it was reasonable to specify this classification. Specifically classifying mechanical breakdown as other liability occurrence is designed to ensure consistency. This language was added for clarification purposes as this issue had arisen in a number of case-by-case determinations.

Proposed § 2642.7 subsection (c) contained most of the language in existing subsection (b). The initially proposed language provided the Commissioner with the option of disaggregating lines. Previously only insurers were allowed this option. This language was added for clarification purposes as this issue had arisen in a number of case-by-case determinations. The Commissioner has determined, in response to comments, that under certain circumstances the Commissioner may find it necessary to disaggregate lines of insurance. This was not specified previously. The Commissioner has determined that this

clarification is necessary.

This subsection was further revised during the course of this rulemaking in response to comments made. Language was added to clarify the standards by which alternative ratemaking methodologies would be measured. Language was added to subsection (c) providing that where a line is determined to be a specialty line, while the rates will not be tested by strict application of the regulations, the methodology used by the insurer must be the most actuarially sound method, consistent with California law and meet the Actuarial Standards of Practice. The rationale underlying the addition of this language was to ensure that a reasonable standard relating to ratemaking in specialty lines was enunciated. The Commissioner determined that this additional language was necessary.

Existing subsection (c) was changed to subsection (d). In initially proposed subsection (d)(4)(F) medical malpractice was specifically exempted from specialty lines. Further changes were made to this subsection. Proposed subsection (d)(4)(F) was deleted. This has the effect of removing professional liability and errors and omissions coverages from the specialty category. Deleting this language also removed the specific exemption for medical malpractice insurance. These changes were made in response to comments submitted during this ratemaking. The rationale for these changes is that the treatment of professional liability and errors and omissions coverages and medical malpractice insurance is now addressed in other sections of the regulation.

Finally existing subsection (d) is now subsection (e). No further changes were made to that subsection. The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2643.2 Rating Basis

Existing § 2642.5 defines "rating basis." The initial draft of the proposed regulations amended the current language to eliminate the reference to existing § 2646.3., Generic Determinations. These changes were proposed in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. The rationale for this change is that the Commissioner has determined that generic determinations, as provided for in CCR § 2646.3, are no longer necessary or practical with respect to the rating basis.

Further changes were made to the language in the proposed section in direct response to comments made during the rulemaking phase. In the current proposed regulation the entire section has been deleted. The rationale for this change is that the term "rating basis" no longer appears in the regulation so there is no need for a definition and rates are no longer computed on the basis of rates charged per exposure.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This proposed new section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2643.6 Interjurisdictional Allocations

In the initial draft of the proposed regulation existing § 2643.6 (a) was amended. The phrase "allocated lost adjustment" was deleted and replaced by the phrase "defense and cost containment." No further changes were made to this subsection.

Existing 2643.6 (1) was similarly amended. The term "allocated and unallocated lost adjustment expenses: was deleted and replaced with the term "defense and cost containment and adjusting and other." No further changes were made to this subsection.

These changes were made due to changes in NAIC reporting requirements, in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many

years of case-by-case rate determinations.

The initial draft also added the words "or the Commissioner" to subsection (c) in order to stay consistent with proposed § 2642.7(c). No further change was made to this section.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2643.8 Factors Calculated by the Commissioner

Proposed § 2643.8 has no counterpart in the existing regulations. Application of the regulations requires certain numerical and other factors. The Commissioner has determined that in most instances the "generic factor" approach as provided for in CCR § 2646.3, is no longer necessary or practical. That rationale behind this new section is to make clear the Commissioner will calculate certain numerical and other factors. These calculations are essential to the regulatory scheme and for application of the ratemaking formula.

Further changes were made to the language in the proposed section in direct response to comments made during the rulemaking phase. The new language provides safeguards against the application of new values where the Commissioner does not publish the new values in the manner set forth in the regulations.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.2 Maximum Permitted Earned Premium

Existing § 2644.2 provides the formula for the calculation of the maximum permitted earned premium. Proposed § 2644.2 makes several fundamental changes to the formula. The formula itself is made up of several factors. The rationales and reasons for these proposed changes are manifold. Changes in reporting and other NAIC related requirements require that the formula be modified and that rate filings be analyzed by applying new nomenclature and new NAIC rules. Rate analysis has evolved and this evolution must be reflected in relation to current rate filing analysis. And, in the experience gained in years of case-by-case determinations, it was discovered that as some of the approaches in the existing regulation are updated these changes may impact the application of other factors. In this case these various changes in reporting and other requirements that necessitate a change in one section of the regulation necessitate further modification in other sections of the regulation in something akin to a chain reaction. These changes must be made in order to maintain internal consistency. Finally, many of the proposed changes to the formula, and the regulations in general, were made in response to comments made in case-by-case rate determinations, workshops and in this rulemaking. Where these suggestions produce more accurate and more consistent results and are in keeping with the general regulatory scheme as upheld in the *20th Century* case, those changes are adopted.

The initial changes to the proposed section include substituting defense and cost containment expenses for allocated loss adjustment expenses in keeping with the new NAIC reporting requirements. The calculation now subtracts fixed investment income, a change proposed in the July 18 Notice..

Amendments made to existing §§ 2644.12, 2644.13, 2644.14, 2644.15 and 2644.19 are also reflected.

The impact and import of these changes are discussed in great detail in the summaries and responses that are part of this rulemaking file and in this update in the related section.

No further change was made to this section.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable.

This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.3 Minimum Permitted Earned Premium

Existing § 2644.3 provides the formula for the calculation of the minimum permitted earned premium. Proposed § 2644.2 makes several fundamental changes to the formula. The formula itself is made up of several factors. The rationales and reasons for these proposed changes are manifold. Changes in reporting and other NAIC related requirements require the formula be modified and that rate filings be analyzed by applying new nomenclature and new NAIC rules. Rate analysis has evolved and this evolution must be reflected in relation to current rate filing analysis. And, in the experience gained in years of case-by-case determinations it was discovered that as some of the approaches in the existing regulation are updated these changes may impact the application of other factors. In these cases changes must be made to maintain internal consistency. Finally, many of the proposed changes to the formula, and the regulations in general were made in response to comments made in case-by-case rate determinations, workshops and in this rulemaking. Where these suggestions produce more accurate and more consistent results and are in keeping with the general regulatory scheme as upheld in the *20th Century* case, those changes are adopted.

The initial changes to the proposed section include substituting defense and cost containment expenses for allocated loss adjustment expenses in keeping with the new NAIC reporting requirements. The amendments made to existing §§ 2644.12, 2644.13, 2644.14, 2644.15 and 2644.19 are also reflected. The impact and import of these changes are discussed in great detail in the summaries and responses that are part of this rulemaking file and in this update in the related section.

No further change was made to this section.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.4 Projected Losses

No amendment to current subsection 2644.4(a) was proposed. No further change was made to this subsection.

Existing subsection (b) provides that for medical malpractice insurance, where the use of claims-made and not occurrence policies predominate, projected losses are calculated on a report year basis. This language specifically addressing medical malpractice was deleted. The rationale for this amendment is that the treatment of medical malpractice as it relates to projected losses is now addressed in other sections of the regulation. The amended subsection provided projected losses shall be calculated by applying the loss trend factor separately to data from each accident-year in the recorded period and for claims-made policies projected losses shall be calculated on a report-year basis. The Commissioner has determined that this approach is appropriate. No further changes were made to this subsection.

Proposed subsection (c) has no counterpart in the current regulations. The initial proposed language provides that for policies providing multi-year coverages, projected losses shall be calculated on a policy-year basis. The rationale for this change is that although subject to the provisions of Proposition 103 and these regulations, treatment of mechanical breakdown and other policies providing coverage on a multi-year basis is not specifically addressed in the current regulations. The question of the treatment of mechanical breakdown as it relates to projected losses has arisen in a number of case-by-case determinations. The proposed language is intended to clarify how projected losses are to be calculated in mechanical breakdown and other multi-year coverages. The language in this subsection was changed in response to comments made at workshops and during this rulemaking. For these reasons and due to experience gained in many years of case by case determinations the Commissioner has determined that this new proposed language is necessary. No further change was made to this subsection

Proposed subsection (d) has no counterpart in the current regulations. The initial draft of the proposed regulations added language providing that for policies providing death, disability and retirement

coverage, projected losses shall be calculated using a sound actuarial method. This language was added in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. Further changes were made to the language in the proposed section in direct response to comments made during the rulemaking phase. The initially proposed language was deleted. The rationale for this is that policies providing death, disability and retirement coverages are sold in conjunction with medical malpractice insurance and the treatment of medical malpractice insurance as it relates to projected losses is addressed in other sections of the regulation.

As stated above subsection (d) in the initial draft was deleted. The language that was found in subsection (e) in the initial draft is now in subsection (d). It will be referred to as "subsection (d)."

Initially subsection (d) provided that the Commissioner would have the option to disaggregate a line. This language was deleted during the rulemaking as it was redundant. (See proposed § 2642.7(c)).

In general as initially proposed subsection (d) provided the requirements relating to loss projection for "specialty lines." This language was amended. Further amendments made this language referring to specialty lines unnecessary and it was deleted. New amended language provides that for professional liability and errors and omissions coverages insurers may use "the most sound actuarial" methodology in lieu of application of sections 2644.5 through 2644.7. As death, disability and retirement coverages are so closely associated with professional liability coverages the newer language would provide for the same treatment as intended in initial subsection (d). These changes were made in response to comments submitted during this rulemaking.

Proposed subsection (f) has no counterpart in the current regulations. New subsection (f) provides that for earthquake coverage and for the fire following earthquake exposure, projected losses and defense and cost containment expenses may, if certain conditions are met, be based on complex catastrophe models. The rationale for this change is that the Commissioner has through actual experience with these models determined that they can be useful under the conditions specified. These changes were made in response to comments submitted during this rulemaking

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.5 Catastrophe Adjustment

Existing § 2645.5 provides for a generic determination of the number of years over which catastrophe losses shall be averaged. The initial draft of the proposed regulations amended the current language to eliminate the reference to existing § 2646.3., Generic Determinations. These changes were proposed in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. The rationale for this change is that the Commissioner has determined that generic determinations, as provided for in CCR § 2646.3, are no longer necessary or practical with respect to the catastrophe adjustment. The language replacing the generic determination language was intended to establish how catastrophe losses were to be averaged by specifying the catastrophe adjustment methodology to be employed for private passenger automobile and homeowners insurance coverages. The new language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations.

Further changes were made to the language in the proposed section in direct response to comments made during the rulemaking phase. The initial language provided that the number of years over which the average shall be calculated shall be at "least 21 and 39 years for homeowners multiple peril fire and wind, respectively." The proposed revision removed the 21 and 39 year requirements and replaced that language with a requirement of at least years 20 years for homeowners multiple peril. Also in response

to comments the differentiation relating to fire and wind was removed. The rationale for these revisions is that in response to comments made, the Commissioner determined that the initial 21 and 39 years requirement was too restrictive and the fire and wind differentiation was unnecessary. Also eliminated was the reference to the advisory loss costs filing. This change was made in response to comments. The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.6 Loss Development

Existing § 2645.6 sets forth the methodology for loss development. There were a number of amendments in the initial draft made in response to comments submitted in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. The initial draft added the requirement that loss-development triangles are to be based on dollar weighted averages as opposed to straight averages. The rationale behind this change was to increase accuracy. The initial draft of the proposed regulations also amended the current language to expand the type of data that might be relied upon in developing losses by allowing the use of policy-year or report-year data in addition to the use of accident-year data. The rationale for this amendment was to increase flexibility in the ratemaking process. The initial draft also eliminated the reference to existing § 2646.3., Generic Determinations, and eliminated other specifics relating to the methodology to be employed in developing losses. The initial language was also modified by the addition of a requirement that catastrophe losses shall be excluded from loss development. The rationale behind this change was that due to experience gained in years of case-by-case rate determinations, the Commissioner determined that the issue of catastrophe losses as it relates to loss development needed clarification. It was also the Commissioner's experience that including catastrophe losses in loss development tended to distort the calculation, leading to inaccurate results.

Further changes were made to the language in the proposed section in direct response to comments made during the rulemaking phase. The Commissioner determined that the deletion of the generic determination language and the elimination of other specifics relating to the methodology to be employed in developing losses required that a specific methodology be substituted. New language was substituted for the deleted generic determination and the language setting forth a specific methodology whereby the methodology to be employed for developing losses was provided in detail. The Commissioner has determined that this new amended language enhances flexibility without sacrificing accuracy and consistency.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.7 Loss and Premium Trend

Existing section 2644.7 defines loss trend. There were a number of amendments in the initial draft made in response to comments submitted in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations.

The definition of loss trend was amended to add specifics relating to the methodology to be used for calculating premium trend. There is no counterpart in the current regulations relating to premium trend. Due to experience gained in many years of case-by-case rate determinations the Commissioner determined that providing a methodology for premium trend would greatly enhance accuracy and consistency. It should also be noted that the premium trend calculation is a well established standard in insurance ratemaking.

Existing subsection (a) was deleted. Subsection (a) provided that loss trend factors would be established

pursuant to a § 2646.3 generic determination. The deletion of this language was in direct response to comments made by the insurance industry in workshops and during the course of case-by-case rate determinations. The new proposed language would allow insurers to use company specific data instead of imputed trends determined by the Commissioner. The rationale for eliminating the generic determination language was to enhance flexibility in the ratemaking process. The Commissioner determined that, as the generic determination language was deleted in favor of a company-specific approach, in order to ensure consistency and accuracy the deletion of the generic determination language required that a specific methodology be substituted. Some language from existing subsection (b) was moved to the initially proposed subsection (a). New language was added to setting forth a specific methodology to be employed.

Proposed subsection (a) was further refined in direct response to comments made during the rulemaking phase. The Commissioner determined that language setting forth the trend methodology lacked specificity. As such, a redraft of the proposed subsection (a) was intended to respond to comments and to provide the level of detail need to ensure accuracy and consistency in the ratemaking process. Language relating to the number of quarters of data to be used, specifics as to the calculation of frequency and severity, and details relating to the type of premium data to be employed were added. The Commissioner has determined that this section now contains sufficient detail as to the methodology to be employed for calculating trend.

As set forth above existing subsection (b) was subsumed by proposed subsection (a).

Much of existing subsection (c) now appears in proposed subsection (b). The language in this section eliminated the § 2646.3 generic determination language. The new language provides that where the trend factor within a given line significantly varies by sub-line, by policy limits, by region of the state, or by coverage, separate trend factors shall be calculated in accordance with that company-specific evidence. The deletion of the generic determination language and the substitution of a company-specific approach were made in direct response to comments made by the insurance industry in workshops and during the course of case-by-case rate determinations. The rationale for the change is to enhance flexibility in the ratemaking process. No further change was made to this subsection.

All of existing subsection (d) was moved into proposed subsection (c) and eliminated. This language was deleted as the experience gained in many years of case-by-case determinations led the Commissioner to determine that the subject matter to which the existing language referred was no longer relevant.

The new language in proposed section (c) sets forth specific credibility standards. Again, the Commissioner determined that, as the generic determination language was deleted in favor of a company-specific approach, in order to ensure consistency and accuracy specific credibility standards are required. Subsection (c) was further clarified in response to Comments to specify the use of "California Fast Track data" as opposed to "Fast Track data."

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.8 Projected Defense and Cost Containment Expenses

Existing section 2644.7 is entitled: Projected Allocated Loss Adjustment Expenses. The initial draft of these regulations deleted the term "allocated loss adjustment expenses" and substituted the term "defense and cost containment." This amendment of this language was made due to changes in NAIC reporting requirements, in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. This change is one of several that required a revision of the minimum and maximum permitted earned premium formulas. As

defense and cost containment expenses do not equate entirely with what were known as allocated loss adjustment expenses, the function of this factor in the minimum and maximum permitted earned premium formulas was also amended. This change represents one of several which required the redesign of the minimum and maximum permitted earned premium formulas. No further change was made to this subsection. Subsection (a) also added a requirement that defense and cost containment expenses be adjusted for catastrophes and pursuant to proposed § 2644.5

While there is a subsection (b) in the existing regulation, that language now appears in subsection (c) in an amended form. Proposed subsection (b) provides that for liability coverages, defense and cost containment expenses may be added to losses for loss development and trend or may be developed using ratios of defense and cost containment expenses to losses. This language was added in response to comments submitted in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. The language was intended to provide clear and concise instruction relating to calculation of these projected expenses. Subsection (b) was further refined by the addition of language which requires the selection of methodology be the most actuarially reasonable in order to make specific the actuarial standard required. The Commissioner determined that this language was required to clarify the original language.

Proposed subsection (c) was former subsection (b). The initial proposed regulation refers to the disaggregation by the Commissioner of a line of insurance into commodity and specialty. The language was added in order to stay consistent with §2642.7(c). The substitution of the term defense and cost containment expenses has been explained. No further change was made to this subsection.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.9 Projected Fixed Expenses

This section is proposed for deletion in accordance with the changes made to proposed § 2644.12 the import of which is discussed in that section.

Section 2644.10 Excluded Expenses

Existing § 2644.10 sets forth various categories of expenses that are not recognized for purposes of ratemaking.

In the initial draft of these regulations, in proposed subsection (b) the current language referencing § 2646.3., Generic Determinations was eliminated. This change was proposed in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. The rationale for this change is that the Commissioner has determined that generic determinations, as provided for in CCR § 2646.3, are no longer necessary or practical with respect to executive compensation. No further change was made to this section.

Also in subsection (b) the formula for calculating allowable executive compensation is added to the existing regulations. This formula has been applied for years in case-by-case rate determinations. The Commissioner determined that this formula should be adopted in a formal rulemaking. No further changes to this subsection we made.

In subsection (d) the term "defense costs and cost containment" was substituted for the term allocated lost adjustment expenses. The rationale for this change has been explained. No further changes to this subsection were made.

Existing subsection (g) was also amended. The additional language provides that the disallowance of expenses shall be accomplished by reducing the efficiency standard by the ratio of the insurer's national

excluded expenses to its national direct earned premium. This change was proposed in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.11 Expense Trend

This section is proposed for deletion in accordance with the changes made to proposed § 2644.12 the import of which is discussed in that section.

Section 2644.12 Efficiency Standard

Existing subsection (a) has been eliminated. It was originally intended that the efficiency standard apply to all companies. The intent was that by applying the efficiency standard as opposed to actual expenses the efficient company would be rewarded while the inefficient company would be barred from passing its inefficiencies on to ratepayers in the form of higher premiums. The rationale behind the redesign of the efficiency standard is to allow the efficiency standard to be applied as it was originally intended to be applied. Accordingly, fixed and variable expenses are replaced with the efficiency standard. It should also be noted that the elimination of allocated loss adjustment expenses and the use of defense and cost containment expenses in its stead also impacted the amendment of the efficiency standard formula. No further change was made to the maximum allowable expense formula.

Proposed subsection (a) eliminates the reference to § 2646.3., Generic Determinations. This change was proposed in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. The rationale for this change is that the Commissioner has determined that generic determinations, as provided for in CCR § 2646.3, are no longer necessary or practical with respect to the efficiency standard. The proposed subsection provides that the Commissioner shall calculate the efficiency standard annually and sets forth the various factors he is required to consider in making that calculation.

Existing subsection (c) is now proposed subsection (b). Some minor revisions were made to this subsection in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. The existing regulation language sets a separate efficiency standard for insurers selling through employees of the insurer not functioning as agents. New proposed language changes this terminology to insurers "selling insurance on a direct basis." The rationale for this amendment is clarification and a recognition that distribution systems, and the nomenclature associated with them, have evolved since the regulations were first promulgated. The amendments also recognize that there is a trend in the insurance industry whereby insurers who may traditionally have been associated with one kind of distribution system are now utilizing a number of distribution systems. Subsection (b) also allows for the Commissioner to make generic determinations under certain specific circumstances. This amendment was made in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. The amendment is designed to enhance consistency and accuracy. Subsection (b) was further refined during the rulemaking phase in direct response to comments. For clarification purposes language was added to specify that where an insurer is using more than one distribution system, the efficiency standard shall consist of an average weighted by earned premium for each distribution system.

There is no counterpart for proposed subsection (c) in the existing regulations. Proposed subsection provides the efficiency standard shall be calculated as the arithmetic average of the latest three years for which data are available. This amendment was made in response to comments submitted in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. The Commissioner has determined that this amendment is necessary in order to make clear how the calculation will be performed. There were no further modifications to this language.

Proposed subsection (d) is a minor modification of existing subsection (d) intended to be a clarification relating to how the calculation is to be performed. There were no further modifications to this language. Proposed subsection (e) has no counterpart in the existing regulations. The new language is intended to be a clarification relating to how the calculation is to be performed. There were no further modifications to this language.

Proposed subsection (f) has no counterpart in the existing regulations. The new language is intended to be a clarification relating to how the calculation is to be performed. There were no further modifications to this language.

Proposed subsection (g) has no counterpart in the existing regulations. The subsection does not appear in the initial proposed regulations. The language contained in proposed subsection (g) is now found in proposed subsection (k). The language in the new proposed subsection (g) is intended to be a clarification relating to how the calculation is to be performed. This change was made in response to comments made during the rulemaking phase.

Proposed subsection (h) has no counterpart in the existing regulations. The subsection does not appear in the initial proposed regulations. The language in the new proposed subsection (h) is intended to be a clarification relating to how the calculation is to be performed. This change was made in response to comments made during the rulemaking phase.

Proposed subsection (i) has no counterpart in the existing regulations. The subsection does not appear in the initial proposed regulations. The language in the new proposed subsection (i) is intended to be a clarification relating to how the calculation is to be performed. This change was made in response to comments made during the rulemaking phase.

Proposed subsection (j) has no counterpart in the existing regulations. The subsection does not appear in the initial proposed regulations. The language in the new proposed subsection (j) is intended to be a clarification relating to how the calculation is to be performed. This change was made in response to comments made during the rulemaking phase.

Proposed subsection (k) has no counterpart in the existing regulations. The language in this subsection appears in the initial proposed regulations in initial subsection (g). The language in the new proposed subsection (k) is intended to be a clarification relating to how the calculation is to be performed. This change was made in response to comments made during the rulemaking phase.

Proposed subsection (a) eliminates the reference to § 2646.3., Generic Determinations. This change was proposed in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. The rationale for this change is that the Commissioner has determined that generic determinations, as provided for in CCR § 2646.3, are no longer necessary or practical with respect to the efficiency standard. The proposed subsection provides that the Commissioner shall calculate the efficiency standard annually and sets forth the various factors he is required to consider in making that calculation.

Existing subsection (c) is now proposed subsection (b). Some minor revisions were made to this subsection in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. The existing regulation language sets a separate efficiency standard for insurers selling through employees of the insurer not functioning as agents. New proposed language changes this terminology to insurers "selling insurance on a direct basis." The rationale for this amendment is clarification and a recognition that distribution systems, and the nomenclature associated with them, have evolved since the regulations were first promulgated. The amendments also recognize that there is a trend in the insurance industry whereby insurers who may traditionally have been associated with one kind of distribution system are now utilizing a number of distribution systems. Subsection (b) also allows for the Commissioner to make generic determinations under certain specific circumstances. This amendment was made in response to

comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. The amendment is designed to enhance consistency and accuracy. Subsection (b) was further refined during the rulemaking phase in direct response to comments. For clarification purposes language was added to specify that where an insurer is using more than one distribution system, the efficiency standard shall consist of an average weighted by earned premium for each distribution system.

There is no counterpart for proposed subsection (c) in the existing regulations. The proposed subsection provides the efficiency standard shall be calculated as the arithmetic average of the latest three years for which data are available. This amendment was made in response to comments submitted in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. The Commissioner has determined that this amendment is necessary in order to make clear how the calculation will be performed. There were no further modifications to this language. Proposed subsection (d) is a minor modification of existing subsection (d) intended to be a clarification relating to how the calculation is to be performed. There were no further modifications to this language. Proposed subsection (e) has no counterpart in the existing regulations. The new language is intended to be a clarification relating to how the calculation is to be performed. There were no further modifications to this language.

Proposed subsection (f) has no counterpart in the existing regulations. The new language is intended to be a clarification relating to how the calculation is to be performed. There were no further modifications to this language.

Proposed subsection (g) has no counterpart in the existing regulations. The subsection does not appear in the initial proposed regulations. The language contained in proposed subsection (g) is now found in proposed subsection (k). The language in the new proposed subsection (g) is intended to be a clarification relating to how the calculation is to be performed. This change was made in response to comments made during the rulemaking phase.

Proposed subsection (h) has no counterpart in the existing regulations. The subsection does not appear in the initial proposed regulations. The language in the new proposed subsection (h) is intended to be a clarification relating to how the calculation is to be performed. This change was made in response to comments made during the rulemaking phase.

Proposed subsection (i) has no counterpart in the existing regulations. The subsection does not appear in the initial proposed regulations. The language in the new proposed subsection (i) is intended to be a clarification relating to how the calculation is to be performed. This change was made in response to comments made during the rulemaking phase.

Proposed subsection (j) has no counterpart in the existing regulations. The subsection does not appear in the initial proposed regulations. The language in the new proposed subsection (j) is intended to be a clarification relating to how the calculation is to be performed. This change was made in response to comments made during the rulemaking phase.

Proposed subsection (k) has no counterpart in the existing regulations. The language in this subsection appears in the initial proposed regulations in initial subsection (g). The language in the new proposed subsection (k) is intended to be a clarification relating to how the calculation is to be performed. This change was made in response to comments made during the rulemaking phase.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.15 Profit Factors

The proposed amendment to this section adds one word, "underwriting." The proposed addition of this word is designed to make clear that the tax factor in question is the underwriting federal income tax factor. This change was made in response to comments submitted in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. There were no further modifications made to this language.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.16 Rate of Return

Existing § 2644.16 provides that the Commissioner shall determine the maximum and minimum permitted after-tax rate of return through the generic determination process. The initial draft of the proposed regulations amended the current language.

The language contained in existing § 2644.16 has been deleted.

Initial subsection (a) provided that the maximum after-tax rate of return would be 11%. In response to comments made during the course of this rulemaking this section was modified. Subsection (a) now provides the maximum after-tax rate of return means the risk free rate, as defined in § 2644.20 (d), plus 6%. It is important to note that the 11% in the initial regulation and the modified language in the new proposed regulation represent a move away from simple historical averages and a move toward recognition of certain aspects of econometric models, like application of the risk-free rate, in the rate of return calculation. The Commissioner's recognition of aspects of various econometric models was triggered by comments made in the several workshops held before the July 18, and due to experience gained in many years of case-by-case rate determinations.

Subsection (b) provides for the minimum after-tax rate of return. Taken together subsections (a) and (b) provide for the range of reasonable rates of return.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.17 Leverage Factor and Surplus

Existing § 2642.4 provides the definition of "leverage factor and surplus" and provides for a generic determination by the Commissioner of leverage factors by line of insurance. The initial draft of the proposed regulations amended the current language in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations.

As initially proposed subsection (a) eliminated the use of net written premium in favor of earned premium. The amendment also specifies the use of the average of year-beginning and year-end surplus. This change was made in response to workshop comments indicating that because the leverage factor as it operates in the permitted earned premium formulas is a gross leverage factor, references to net are potentially confusing. The rationale behind this amendment is the enhancement of accuracy and specificity. The change was also needed to ensure internal consistency. There were no further changes made to this subsection.

As initially proposed subsection (b) eliminated the existing § 2646 generic determination. This change was made in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. The rationale for this change is the Commissioner has determined that generic determinations, as provided for in CCR §

2646.3, are no longer necessary or practical with respect to leverage factors and surplus. Instead, the amendment provides that the Commissioner shall calculate industry-wide leverage factors for each insurance line annually, within 45 days of the publication of the necessary source data. During the course of this rulemaking this subsection was further amended in order to specify the source data to be used and how the calculation of the leverage factors was to be performed. This language was added in direct response to comments.

As initially proposed subsection (b) also provided for distinct treatment for medical malpractice, other liability and product liability, providing for separate leverage factors for claims-made and occurrence. Allocation of national industry surplus was also specifically addressed. There were no further adjustments to this portion of subsection (b).

Further changes were made to subsection (b). A requirement relating to a further mathematical step was eliminated. This change was made in direct response to comments made during the rulemaking. The Commissioner determined that this further mathematical step was not necessary and may have been overly restrictive.

No further amendments were made to the language relating to the treatment of earthquake lines but the paragraph was broken out to facilitate readability.

Existing subsection (c) was amended. The existing § 2646 generic determination was eliminated for the reasons set forth above.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.18 Federal Income Tax Factors

Existing section 2644.18 was eliminated entirely. This change was made in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. The Commissioner determined that the regulations relating to the impact of federal taxes needed to be updated.

Proposed subsection (a) provided a streamlined approach relating to the "underwriting federal income tax factor." No further changes were made to this language.

Proposed subsection (b) provides the methodology relating to "investment federal income tax factor." This new factor is applied most notably in the maximum permitted earned premium and minimum permitted earned premium calculations and in the calculation of the investment income factor. No further changes were made to this language.

Due to experience gained in many years of case-by-case rate determinations the Commissioner determined that as investment income and federal taxation play such an important role in insurance ratemaking a new approach relating to the impact of federal taxes as it relates to investment income was necessary and required.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.19 Investment Income Factors

Existing section 2644.19 was eliminated entirely. This change was made in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of

case-by-case rate determinations. The Commissioner determined that the regulations relating to the impact of investment income needed to be updated.

Proposed section 2644.19 provides for a much more comprehensive approach to the calculation of investment income. The rationale for this new proposed formula is to increase accuracy in measuring the impact of investment income in ratemaking. The new formula also recognizes and takes into account that investment income may be "fixed" or "variable." Fixed investment income appears in the numerator and variable investment income appears in the denominator.

Due to experience gained in many years of case-by-case rate determinations, the Commissioner determined that given the important role investment income plays in insurance ratemaking a new approach relating to the impact of investment income was necessary and required.

No further modifications were made to the language in this section.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.20 Projected Yield

Existing section 2644.20 defines projected yield. Existing section 2644.20 was eliminated entirely. This change was made in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. Due to experience gained in many years of case-by-case rate determinations the Commissioner determined that given the important role investment income plays in insurance ratemaking a new approach relating to the impact of investment income was necessary and required. As yield is a key factor in the calculation of investment income a more modern and comprehensive approach was needed.

Proposed subsection (a) provides that the yield for each asset class shall be based on an average of the most recent available three complete months. This approach recognizes using a specific yield without the benefit of a weighted average is apt to produce anomalous results. This comprehensive definition of "projected yield" is required to insure accuracy and consistency in ratemaking. No further changes were made to this language.

Proposed subsection (b) allows bond asset classes to be subdivided and provides specifics as to the new, comprehensive classification process. This comprehensive approach is required to insure accuracy and consistency in ratemaking.

Proposed subsection (c) defines "yields currently available on securities in US capital markets and provides specifics as to the new, comprehensive classification process. This comprehensive approach is required to insure accuracy and consistency in ratemaking. In response to comments made during the ratemaking process the use of the term "ValuBond" following the term "Yahoo.com" in subsection (c) (2)(B) and (C) and in (c)(3)(B) and (C) was eliminated.

Proposed subsection (d) defines the "risk-free rate." Further amendments were made to this language during the rulemaking process. The word medium was deleted and was replaced with the word intermediate.

Proposed subsection (e) provides for further adjustment of the projected yield. No further changes were made to this language.

Proposed subsection (f) provides the final adjustment made to projected yield. No further changes were made to this language.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.21 Reserves Ratio

Existing section 2644.21 defines reserves ratio. Existing section 2644.21 was eliminated entirely. This change was made in response to comments made in the several workshops held before the July 18 Notice and due to experience gained in many years of case-by-case rate determinations. Due to experience gained in many years of case-by-case rate determinations the Commissioner determined that current regulations relating to the reserves ratios was too simplistic and out of date. The Commissioner has determined that a new and more comprehensive approach is required. The amended regulation recognizes different reserves ratios for each line of business, rather than a single reserves ratio applicable to all business written by the company. The amended regulation also utilizes an unearned premium reserves ratio and a loss reserves ratio, rather than the current single reserves ratio. The rationale for this change is to enhance accuracy and to ensure internal consistency as using an industry-wide by-line reserves ratio is consistent with using an industry-wide by-line leverage ratio. Proposed subsection (a) defines "unearned premium reserves ratio" and provides for a calculation. There were no further changes to this language.

Proposed subsection (b) defines "loss reserves ratio" and provides for a calculation. There were no further changes to this language.

Proposed language also part of subsection (b) provides that there shall be one industry-wide unearned premium reserves ratio and one loss reserves ratio for each line of business and provides the source for the data to be used in these calculation as well as other relevant specifics. In addition, the subsection specifies that for other lines of business subject to catastrophes, mass torts and other unusual events, the Commissioner shall modify the industry-wide numbers where he finds that they do not provide a reliable estimate of future expectations of the reserve ratios, pursuant to section 2646.3. There were no further changes to this language.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.23 Credibility Adjustment

Existing section 2644.23 has been significantly amended in the initial regulations.

Proposed subsection (a) provides that where data lack credibility a credibility adjustment shall be made, but eliminates language that the Commissioner has determined is no longer necessary.

Proposed subsection (b) eliminates the § 2646.3 generic determination. The Commissioner has determined a generic determination relating to the credibility adjustment is no longer necessary or practical. The amended language provides that for homeowners and auto coverages 3000 claims is sufficient for full credibility. The Commissioner has determined that three thousand claims is a reasonable standard, based on the variability of the frequency and severity of homeowners and private passenger auto claims. The word standard was deleted from this subsection in response to comments made during this rulemaking. This section also provides the formula for credibility weight to be applied in subsection (c).

In the initial draft subsection (c) was eliminated entirely. Amended subsection (c) provides the formula to be used when defense and cost containment cost data is less than fully credible. The Commissioner has determined that this more comprehensive approach is required in order to bring the regulations up to date with modern rate analysis standards, to enhance accuracy and to keep the regulations internally consistent.

There is no subsection (d) in the existing regulations. New subsection (d) provides the complements of credibility formula to be used as part of the credibility adjustment formula set forth in subsection (c). The Commissioner has determined that this subsection is required in order to bring the regulations up to date with rate analysis standards, to enhance accuracy and to keep the regulations internally consistent. No further changes were made to this language.

New proposed subsection (e) defines complement trend. The Commissioner has determined that this

subsection is a required definition relevant to the credibility adjustment formula. No further changes were made to this language.

New proposed subsection (f) defines annual trend. In response to comments made during the rulemaking, the first sentence of the initially proposed subsection was eliminated and replaced with new language. The rationale for this change was clarification. Otherwise the Commissioner has determined that this subsection is a required definition relevant to the credibility adjustment formula.

New proposed subsection (g) allows for the use of an alternative complementary loss and defense and cost containment expense under certain circumstances provided that the alternative is actuarially sound and reasonable in the circumstance. The Commissioner recognizes that the regulations cannot take into account every contingency. The Commissioner has determined that this new language enhances flexibility without sacrificing accuracy and consistency. No further changes were made to this subsection.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.24 Trended Current Rate Level Earned Premium

Proposed § 2644.24 has no counterpart in the current regulations. The proposed new section describes an "on-level adjustment" that is a standard in modern rate analysis standards. The rationale for this new language is that this adjustment was not specified in the existing regulations but should have been. The Commissioner has determined this language is necessary as a clarification of the procedure that will be applied.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.25 Reinsurance

Proposed § 2644.25 has no counterpart in the current regulations.

Subsection (a) provides that for all lines other than those specified, ratemaking shall be on a direct basis. This represents no change from the current regulatory approach. The rationale behind this language is to minimize misunderstandings as to the application of this section. No further changes were made to this language.

Subsection (b) provides that reinsurance shall be recognized in the ratemaking formula for earthquake and medical malpractice facultative reinsurance under certain circumstances. The rationale for the new approach is that due to experience gained in years of case-by-case rate determinations, the Commissioner has determined that in these specific circumstances, in these lines, the reliance on reinsurance is such that it may be reasonable for the cost of reinsurance be recognized. (For further detail see (In the Matter of the Rate Applications of First National Insurance Company of America, SAFECO Insurance Company of America, and SAFECO Insurance Company of Illinois, File No. PA04041210.) No further changes were made to this language.

Subsection (b) also sets forth a modified version of the maximum permitted earned premium calculation recognizing reinsurance. The rationale for this modified formula is that allowing for reinsurance to be recognized is a significant departure from the original regulatory scheme and while the Commissioner is willing to allow for the recognition of reinsurance under these limited circumstances, the impact must be such that results are accurate and reasonable. This modified formula is designed to ensure that the results are both accurate and reasonable. No further changes were made to this language.

Subsection (c) provides specifics as to the calculation of fixed investment income to be used in the modified formula. The rationale for this subsection is to allow for the recognition of reinsurance under these limited circumstances while ensuring that results are accurate and reasonable. No further changes

were made to this language.

Subsection (d) provides reinsurance costs shall be allowed for ratemaking purposes only if the reinsurance agreement was entered into in good faith in an arms-length transaction and at fair market value for the coverage provided. Additionally, there must be an acceptable transfer of risk, and the reinsurance must comply with all applicable Statutory Accounting Principles. The rationale for this subsection is to allow for the recognition of reinsurance under these limited circumstances, to ensure results are accurate and reasonable and to prevent abuses relating to the recognition of reinsurance. No further changes were made to this language.

Subsection (d) provides that reinsurance between affiliated entities shall not be recognized. The rationale behind this is that through manipulation reinsurance in transactions between affiliated insurers might be done in such a way as to undermine the regulatory scheme. It should be noted that reinsurers are not subject to Proposition 103, making these precautions that much more reasonable. No further changes were made to this language.

Subsection (f) provides there will be no allowance for reinsurance through unauthorized reinsurers. The rationale for this language is that reinsurers are not subject to Proposition 103 and therefore some limitations must be placed on these transactions due to consumer protection requirements contained in Proposition 103. No further changes were made to this language.

Subsection (g) provides that copies of the reinsurance agreements shall be submitted with the filing. This language relates specifically to the three previous subsections. No further changes were made to this language.

Subsection (h) provides that reinsurance shall include other risk financing mechanisms, such as catastrophe bonds. This is a definition required for clarity purposes. No further changes were made to this language.

Subsection (h) relates to earthquake lines and provides for a hearing upon request under certain circumstances. The rationale for this requirement is the consumer protection requirements contained in Proposition 103 and the potential for abuse in this area. No further changes were made to this language.

Subsection (i) relates to medical malpractice lines and provides for a hearing upon request under certain circumstances. The rationale for this requirement is the consumer protection requirements Proposition 103 and the potential for abuse in this area. No further changes were made to this language.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.26 Reinsurance Recoverables

Proposed § 2644.26 has no counterpart in the current regulations. Proposed new section 2644.26 defines reinsurance recoverables, and is included for clarification purposes. This section relates directly to proposed § 2644.26.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.27 Variance Request

The several variances in the existing regulations are found in § 2646.4(c). In the proposed regulations, the variance provisions have been moved. The several variances are now found in proposed § 2644.27. Subsection (a) contains language found in existing 2646.4(b)(2). While proposed subsection (a) is "new," it contains language in the current regulation is therefore not the subject of this ratemaking. The definition is included for clarification purposes.

Proposed subsection (b) has no counterpart in the existing regulations. This subsection provides the procedure to be employed in making a variance request and is necessary to clarify that procedure. The initial language was amended. The words "or" was deleted and the words "loss development factors or trend is being proposed" were added to the end of subsection (b)(iv). This change was made in response to comments made during this rulemaking and for clarification purposes.

Proposed subsection (c)(d) and (e) have no counterpart in the existing regulations. These subsections provide further information regarding the procedure to be employed in making a variance request and are necessary to clarify that procedure. There were no further changes made to these subsections.

Proposed §2644.27(f) corresponds to § 2646.6(c) in the current regulations.

Proposed § 2644.27(f)(1) corresponds to § 2646.4(c)(1) in the current regulations.

Proposed § 2644.27(f)(2) corresponds to § 2646.4(c)(2) in the current regulations.

Proposed § 2644.27(f)(3)(A) corresponds to § 2646.4(c)(3)(A) in the current regulations.

Proposed § 2644.27(f)(3)(B) corresponds to § 2646.4(c)(3)(B) in the current regulations.

Proposed § 2644.27(f)(3) has no counterpart in the current regulations and was added in response to comments during the course of this rulemaking.

Proposed § 2644.27(f)(4) has no counterpart in the current regulations.

Proposed § 2644.27(f)(5) is a variant of § 2646.4(c)(4) in the current regulations.

Proposed § 2644.27(f)(6) corresponds to § 2646.4(c)(5) in the current regulations.

Proposed § 2644.27(f)(7) corresponds to § 2646.4(c)(7) in the current regulations

Proposed § 2644.27(f)(8) corresponds to § 2646.4(c)(8) in the current regulations

Proposed § 2644.27(f)(9) has no counterpart in the current regulations. Due to the experience gained in years of case-by-case rate determinations and in response to comments made in the previous workshops the Commissioner has determined that this variance is reasonable and necessary. The Commissioner recognizes that the regulations cannot take into account every contingency. The Commissioner has determined that this new language enhances flexibility without sacrificing accuracy and consistency. The language in this section was further refined in response to comments made during this rulemaking.

In subsection (9)(C) the word settling was deleted and replaced by the word "closing." In addition, subsection (9)(E) was added, also in response to comments made during the course of this rulemaking.

Proposed § 2644.27(f)(10) has no counterpart in the current regulations. Due to the experience gained in years of case-by-case rate determinations and in response to comments made in the previous workshops the Commissioner has determined that this variance is reasonable and necessary. The Commissioner recognizes that the regulations cannot take into account every contingency. The Commissioner has determined that this new language enhances flexibility without sacrificing accuracy and consistency.

The language in this section was further refined in response to comments made during this rulemaking. In subsection (10)(D) the word settling was deleted and replaced by the word "closing."

Proposed § 2644.27(f)(10) has no counterpart in the current regulations. The Commissioner determined that this language was necessary for clarification purposes.

Note: Existing section 2646.4(d) is proposed for deletion as no longer relevant as it pertains only to past rate rollbacks.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2644.50 Refiling of Approved Rates

Proposed § 2644.50 has no counterpart in the current regulations. California Insurance Code Section 1861.05(a) provides that a rate "may not remain in effect" if it no longer complies with the applicable statutory standards. Under proposed section 2644.50, in certain circumstances, the Commissioner may

require an insurer to make a rate filing to ensure that the insurer's rates continue to comply with applicable law. Language proposed in this section also clarifies that nothing in the section shall be construed to specify how often an insurer may file a rate application. The rationale for this proposed section is to clarify the means by which the Commissioner may require an insurer to make a rate filing in order to determine whether the rates being applied are excessive.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2646.3 Generic Determinations

There is no change proposed relating to existing § 2646.3(a)

Proposed § 2646.3(b) amends the existing § 2646.3(b). The Commissioner has determined that portions of that subsection relating to notice and other procedural language are unnecessary and the remaining language makes clear generic determinations are to be adopted as a regulation pursuant to the Government Code. As the Government Code provides all the necessary notice and procedural requirements the deleted language was unnecessary.

Existing subsection (c) and (d) were unchanged. Subsection (e) was deleted as the procedures relating to petitions made to the Commissioner are found elsewhere in the law.

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2646.4 Hearing on Individual Insurers' Rates

Existing subsection (a) was unchanged.

There were minor amendments to subsection (b). Language in subsections (b)(1) and (2) referring to generic determinations was deleted. The rationale for this amendment was that in almost all instances the factors referred to in the subsection will not have been calculated as generic determinations.

Existing § 2646.4(c) sets forth the valid bases for requesting a variance. As previously described, the variances are now found in §2644.27. That is the rationale for the minor amendments found in proposed § 2646.4(b)(2)

Existing section 2646.4(e) is renumbered as section 2646.4(c).

The Commissioner has determined that the language contained in this section is necessary for purposes of clarity and to ensure a consistent and fair application of these regulations. This section is also a necessary component in a regulatory scheme designed to keep the job of rate regulation manageable. This section implements, interprets, and makes specific the requirement in California Insurance Code Section 1861.05

Section 2648.4 Complete Application

New subsection (c) sets forth the form for requesting a variance, specifying the information set forth in section 2644.27 and making it clear the manner in which the required information shall be provided. It is designed to simplify the variance request process, so insurers will easily be able to determine the format in which to submit a variance request.

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