STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
300 Capitol Mall, 17th Floor
Sacramento, CA 95814

STATEMENT OF REASONS

NET COST OF REINSURANCE AND RATEMAKING

December 27, 2024 **REG-2024-00016**

Exempt Rulemaking

Pursuant to Government Code section 11340.9(g), this proceeding is exempt from the rulemaking provisions of the Administrative Procedure Act.

EXPLANATION OF THE NEED FOR IMMEDIATE ACTION

Addressing the increased climate risks to California communities is a high priority for the state, especially because wildfire risks have had significant consequences for insurance availability and affordability in recent years.

Climate change has made California hotter and drier over the last several decades, resulting in more frequent wildfires of greater intensity.[1] Since 2017, California has experienced the eight largest wildfires in state history,[2] thirteen of the most destructive wildfires,[3] and seven of the deadliest wildfires, which includes the Camp Fire - the single deadliest wildfire in the history of the state resulting in the loss of 85 lives.[4]

As the frequency and severity of these growing climate threats increased, California's insurers began making new and different business decisions that further exacerbated the insurance availability issues experienced by consumers. Data collected by the California Department of Insurance (Department) shows that the annual number of non-renewals by insurance

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[1] Governor Gavin Newsom, "EXECUTIVE ORDER N-13-23," Executive Department of the State of California, accessed December 21, 2024, https://www.gov.ca.gov/wp-content/uploads/2023/09/9.21.23-Homeowners-Insurance-EO.pdf

[2] "Top 20 Largest California Wildfires," California Department of Forestry and Fire Protection, accessed August 2, 2024, https://34c031f8-c9fd-4018-8c5a-4159cdff6b0d-cdn-endpoint.azureedge.net/-/media/calfire-website/our-impact/fire-statistics/top-20-largest-ca-wildfires.pdf?rev=0899d8b12f964f8aaa90f912bf07d41b&hash=860D259F6863891425BB451612F52BF2

[3] "Top 20 Most Destructive California Wildfires," California Department of Forestry and Fire Protection, accessed December 21, 2024, https://34c031f8-c9fd-4018-8c5a-4159cdff6b0d-cdn-endpoint.azureedge.net/-/media/calfire-website/our-impact/fire-statistics/top-20-destructive-ca-wildfires.pdf?rev=9e4974c273274858880c2dd28292a96f&hash=29E21CBFCE8D9885F606246607D21CEB

[4] "Top 20 Deadliest California Wildfires," California Department of Forestry and Fire Protection, accessed December 21, 2024, https://34c031f8-c9fd-4018-8c5a-4159cdff6b0d-cdn-endpoint.azureedge.net/-/media/calfire-website/our-impact/fire-statistics/top-20-deadliest-ca-wildfires.pdf?rev=dddeac543dd84d21a4b01ad6bed5f48c&hash=6A2BD57BB8EC29DB9EC0C94F92B00F52

companies is higher for the years 2018-2021 than it was in 2015. Insurers have cited exposure to catastrophic weather events, higher construction repair costs, global inflation, and greater reinsurance premiums as the primary drivers of their decision to pull back from the California market. Top insurance groups paused or restricted writing new property insurance policies and/or renewing property insurance policies, leaving consumers with fewer options and higher costs. In 2023, two of California's largest insurance carriers, representing over 27% of the admitted insurance market in the state, announced they would stop issuing new homeowners and commercial property insurance policies in California; several others, representing an additional 36% of the market, announced plans to limit new policy origination; and insurer-initiated non-renewals were 28% higher statewide from 2019 through 2021 compared to 2015 through 2018, with the highest impacts in the top ten counties with the highest wildfire risk, where non-renewals increased by 158% over that time period.[5]

An increasing number of California's property owners found themselves unable to obtain insurance from an admitted insurer in the voluntary market and were forced to turn to California's insurer of last resort, the FAIR Plan. From 2015-2018, the FAIR Plan consistently represented approximately 1.5% of the California insurance market. The FAIR Plan's market share began to rise in 2019, and has continued to consistently increase year over year. Today, the FAIR Plan represents approximately 4% of the admitted market.

On September 21, 2023, California Governor Gavin Newsom issued Executive Order N-13-23 ("Order") to take "prompt regulatory action" to strengthen and stabilize California's marketplace for homeowners insurance and commercial property insurance, and to consider whether the recent sudden deterioration of the private insurance market presents facts that support emergency regulatory action. The Order requested the Insurance Commissioner to consider various goals in crafting an appropriate regulatory response, including tailoring "the rate approval process to account for all factors necessary to promote a robust, competitive insurance marketplace. . ." Additionally, the Order directed the Commissioner to not only maintain the solvency of the FAIR Plan but identify mechanisms to reduce its market share in underserved areas.

The Insurance Commissioner has broad authority to adopt rules to promote the public welfare, including under California Insurance Code Sections 1861.01, 1861.05, and 1861.055 to adopt regulations governing the prior approval process for insurance rate change applications, and to adopt emergency regulations under California Government Code Section 11346.1 and Insurance Code Section 12921.7. The Sustainable Insurance Strategy, a comprehensive, multi-phase initiative aimed at modernizing the state's insurance market to ensure accessible insurance for all Californians, create a resilient insurance marketplace, and protect consumers and communities from the adverse impacts of climate change uses the Commissioner's broad rulemaking authority to improve insurance availability by increasing rate setting accuracy so that insurers are more willing to offer coverage in even the higher-risk areas of California.

In 2023, Ceres and the Department utilized the National Association of Insurance Commissioners (NAIC) climate risk survey to conduct the first-ever systematic review of insurers' climate-risk strategies. The study revealed that reinsurance is the primary strategy many

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[5] Governor Gavin Newsom, "EXECUTIVE ORDER N-13-23," Executive Department of the State of California, accessed July 31, https://www.gov.ca.gov/wp-content/uploads/2023/09/9.21.23-Homeowners-Insurance-EO.pdf

companies use to continue to write and expand coverage in higher risk parts of California and across the country. The report notes that many companies evaluate their climate risks alongside their reinsurance contracts as they see reinsurance as part of their climate risk management strategy.[6] Insured natural disaster losses have increased 5-7% annually for the last 30 years, and in order to cover those losses insurance companies must purchase more reinsurance. Because reinsurance is an expense incurred by insurance companies as a cost of writing property catastrophe risks, and the cost of purchasing adequate reinsurance has been increasing with the increase of natural disasters, it makes sense that the net cost of reinsurance (NCOR) in property insurance rates is part of the Commissioner's comprehensive strategy to address the limits of Proposition 103 and increase the writing of homes and businesses across the state. The NCOR consists of the costs associated with a reinsurer providing coverage to a primary insurer.

California is one of the few states in the nation that does not allow insurance companies to recover the costs of purchasing reinsurance in their rates. Currently, California only allows ratemaking for all lines and sublines on a direct basis, with an exception for earthquake and for medical malpractice facultative reinsurance with attachment points above one million dollars. The present rulemaking proposes to allow the consideration of the cost or benefits of reinsurance for specific catastrophe perils and exposure for commercial property insurance and residential property insurance within specific property lines. Allowing insurance companies to recognize and recover their California-only NCOR in their rates will encourage carriers to re-enter and expand their business in the California property market because their rates will more accurately reflect the cost of doing business in California. In addition to providing necessary insurance coverage to protect consumers and businesses, the calculation and inclusion of the NCOR in residential and commercial property insurance rates will promote insurer solvency and market stability. Companies utilizing reinsurance will commit to increasing coverage in wildfire distressed areas; as these areas are defined by the Department in its separate Catastrophe Modeling and Ratemaking regulation.

To allow for an efficient review process and preserve the confidentiality of an individual insurer's reinsurance program, the Department proposes to create a standard NCOR that establishes a benchmark for all insurance companies. This is similar to how the Department reviews other allowable expenses in rate filings currently reflected in the efficiency standard. Companies that seek to utilize the NCOR would have to demonstrate an increased commitment of policies written in higher risk areas. This is similar to the catastrophe modeling in ratemaking regulation which establishes thresholds that insurance companies must meet in order to utilize forward-looking modeling.

Property catastrophe risk requires insurers to hold additional capital in order to ensure their ability to fulfill promises to policyholders after a large claims event. Many insurers transfer some portion of the risk (e.g., for events occurring from 1-in-10 to 1-in-250 years) through reinsurance or alternative financing mechanisms. Purchasing reinsurance and holding surplus to support the retained risk both represent costs for the insurer, and higher layers of loss are more volatile (i.e., have higher risk), for which investors demand higher returns.

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[6] Kara Voss, Steven Rothstein & Michael Peterson, *Climate risk management in the U.S. insurance sector,* (July 2023), https://www.ceres.org/resources/reports/climate-risk-management-us-insurance-sector, at 33.

Under the Standard NCOR proposal, the Department would derive market-expected returns for property catastrophe risk by loss probability by analyzing data on reinsurance placements and/or various Insurance Linked Security (ILS) market prices, e.g., catastrophe bonds. The Department can calculate permitted return multiples for specific loss probability layers and promulgate them as the Standard NCOR in relation to the expected / modeled losses in those layers. Insurers can then apply the approved Standard NCOR multiples to California-only modeled wildfire, flood, and/or fire following earthquake losses within their property rate filings to yield their permitted Standard NCOR provision. Insurers will not need to provide information on their individual reinsurance structure or costs in rate filings since calculations are based on industry risk transfer benchmarks.

The consideration of the cost or benefits of reinsurance to be allowed in ratemaking must fit within the existing rate approval process, as referenced in the Order.

This rulemaking amends Section 2642.7 to include flood as a category of insurance used when insurance is required to be classified by line in the review of rates subchapter. This rulemaking amends section 2644.16 related to the rate of return. This rulemaking amends Section 2644.25 to note that the catastrophe perils within the property lines listed in subdivision (b) of section 2644.25.1 are exempted from ratemaking on a direct basis, similar to the exemption for earthquake and for medical malpractice facultative reinsurance with attachment points above one million dollars. This rulemaking adds section 2644.25.1 to allow consideration of the cost or benefits of reinsurance for the catastrophe perils of flood, fire following earthquake, and wildfire exposure for commercial property insurance and "qualifying residential property insurance," as that is defined in section 2644.4.8, within the property lines of fire, allied lines, private flood, homeowners, farm owners, and commercial non-liability. Section 2644.25.1 additionally allows consideration of the cost of benefits of reinsurance for the specified catastrophe peril exposures covered under a renter's insurance policy, an HO-6 policy, or the equivalent of an HO 6 policy. This rulemaking adds section 2644.25.2 to describe how the commissioner will calculate the Standard NCOR parameters as permitted return multiples for specific loss probability layers, which represent the net cost for a reasonably efficient insurer to purchase reinsurance coverage and/or hold additional capital for exposure to the occurrence of catastrophic property loss. This rulemaking adds section 2644.25.3 to establish the commitments required in order for companies to consider the cost or benefits of reinsurance for the California-only catastrophe perils and lines of business detailed in section 2644.25.1. This rulemaking amends section 2644.27 regarding variance requests to describe how an insurer can request a variance from the Standard NCOR.

The California Department of Insurance's (the Department) proposed amendments to the regulations are described in more detail below.

REASONABLE NECESSITY OF THE INDICATED REGULATORY ACTION

<u>Amend Section 2642.7.</u>

The Department proposes to amend section 2642.7(a) for the specific purpose of adding flood as a line of insurance.

(a) Wherever in this subchapter insurance is required to be classified by line, the classification shall be into one of the following categories:

(1) Fire

(2) Allied Lines

(3) Farmowners multiple peril

(4) Homeowners multiple peril

(5) Commercial multiple peril liability

(6) Commercial multiple peril non-liability

(7) Inland marine

(8) Medical malpractice

(9) Earthquake

(10) Other liability

(11) Products liability

(12) Private passenger automobile liability

(13) Private passenger automobile physical damage

(14) Commercial automobile liability

(15) Commercial automobile physical damage

(16) Aircraft

(17) Fidelity

(18) Surety

(19) Burglary and theft

(20) Boiler and machinery~~.~~

(21) Flood.

The proposed amendment is reasonably necessary because section 2642.7 requires that whenever insurance is to be classified by line it needs to be in one of the listed categories. The flood line is a line that the NAIC added to the Uniform Property & Casualty Product Coding Matrix some time ago, and the California regulations were never updated to reflect this addition.

Flood is a line of insurance that is recognized in California in ratemaking and on the NAIC Annual Statement, therefore it should be listed in this section, and the section was never amended to do so. This amendment cleans up California's regulatory text to make it reflective of the regulatory reporting requirements insurers are currently following when reporting flood business.

Amend Section 2644.16.

The Department proposes to amend section 2644.16 for the specific purpose of allowing the consideration for the Standard NCOR.

(d) Notwithstanding subdivision (c), the Commissioner shall permit consideration for the cost or benefits of reinsurance according to subdivision (b) of 2644.25.1.

The purpose of the proposed addition of subdivision (d) is to cross-reference section 2644.25.1 and the net cost of reinsurance in the rate of return section.

It is reasonably necessary to add subdivision (d) to ensure that the Standard NCOR is permitted even if an individual insurer retains the catastrophe risk. From an actuarial standpoint, retained risk loads could be viewed as part of the profit provision, if the Standard NCOR was not cross-referenced in this section it could be unclear whether the Standard NCOR provision is permitted in those cases.

Amend Section 2644.25.

The Department proposes to amend section 2644.25 for the specific purpose of noting that that the catastrophe perils within the property lines listed in subdivision (b) of section 2644.25.1 are also exempted.

(a) For all lines and sublines except for those listed in the next subparagraph, and the catastrophe perils within the property lines listed in subdivision (b) of section 2644.25.1, ratemaking shall be on a direct basis, with no consideration for the cost or benefits of reinsurance.

The specific purpose of the proposed amendment to subdivision (a) is to add that the catastrophe perils within the property lines listed in subdivision (b) of section 2644.25.1 are also exempted from ratemaking on a direct basis.

The proposed amendment is reasonably necessary because it specifically says that for all lines and sublines listed ratemaking shall be on a direct basis, and only exempts earthquake and medical malpractice facultative reinsurance with attachment points above one million dollars from ratemaking on a direct basis. With the addition of section 2644.25.1, the cost or benefits of reinsurance for the catastrophe perils of flood, fire following earthquake, and wildfire exposure for commercial property insurance and residential property insurance within the property lines of fire, allied lines, private flood, homeowners, farm owners, and commercial non-liability, will be allowed if the insurer makes specific commitment, therefore a cross reference to section 2644.25.1 is needed to make clear that there are other exemptions from ratemaking on a direct basis.

Adopt Section 2644.25.1

The Department proposes to adopt section 2644.25.1 for the specific purpose of providing an exemption from ratemaking on a direct basis to consider the cost or benefits of reinsurance for specific catastrophe perils and exposure for commercial property insurance and residential property insurance within specific property lines, and to describe how the maximum permitted earned premium will be calculated.

The Department's 2023 review of insurance companies' NAIC annual climate risk disclosures illustrate that reinsurance is an important component of how insurance companies manage their risk, which enables them to write policies despite growing risks from natural disasters. The proposed addition of section 2644.25.1 is reasonably necessary because allowing insurance companies to recognize and recover their California-only NCOR in their rates will encourage carriers to re-enter and expand their business in the California property market because their rates will more accurately reflect the cost of doing business in California. In addition to providing necessary insurance coverage to protect consumers and businesses, the calculation and inclusion of the NCOR in residential and commercial property insurance rates will promote insurer solvency and market stability. The proposed addition of section 2644.25.1 also aligns with ratemaking principles and state regulations. For example, the Casualty Actuarial Society (CAS) Statement of Principles Regarding Property and Casualty Insurance Ratemaking states that ratemaking should provide for all costs so that the insurance system is financially sound, and California Insurance Code section 1861.05 states that no rate shall be approved or remain in effect which is excessive or inadequate.

(a) Ratemaking shall be on a direct basis, with no consideration for the cost or benefits of reinsurance, except for the lines listed in section 2644.25, and the catastrophe perils within the property lines listed in subdivision (b).

The purpose of subdivision (a) is to make clear that ratemaking will remain on a direct basis in California except for the exemptions provided in section 2644.25 and the catastrophe perils

within the property lines listed in subdivision (b). It is reasonably necessary to provide this detail because the proposed regulations will only be impacting a subset of rate applications that the Department processes.

(b) For the catastrophe perils of flood, fire following earthquake, and wildfire exposure for commercial property insurance and "qualifying residential property insurance," as that is defined in section 2644.4.8, within the property lines of fire, allied lines, private flood, homeowners, farm owners, and commercial non-liability, the maximum permitted earned premium is calculated as described in subpart (1). Additionally, for an insurer that thus complies with section 2644.4.8 with respect to such "qualifying residential property insurance," the maximum permitted earned premium is calculated as described in subpart (1) for wildfire exposure covered under a renter's insurance policy, an HO-6 policy, or the equivalent of an HO-6 policy.

The purpose of subdivision (b) is to detail the specific catastrophe perils and property lines that will be exempted from ratemaking on a direct basis.

The lines and exposures that the Department proposes to add in subdivision (b) make clear that these regulatory amendments apply only to a specific type of property catastrophe coverage. With this proposed rulemaking the Department wants insurers to re-enter and expand their business in the California property market, particularly in wildfire distressed areas. Therefore, subdivision (b) is reasonably necessary to make clear what perils and lines the NCOR will relate to in order to provide a measured solution to a specific problem.

The use of the specific catastrophe perils of flood, fire following earthquake, and wildfire are similar lines and exposures within lines (perils) as those found in section 2644.4.5 for Catastrophe Modeling. It is reasonably necessary for the Department to reflect similar lines and exposures within lines (perils) as those found in section 2644.4.5 for Catastrophe Modeling with the perils and lines found in the reinsurance section because when an insurer files a complete rate application, it is required to use the same catastrophe (CAT) model(s) for the Standard NCOR and modeled CAT adjustments pursuant to proposed section 2644.25.2(k). Use of similar lines and exposures within lines (perils) is reasonably necessary to ensure consistency within the ratemaking formula, i.e., so that the loss cost and NCOR provisions are based on the same modeled estimates of CAT losses.

The Department expanded the lines of insurance for which catastrophe models could be used to project losses by adding the flood line because the restriction on the use of flood models impacted the willingness and ability of insurers to enter the private flood insurance market in California. Without the ability to use catastrophe modeling for flood, insurers do not have a way to accurately set rates for flood coverage. The Department determined that it is reasonably necessary to expand the lines of insurance for which catastrophe models may be used to project losses where the data required by the standard methodology, as specified in Sections 2644.5 through 2644.7, did not exist, which was ultimately reasonably necessary to address availability issues. As noted above, it is reasonably necessary to include flood as a catastrophe peril that is

eligible to receive the Standard NCOR because it reflects the importance of continuity between the Catastrophe Modeling regulations and the proposed reinsurance regulations.

The purpose of the cross-citation to the definition of "qualifying residential property insurance," found in section 2644.4.8 is to make sure that due to the connection between the use of catastrophe models and Standard NCOR in a complete rate filing, the definitions need to be the same. "Qualifying residential property insurance," as that is defined in section 2644.4.8, makes clear that these regulatory amendments apply to insurers requesting rate changes for residential homeowners' policies that provide coverage for individually owned residential structures of not more than four dwelling units. It is reasonably necessary to identify the type of residential insurance policies most impacted by the current insurance availability crisis and thus to define "qualifying residential property insurance" (QRPI) to help communicate to insurers the type of residential policies that insurers may be presumed to have demonstrated a need to consider the Standard NCOR for by committing to write more of these policies. Allowing the inclusion of exposure covered under a renter's insurance policy, an HO-6 policy, or the equivalent of an HO-6 policy is reasonably necessary to mirror the language in the in section 2644.4.5(b) for Catastrophe Modeling. Additionally, it recognizes that splitting off exposure covered under a renter's insurance policy, an HO-6 policy, or the equivalent of an HO-6 policy is difficult in rate filings where these policy types are often lumped together.

Subdivision (b) also provides a formula, the purpose of which is to explain how the maximum permitted earned premium is calculated.

(1) the quotient of

(A) the sum of

(i)(1) projected losses, as defined in section 2644.4,

(2) plus projected defense and cost containment expenses (DCCE), as defined in section 2644.8,

(ii) multiplied by 1 minus the fixed investment income factor as defined in section 2644.19(a),

(B) minus projected ancillary income, as defined in section 2644.13,

(2) divided by the maximum denominator, as defined in subpart (4) of this section,

(3) plus the quotient of

(A) the Standard NCOR as defined in section 2644.25.2(j),

(B) divided by 1 minus the variable expense factor, as defined in section 2644.14.

Stated as a formula:

$$Max\ Permitted\ EP = \frac{(losses\ +\ DCCE)\ x\ (1 - \ fixed\ invest\ inc\ factor)\ -\ ancil\ income}{max\ denom} + \frac{standard\ net\ cost\ of\ reinsurance}{1 - var\ exp\ factor}$$

(4) The maximum denominator means:

(A) 1.0,

(B) minus the efficiency standard, as defined in section 2644.12,

(C) minus the maximum profit factor, as defined in section 2644.15,

(D) plus the variable investment income factor, as defined in section 2644.19(b).

Stated as a formula:

$$Max\ denom = 1 - \text{eff std} - \text{profit factor} + \text{var invest inc factor}$$

At a high level, the NCOR represents the expected reinsurer operating expenses and profit; that is, it consists of the costs associated with a reinsurer providing coverage to a primary insurer. The NCOR is generally calculated as the expected cash outflow to the reinsurer minus the expected cash inflow from the reinsurer to the ceding company, or reflected as a formula:

Net Cost of Reinsurance = Reinsurance Premium – Expected Ceded Loss

When an insurer incorporates the NCOR into its overall rate indication it can do so as a "gross loss plus NCOR" or a "net loss plus reinsurance premium" approach. The formula in subdivision (b) is based on a "gross loss plus NCOR" approach, which calculates the NCOR based on the formula above and adds it into the ratemaking formula as an additional fixed expense along with the expected total loss. Since the Commissioner's Sustainable Insurance Strategy emphasizes the incorporation of California-only net reinsurance costs in rates, it is reasonably necessary to develop the Standard NCOR methodology to produce a standardized NCOR rather than a standardized reinsurance premium. Market prices for catastrophe risk can be estimated through the use of publicly available CAT bond data, with return multiples equal to the CAT bond spread above expected loss, divided by its expected loss. However, since CAT bonds only represent a subset of the reinsurance market, the Department issued the Property CAT Reinsurance Data Call on October 18, 2024, to obtain information that would help the Department analyze what appropriate NCOR multiples would be. Similarly to the return multiples on the CAT bond data, NCOR multiples will be calculated as reinsurance premiums less modeled recoveries, divided by the modeled recoveries. Thus, the "gross loss plus NCOR" approach is a natural fit for the Standard NCOR methodology. The formula in subdivision (b) is based on a formula currently in regulation in section 2644.2, which provides the "gross loss" component, and the Standard NCOR provides the "plus NCOR" component.

In both actuarial literature and other states, losses and expenses, including the NCOR, are typically grossed up for all variable expenses plus profit. Modifying the formula in 2644.2 to add the Standard NCOR provision, grossed up for specific variable expenses, is reasonably necessary because it ensures consistent treatment of the expected reinsurance recoveries and the reinsurance premiums (since the two are netted prior to grossing up for the variable expenses), and it ensures that the permitted NCOR provision is not artificially reduced by agent commission and/or state premium tax rates. Writing the formula to include the NCOR is reasonably necessary to encourage carriers to re-enter and expand their business in the California property market, particularly in the distressed areas, because it reflects that the NCOR is an actual cost and its inclusion will allow rates to more accurately reflect the cost of doing business in California, and promote insurer solvency and market stability

The formula in section 2644.25.1(b) reflects only agent commissions and state premium taxes in the NCOR component. The formula disallows the collection of additional premiums to support an insurer's other expenses or to yield additional profit on the NCOR. It is reasonably necessary to write the formula in this way to balance the impact to consumers that allowing the inclusion of the net cost of reinsurance in ratemaking has on resulting rates.

If an insurer chooses to submit a variance pursuant to section 2644.27(f)(11), the formula provided in 2644.25.1(b) could be used once the insurer calculates their total NCOR provision, allocates it to the California lines and/or perils in the filing, and expresses it on a per-exposure basis. This approach would be similar to how other states allow insurers to calculate the NCOR.

> (c) The cost or benefits of reinsurance shall be allowed for ratemaking purposes as set forth in this section only if the insurer complies with the insurer commitments defined in section 2644.25.3.

The purpose of subdivision (c) is to make clear that the cost or benefits of reinsurance, or allowing the NCOR, will only be allowed for ratemaking purposes if the insurer complies with the insurer commitments defined in section 2644.25.3.

It is reasonably necessary to add that the NCOR will only be available if the insurer makes the commitments defined in section 2644.25.3 because it makes clear that NCOR is not simply available to insurers, but they must make specific commitments to obtain its benefits. Insurers who commit to meeting these underwriting targets will be presumed to have demonstrated a need to use NCOR for ratemaking purposes. Additionally, after numerous extremely destructive and catastrophic fire seasons, many policyholders have been unable to find insurance in the voluntary market, resulting in a rapid expansion of the FAIR plan. Insurers have paused or ceased writing new business, as well as nonrenewed existing business, in higher-risk wildfire-prone areas because the actual costs of writing business in these higher-risk areas is not necessarily reflected in an insurer's rates. Accordingly, insurers who commit to writing specified additional new policies, and renewing certain existing policies, in higher-risk wildfire-prone areas in compliance with the insurer commitment set forth in section 2644.25.3, will be permitted to use the NCOR for ratemaking purposes. Allowing insurers to include the NCOR will result in more appropriate, accurate rates which in turn will encourage insurers to maintain and increase their market

presence in California, as well as promote the goal of avoiding excessive, inadequate or arbitrary rates.

Adopt Section 2644.25.2

The Department proposes to adopt section 2644.25.2 for the specific purpose describing how the Department will be determining the Standard NCOR.

The proposed addition of section 2644.25.2 is reasonably necessary because it describes how the Department will establish a Standard NCOR. On August 21, 2024, the Department first presented the Standard NCOR concept in a presentation to interested parties titled, "Net Reinsurance Costs in California Ratemaking" (hereinafter, August Presentation). The August Presentation illustrated the Department's goals in revising the regulations to allow for the NCOR in rates. The Department wanted to ensure speed-to-market so that these regulations and this plan could begin addressing the availability crisis and start helping consumers as quickly as possible. The regulations should also support new CDI filing review timelines as discussed in the Complete Property and Casualty Rate Application Regulations. The Department was also cognizant that the regulations needed to preserve reinsurance contract confidentiality, reflect company-level complexity, provide public transparency, recognize California-only exposures, follow actuarial principles, and focus on key lines of business and perils. The Standard NCOR approach directly supports these goals.

The Standard NCOR is the permitted expected return for property CAT risk that applies to California-only modeled catastrophe losses. The Department needed to determine what an appropriate California-only NCOR would be while recognizing that reinsurance programs contain proprietary information that is highly confidential, and that reinsurance contracts typically cover multiple states. A bespoke NCOR that relates to an individual insurance company and their specific reinsurance costs would be highly unworkable as the requirements of Proposition 103 would require the disclosure of their reinsurance contracts. On a more practical note, the administrative challenge of reviewing a company's specific reinsurance program to determine what an appropriate California-only NCOR would be does not address the urgency of the availability crisis California is currently facing. The establishment of the Standard NCOR creates a process that will be reflective of the California market and the business written here without jeopardizing the confidentiality of a specific company's reinsurance program or contracts. Through the collection and use of data on reinsurance placements and/or publicly available data on various ILS market prices, e.g., CAT bonds, the Department can assess the market-expected returns for property CAT risk by loss probability as derived from these sources. The Department can then determine permitted return multiples for specific loss probability layers to apply in a NCOR calculation. The information obtained from the collection of data will allow the Department the ability to compare the information derived from the CAT bond data to the broader reinsurance market and to tailor the Standard NCOR to be reflective of the California market and the business written here.

The Standard NCOR will be used in the formula in subdivision (b) of section 2644.25.1.

(a) The Commissioner shall calculate the Standard Net Cost of Reinsurance (Standard NCOR) parameters from time to time as conditions warrant, and when updated source data is available. Data and information used to calculate the Standard NCOR shall prioritize the following:

  (1) Information that represents the diversity and scope of insurance companies operating in California.
  (2) Data that is most relevant to the current market conditions.
  (3) Data and information that support the most actuarially sound parameters.
  (4) Comprehensive data that is available, reliable, and reduces long-term volatility in the Standard NCOR methodology.

The purpose of subdivision (a) is to require the Commissioner to calculate the Standard NCOR parameters, provide the frequency and timing of updates to the parameters, and describe what the data and information used to determine the Standard NCOR will prioritize.

Updates to the Standard NCOR parameters are needed to recognize changes in reinsurance costs over time. There is ample evidence that such costs do change over time. For example, the average property CAT reinsurance rate-on-line (ROL) in the United States has increased 180% from 1990 to 2024 according to Guy Carpenter, a major reinsurance broker.[7] The ROL is a measure of reinsurance pricing which equals the average reinsurance premium divided by the coverage limit.

It is reasonably necessary that subdivision (a) does not prescribe a particular update frequency in order to allow for flexibility in the Commissioner's response to market conditions. Compared to updates for the Efficiency Standard, a longer timeframe is needed for the analysis supporting future updates to the Standard NCOR parameters. This is due to the complexity and needed quality control of reinsurance information retrieved from a data call versus expense data retrieved from NAIC annual statements, which is more straightforward and has already been highly vetted for financial reporting purposes.

The explanation of the data and information used to calculate the Standard NCOR is reasonably necessary to reflect the Department's recognition that in order to be truly effective the Standard NCOR is a "living" determination that will need to reflect the diversity of the insurance companies that operate here, and the changing nature of the reinsurance market.

(b) The Standard NCOR parameters shall be expressed as permitted return multiples for specific loss probability layers, which represent the net cost for a reasonably efficient

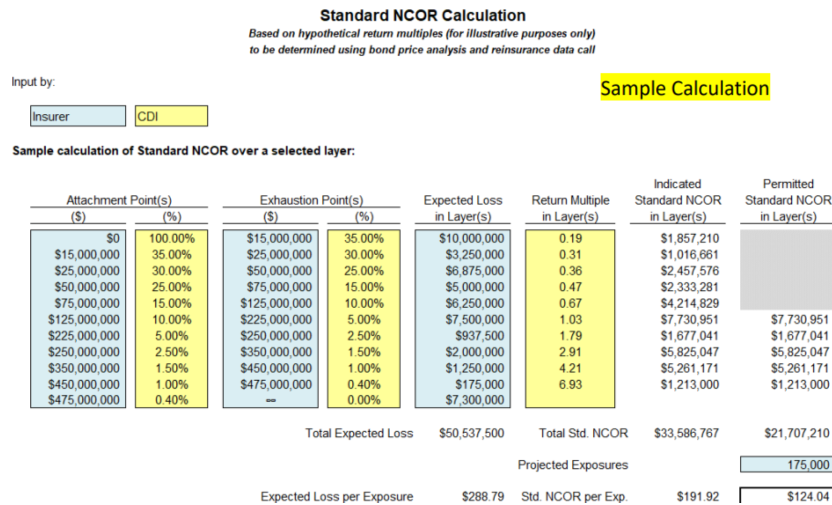
[7] Data from Guy Carpenter as presented by Artemis.bm, retrieved December 20, 2024, from https://www.artemis.bm/us-property-cat-rate-on-line-index/

insurer to purchase reinsurance coverage or hold additional capital for exposure to the occurrence of catastrophic property loss, or both.

(1) Loss probability layers represent the coverage ranges within reinsurance contracts, where the reinsurer typically provides coverage for losses exceeding a certain dollar threshold up to a given dollar limit. The dollar thresholds and limits of these individual reinsurance coverage layers correspond to specific probabilities of loss, which can be used to aggregate and compare data across reinsurance contracts of varying sizes with different underlying risks.

The purpose of subdivision (b) is to explain how the Standard NCOR parameters will be expressed, and to provide a definition of loss probability layers.

As illustrated in Figure 1 below, which was provided in the August Presentation, the Standard NCOR parameters are a set of permitted return multiples (third yellow column) for loss probability layers (first two yellow columns):



Standard NCOR Calculation

Based on hypothetical return multiples (for illustrative purposes only) to be determined using bond price analysis and reinsurance data call

Input by: Insurer | CDI

Sample Calculation

Sample calculation of Standard NCOR over a selected layer:

Attachment Point(s) ($)	Attachment Point(s) (%)	Exhaustion Point(s) ($)	Exhaustion Point(s) (%)	Expected Loss in Layer(s)	Return Multiple in Layer(s)	Indicated Standard NCOR in Layer(s)	Permitted Standard NCOR in Layer(s)
$0	100.00%	$15,000,000	35.00%	$10,000,000	0.19	$1,857,210	
$15,000,000	35.00%	$25,000,000	30.00%	$3,250,000	0.31	$1,016,661	
$25,000,000	30.00%	$50,000,000	25.00%	$6,875,000	0.36	$2,457,576	
$50,000,000	25.00%	$75,000,000	15.00%	$5,000,000	0.47	$2,333,281	
$75,000,000	15.00%	$125,000,000	10.00%	$6,250,000	0.67	$4,214,829	
$125,000,000	10.00%	$225,000,000	5.00%	$7,500,000	1.03	$7,730,951	$7,730,951
$225,000,000	5.00%	$250,000,000	2.50%	$937,500	1.79	$1,677,041	$1,677,041
$250,000,000	2.50%	$350,000,000	1.50%	$2,000,000	2.91	$5,825,047	$5,825,047
$350,000,000	1.50%	$450,000,000	1.00%	$1,250,000	4.21	$5,261,171	$5,261,171
$450,000,000	1.00%	$475,000,000	0.40%	$175,000	6.93	$1,213,000	$1,213,000
$475,000,000	0.40%	∞	0.00%	$7,300,000			
			Total Expected Loss	$50,537,500	Total Std. NCOR	$33,586,767	$21,707,210
					Projected Exposures		175,000
			Expected Loss per Exposure	$288.79	Std. NCOR per Exp.	$191.92	$124.04

Figure 1

Market-expected returns for property CAT risk by loss probability can be derived from reinsurance placements and/or various ILS market prices, e.g., CAT bonds. CDI can calculate permitted return multiples for specific loss probability layers and promulgate them as the Standard NCOR in relation to the expected / modeled losses in those layers.

(c) The Standard NCOR parameters shall be set separately for insurer/coverage groups.

(1) Insurer/coverage groups shall be assigned based upon objectively measurable or observable characteristics of the insurer and/or the coverage provided by the insurer to its policyholders for the catastrophe perils within property lines listed in subdivision (b) of section 2644.25.1.

(2) The Commissioner shall establish no less than three insurer/coverage groups, and may establish additional insurer/coverage groups based on the Commissioner's review and determination of updated and credible source data, to achieve a more actuarially sound result.

The purpose of subdivision (c) is to state that there will be multiple groupings of the Standard NCOR parameters.

Rather than using one set of parameters for all insurers, coverages, perils, etc., multiple sets of parameters will likely be needed to enable soundness of the reinsurance cost estimates. Establishing multiple groupings of the Standard NCOR parameters is reasonably necessary to recognize the diversity of insurance companies operating in California. It also reflects that different insurers have different reinsurance programs. Reinsurance contracts between an individual insurer and their reinsurers are tailored to meet the insurer's reinsurance needs based on their specific portfolio of policies. A one-size-fits all approach may disadvantage insurers with one type of portfolio versus another (e.g., small versus large in size, concentrated in California versus not, etc.) The use of multiple parameter sets allows for the estimated reinsurance costs within a group to better align with the actual reinsurance costs of insurers placed in that group. Feedback the Department received from interested parties at the August Presentation and the December 5, 2024, Public Workshop (Public Workshop) indicated that insurers strongly recommend the use of multiple sets of the Standard NCOR parameters. The reason for multiple parameters is that it would be able to consider the differences in insurer/coverage groups, as discussed more fully in the next subdivision.

(d) In setting the insurer/coverage groups, the Commissioner shall determine whether adopting separate parameters for a given characteristic, or combination of characteristics, would produce a more actuarially sound result.

(1) If the Commissioner determines that adopting separate parameters for a given characteristic, or combination of characteristics, would produce a more actuarially sound result, the Commissioner shall set the parameters separately, pursuant to section 2646.3.

(A) Characteristics that may be relevant include, but are not limited to, insurer capital structure, amount of insurance being written based on premium or policy counts, percentage of insurance written in California, property line of business, and/or catastrophe peril.

The purpose of subdivision (d) is to state that there will be multiple insurer/coverage groups, and the group criteria will be based on actuarial soundness.

One of the Department's goals, as stated above, was to provide an approach that was not bespoke to a specific insurance company, but rather provided a reasonable standard to determine the Standard NCOR. In order to maintain a standardized approach that does not infringe upon the

confidentiality of an individual insurer's reinsurance program, the group criteria will not be based on characteristics of individual company reinsurance purchases. Rather, they will be based on characteristics of the insurer and/or the coverage which they are providing to policyholders.

The Department recognizes the proprietary nature of reinsurance agreements and programs, and thus determined that it was reasonably necessary to create an analysis that would not rely on the review of individual reinsurance contracts. By bundling insurers into coverage groups, or as the Department has referred to "t-shirt sizes," the Department is identifying relevant characteristics of insurers without identifying any specific insurer.

Not identifying specific insurers is important because the Department is not reviewing specific reinsurance contracts, it is not allowing the pass-through of a specific insurer's reinsurance program, but rather determining actuarially sound groups that reflect the diversity of companies, the types of business, and the amounts of business that is being written in California. Establishing groups, rather than undertaking a review of bespoke reinsurance programs, presents administrative efficiencies by using a standard that is sufficiently tailored and actuarially sound for the companies in the specific group, while still allowing for efficiencies gained via the use of a standard.

Grouping will help the Department review applications expediently so insurers can begin writing in the areas of the state that need it the most. The grouping will also provide insurers with a meaningful opportunity to participate in making the commitments and writing more policies in the distressed areas because they don't have to provide contracts and proprietary information that could potentially damage their business operations. As the relationships between insurer/coverage characteristics and observed reinsurance program costs may change over time, the regulation text allows the specific criteria used to group insurers to be periodically re-evaluated by the Commissioner.

The examples of potential characteristics for use in group criteria help clarify these concepts, illustrate practical applications and variability, and build an intuitive understanding of the need for multiple sets of the Standard NCOR parameters. Additionally, the examples of characteristics provided in subdivision (d)(1)(A) align with interested party feedback received after the August Presentation and the Public Workshop.

(e) In determining whether a given characteristic, or combination of characteristics, would produce a more actuarially sound result, the Commissioner shall consider:

(1) The relationship with expected property catastrophe reinsurance costs;

(2) Common or standardized industry practices related to expected property catastrophe reinsurance costs;

(3) Limitations created by business practices and whether such limitations are likely to have a significant impact;

(4) The degree to which expected property catastrophe reinsurance costs vary within an insurer/coverage group (homogeneity);

(5) The size of an insurer/coverage group and its predictive value for expected property catastrophe reinsurance costs (credibility);

(6) The tradeoffs between practical and other relevant considerations (practicality); and

(7) The reasonableness of the results that proceed from their use.

The purpose of subdivision (e) is to list the standards for actuarial soundness of the Standard NCOR parameter groupings detailed in subdivision (d).

It is reasonably necessary to include subdivision (e) in the proposed regulation because it aligns the regulation with actuarial standards and industry best practices. The items the Commissioner must consider when determining whether a given characteristic, or combination of characteristics, would produce a more actuarially sound result is based on Actuarial Standard of Practice (ASOP) No. 12 Risk Classification. ASOP 12 applies to actuaries when designing, reviewing, or changing systems which are used to assign risks to groups based upon the expected cost or benefit of the coverage or services provided.

In the drafting of subdivision (e), the Department explicitly included language from the following sections of ASOP 12:

- 3.2.1 Relationship with expected outcomes
- 3.2.3 Objectivity (in (b) above)
- 3.2.4 Practicality (in actuarial considerations below)
- 3.2.6 Industry Practices
- 3.2.7 Business Practices
- 3.3.2 Actuarial Considerations: homogeneity, credibility, practicality
- 3.3.4 Reasonableness of Results

The Department did not explicitly include language from the following sections:

- 3.2.2 Causality, since this is not necessary per ASOP 12
- 3.2.5 Applicable Law, since this is the relevant law/regulation
- 3.3.1 Intended Use, since this is restricted to a specific use case
- 3.3.3 Other Considerations, since this repeats Applicable Law, Industry Practices, and Business Practices.

(f) To determine the specific loss probability layers, the Commissioner shall consider:

(1) Common or standardized industry practices for both the purchase of property catastrophe reinsurance and the modeling of loss return periods;

(2) The homogeneity of return multiples by layer;

(3) The credibility of return multiple data by layer;

(4) The practicality of the number of layers; and

(5) The reasonableness of the results that proceed from their use.

The purpose of subdivision (f) is to list the standards for setting the Standard NCOR's loss probability layers as defined in subdivision (b).

The addition of subdivision (f) is reasonably necessary to include in the proposed regulation because it aligns the regulation with actuarial standards and industry best practices. Similar to subdivision (e), the standards language is based on ASOP 12, with the following additional exclusions due to the below considerations which are specific to loss probability layers:

- 3.2.1 Relationship with expected outcomes, since the Standard NCOR structure assumes a relationship between expected reinsurance costs and loss probabilities
- 3.2.3 Objectivity, since loss probabilities are inherently objective
- 3.2.7 Business Practices, since we would not expect significant limitations other than those already reflected in Industry Practices or Practicality

The language "common or standardized industry practices" is meant to link the parameters and structure of the Standard NCOR with the structure of actual reinsurance programs and typical loss modeling. That is, the parameters and structure of the Standard NCOR will be based on a review of industry data.

(g) For each specific loss probability layer, the permitted return multiple shall be the average return multiple over the layer, calculated as the definite integral from the starting loss probability to the ending loss probability of a curve of best fit on return multiples by loss probability from the source data, as defined in section (i) of this section, divided by the length of the integration interval.

(1) In calculating curves of best fit, the Commissioner may exclude insurers and/or reinsurance coverage layers for which reliable data are not readily available in the source data.

(2) The Commissioner may consider, but is not limited to the consideration of, the currentness, consistency, reasonability, sufficiency, and any known limitations of the data when determining its reliability.

The purpose of subdivision (g) is to define the calculation of the Standard NCOR's permitted return multiples in subdivision (b). In subparts (1) and (2) the proposed regulation text allows flexibility in the data included/excluded from the calculation.

Given the insurer/coverage groupings set in (c) to (e) and loss probability layers set in (f), the calculation language logically follows from the Standard NCOR approach, as detailed in the August Presentation, and the mathematical definition of the average value of a function over an interval. It is reasonably necessary to include this language to make clear how the Department will determine a specific loss probability layer.

(h) Since the net cost for a reasonably efficient insurer to purchase reinsurance coverage and/or hold additional capital for exposure to the occurrence of catastrophic property loss may vary by the combination of catastrophe perils and/or property lines covered in California, where multiple catastrophe perils and/or property lines are covered in California, the Commissioner shall set both the level of detail at which the Standard NCOR parameters shall apply and the methodology by which the results are combined.

(1) Level of detail and methodology

(A) In setting the level of detail at which the Standard NCOR parameters shall apply and the methodology by which the results are combined, the Commissioner shall determine whether adopting a given treatment would produce a more actuarially sound result.

(B) The Commissioner shall consider, but is not limited to the consideration of, the following methodologies when determining whether a given treatment will produce a more actuarially sound result:

(i) Applying the Standard NCOR parameters to each catastrophe peril and/or property line in California individually, with or without covariance adjustments;

(ii) Applying the parameters to all catastrophe perils and property lines combined and allocating the results to individual catastrophe perils and property lines; or

(iii) A combination of (i) and (ii).

(2) If the Commissioner determines that a given treatment would produce a more actuarially sound result, the Commissioner shall adopt such treatment, pursuant to section 2646.3.

The purpose of subdivision (h) is to explain that reinsurance costs vary by the combination of risks, and to state that where an insurer covers multiple California lines and/or perils, there will

be a level at which the Standard NCOR parameters apply and a methodology to combine their results across these California lines and/or perils. Subdivision (h) also explains that the level at which the Standard NCOR parameters apply and the methodology used to combine the results will be based on actuarial soundness.

It is reasonably necessary to add subdivision (h) because the level of detail at which the Standard NCOR parameters apply must be considered since loss probabilities vary by data aggregation level, and this level typically differs between insurers' property CAT reinsurance coverage and their rate filing submissions.

That is, insurers' property CAT reinsurance contracts typically cover multiple states, lines of insurance, and/or perils. However, insurers' rate filings are submitted in California by line of insurance, and property lines may cover one or more CAT perils. Subdivision (h) states that the Commissioner will determine how best to relate the level of detail through the Standard NCOR application and the methodology.

Since a primary goal of the regulation revisions is to recognize California-only exposures, the Standard NCOR parameters will be intended to apply to California lines and perils only. It is reasonably necessary to do this allocation to control the impact of the NCOR on consumers, meaning California consumers will not be paying for an insurer's reinsurance program covering catastrophes in other parts of the country. The Standard NCOR parameter groupings detailed in subdivision (c) allow needed flexibility in recognizing reinsurance cost differences between insurers that write in California only versus those that write in multiple states.

Since an insurer often writes multiple California lines and/or perils, it is necessary to set the level at which the Standard NCOR parameters apply, i.e., to what combination of lines and/or perils, and how the results will be combined and/or allocated to the levels in their rate filings.

It is reasonably necessary to include subdivision (h)(2) in the regulation text because actuarial soundness provides an appropriate basis for determining the level of detail and methodology to be used; this basis is internally consistent with both subdivisions (d) and (f).

The examples of potential levels and methods help clarify these concepts, illustrate practical applications and variability, and build an intuitive understanding of the need for specifying the level of detail and methodology to be used.

The examples provided align with common industry and actuarial techniques, i.e.:

- For an insurer with multiple California lines and/or perils, there may be relationships between the individual lines and/or perils. Where there are relationships between individual variables, covariance adjustments are often used.
  - For example, NAIC's Risk Based Capital (RBC) formula uses a simple square root rule which reduces the aggregate charge by assuming less-than-perfect correlation between most components (i.e., R_1 to R_5):

Total P/C RBC

$$R_0 + \sqrt{(R_1)^2 + (R_2)^2 + (R_3)^2 + (R_4)^2 + (R_5)^2}$$

- The total Standard NCOR will need to be allocated to the California lines and/or perils within a rate filing (a California-specific, top-down approach) if the total is calculated by either:
  - Using a formula like the above which combines individual results by California line and/or peril with a covariance adjustment, or
  - Using inputs that are already stated on a combined basis (e.g., the blue columns on Figure 1 already reflect all California lines and/or perils).

- If the total Standard NCOR is instead calculated as the simple sum of individual California lines and/or perils (a California-specific, bottom-up approach), no allocations are needed.

- In other states, the total NCOR for a given insurer's reinsurance program is typically allocated to the state, lines, and/or perils within a rate filing (a countrywide, top-down approach).
  - This top-down approach is less desirable in California for at least two reasons:
    - Proposition 103 requires rate filing materials to be made public, and an insurer's reinsurance program details are considered to be highly confidential; and
    - A primary goal of the regulation revisions is to focus on California-specific exposures.

(i) Data used in subdivisions (a) through (h) of this section shall be derived from data available to the California Department of Insurance, including from data calls that the California Department of Insurance conducts relating to reinsurance strategies and placement, and/or publicly available data, whatever would produce the most actuarially sound result. If the Commissioner determines that the use of publicly available data alone would produce the most actuarially sound result, the Commissioner shall use such data, pursuant to section 2646.3.

(1) Any data derived from data calls shall only be released to the public in the aggregate so that no individual insurer experience is revealed.

The purpose of subdivision (i) is to state that subdivisions (a) to (h) of this section will be based on data that is available to the Department, whether that data is publicly available or derived from a data call.

It is reasonably necessary to include a provision that discusses the data that the Department will use to establish the Standard NCOR because the determination of the Standard NCOR parameters relies on the analysis of specific data sources. The Department needed to balance competing regulatory concerns when creating the Standard NCOR methodology, i.e.:

- A bespoke NCOR would rely solely on individual insurers' specific reinsurance contracts. As noted above, the review and application of a bespoke NCOR within individual insurer rate filings could not operate with the expediency needed to address the availability crisis. Additionally, a bespoke NCOR would require disclosure of confidential reinsurance contracts and programs, pursuant to the disclosure requirements in Proposition 103, which would not allow insurers to meaningfully participate in making the commitments and writing the coverage so desperately needed in the distressed areas. For these reasons, a bespoke NCOR would be unworkable in California under current conditions.

- The Standard NCOR, rather, relies on a combination of publicly available data and industry information from a data call to reflect both market-expected returns for property CAT risk and the unique dynamics of the California insurance market. The Department explored many options, but the data needed to perform an actuarially sound analysis and to determine the Standard NCOR parameters is not available in existing insurer reporting and/or data calls. The Department administered a data call that was designed to provide a snapshot of the unique California market and to elicit information for the Department to set appropriate Standard NCOR parameters.

Subdivision (i) recognizes the need to balance reinsurance contract confidentiality with the need to provide transparency to the public, which is why it was reasonably necessary to include the language permitting only the release of aggregated data from data calls related to reinsurance strategies and placement. The release of aggregated data, rather than insurer specific data, is reasonably necessary because the Standard NCOR does not create a bespoke NCOR for an individual insurer, but rather uses data from multiple sources to derive a market/industry standard NCOR. Therefore, aggregate data is all that is needed for transparency of the Standard NCOR.

The ability of the Department to use publicly available data, as well as California market data from a data call is consistent with interested party feedback obtained after the August Presentation and with consumer advocate concerns expressed in the Public Workshop regarding the use of CAT bond data only to approximate the broader reinsurance market.

Actuarial soundness provides an appropriate basis for determining the use of any additional, publicly available data; this basis is internally consistent with subdivisions (a), (c), (d), (e) and (h).

While the use of data call information is anticipated to be a primary source of support for the Standard NCOR since it elicits information on the California market and its reinsurance strategies, the use of publicly available data may enhance its soundness, in particular if there are concerns with the currentness of the data call information, the consistency, reasonability, or any other limitations. Thus, flexibility is needed, and it is desirable for any additional data to be publicly available in order to provide transparency.

(j) If an insurer complies with the commitments defined in section 2644.25.3, the insurer may file its complete rate application, made pursuant to section 2648.4, using the Standard NCOR parameters for its insurer/coverage group(s) for the catastrophe perils within property lines listed in subdivision (b) of section 2644.25.1.

(1) The permitted return multiples shall be applied to the expected losses generated from one or a combination of catastrophe models for the specific loss probability layers, at the level of detail set by the Commissioner.

(A) The expected losses may be adjusted to include a provision for defense and cost containment expenses (DCCE), either by applying a historical ratio of noncatastrophe DCCE to noncatastrophe loss or by applying a historical ratio of catastrophe DCCE to catastrophe loss.

(2) The results for multiple catastrophe perils and/or property lines covered in California shall be combined according to the methodology set by the Commissioner, where applicable.

The purpose of subdivision (j) is to make clear that an insurer must comply with specific commitments in order to use the Standard NCOR parameters. The subdivision also explains how the permitted return multiples will be applied in a rate filing, i.e., using the Standard NCOR parameter groupings as detailed in subdivisions (c) and (d) and according to the level and methodology in subdivision (h).
In order to meet the policy goals of ensuring market expansion and providing greater availability of coverage in wildfire risk areas it is reasonably necessary to require specific insurer commitments before an insurer can use the Standard NCOR.

Subdivision (j)(1) explains how the Standard NCOR parameters in subdivision (b) will be applied. This explanation is reasonably necessary to provide clarity and to connect the Department's promulgation of the parameters and methodologies in subdivisions (a) to (h) with the rate filing process.

Subdivision (j)(1)(A) is added to clarify that a DCCE loading is permitted. It is reasonably necessary to include this explanation for several reasons. First, the permitted return multiples are being derived from data call information, in which DCCE is included. Second, based on the data

call information received, the Department is calculating NCOR multiples as a ratio of the net reinsurance cost to expected loss and DCCE recoveries, so the multiples should be applied to insurers' data which is on the same basis. Third, DCCE expenses are a legitimate cost of the claims process and should be considered in insurers' rates.

It is also necessary to specify that an insurer must use a CAT model to calculate the expected losses by loss probability layer for the Standard NCOR since historical losses would not be sufficiently reliable for such a purpose.

(k) It is expected that in an insurer's complete rate application, made pursuant to section 2648.4, any catastrophe model(s) used for subdivision (j) of this section shall be consistent with the catastrophe model(s) used for subdivisions (a) through (c) of section 2644.4.5.

(1) The use of catastrophe models shall comply with the requirements set forth in subdivisions (d) through (f) of section 2644.4.5, and the inclusion of any required model information in the complete rate application proceeding shall make such information public information.

The purpose of subdivision (k) is to make clear that the Department expects insurers to use the same CAT model(s) for the Standard NCOR as for their modeled CAT adjustments, and that the models follow the same requirements and public disclosures.

It is reasonably necessary to require that insurers use the same CAT model(s) for the Standard NCOR as for their modeled CAT adjustments because within an insurer's rate application, the use of the same CAT model(s) for the Standard NCOR and modeled CAT adjustments ensures consistency within the ratemaking formula, i.e., so that the loss cost and net reinsurance cost provisions are based on the same modeled estimates of CAT losses. The same requirements and disclosures for the CAT model(s) should apply for similar reasons.

Adopt 2644.25.3

The Department proposes to adopt section 2644.25.3 for the specific purpose of providing information on the requirements to make and fulfill the commitments needed in order to consider the cost or benefits of reinsurance as permitted by subdivision (b) of section 2644.25.1.

<u>An insurer that opts to make, fulfill, and document the fulfillment of its insurer commitments in the manner specified in this section 2644.25.3 may consider the cost or benefits of reinsurance as permitted by subdivision (b) of section 2644.25.1.</u>

The purpose of this section is to allow insurance companies to consider the cost or benefits of reinsurance in the ratemaking formula where they are presumed to have demonstrated a need to do so by committing to take on the risk of writing additional business, or maintaining existing business as specified, in higher-risk wildfire-prone areas.

California is one of the few states in the nation that does not allow insurance companies to recover the costs of purchasing reinsurance in their rates. Currently, California only allows ratemaking for all lines and sublines on a direct basis, with an exception for earthquake and for medical malpractice facultative reinsurance with attachment points above one million dollars. Insurers in California have been withdrawing from writing business in higher-risk wildfire areas and have indicated that the reason they are withdrawing is, in part, because they cannot develop appropriate rates without the consideration of the cost or benefit of reinsurance. Therefore, it is reasonably necessary to allow insurers who commit to writing more business, or maintaining existing levels of business as specified, in distressed areas, and/or taking out of the FAIR Plan more policies insuring properties impacted by heightened wildfire risk, to consider the cost or benefits of reinsurance because their increased writing in these areas requires the purchase of additional reinsurance. Reinsurance is the primary strategy many companies use to continue to write and expand coverage in higher risk parts of California and across the country. Reinsurance is an expense incurred by insurance companies as a cost of writing property catastrophe risks, and the cost of purchasing adequate reinsurance has been increasing with the increase of natural disasters. Allowing the consideration of the cost or benefits of reinsurance will in turn enable the insurers that make these commitments to charge rates that more accurately reflect the associated increased risk of loss, which will help address the insurance availability problems that California property owners are increasingly experiencing.

<u>The term “qualifying residential property insurance,” for purposes of this section 2644.25.3, is as defined in section 2644.4.8.</u>

The purpose of this section is cross cite to the definition in section 2644.4.8, which makes clear that the regulatory amendments in 2644.4.8 apply to insurers requesting rate changes for residential homeowners policies that provide wildfire coverage for individually owned residential structures of not more than four dwelling units.

It is reasonably necessary to identify the type of residential insurance policies most impacted by the current insurance availability crisis, and to define “qualifying residential property insurance” to help communicate to insurers the type of residential policies that insurers are committing to write more of.

Because a policy of “residential property insurance” is already defined in Insurance Code section 10087, that definition is used as a starting point, and then certain types of insurance that do not

insure structures are carved out of the Section 10087 definition. It is reasonably necessary to exempt renters' and HO-6 insurance policies from this commitment section because such policies do not insure structures. It is also reasonably necessary to avoid double counting HO-6 policies because the commercial commitments will also capture the types of commercial policies that provide fire coverage for condominium structures.

Specifying that the term "qualifying residential property insurance" only includes insurance policies that include coverage for physical structures addresses the problem of having a definition that is broader than the problem this regulation is addressing. By focusing on insurance policies with structures, the definition aligns this section with the types of policies that are most likely to be impacted by the ongoing insurance availability challenges related to wildfire risk such that insurers committing to write more of such policies may be presumed to have demonstrated a need to consider the cost or benefit of reinsurance for ratemaking purposes. The growth in the FAIR Plan from 2018 to 2022 has been in policies that include coverage for the structure.

(a) Distressed areas, and properties insured by FAIR Plan policies, that are to be used in insurer commitments for the purposes of this section 2644.25.3 are as defined in subdivision (a) of section 2644.4.8.

The purpose of subdivision (a) is to cross-cite to the definition of distressed areas in section 2644.4.8(a).

It is reasonably necessary for section 2644.25.3(a) to cross-cite to section 2644.4.8(a) because section 2644.25.3(a) needs to apply the same definitions to a commitment that is made pursuant to section 2644.25.3 as the definitions that are applied to a commitment that is made by an admitted insurer that has demonstrated a need to use CAT modeling. As discussed above, it is a requirement that insurers use the same CAT model(s) for the Standard NCOR as for their modeled CAT adjustments because within an insurer's rate application, the use of the same CAT model(s) for the Standard NCOR and modeled CAT adjustments ensures consistency within the ratemaking formula, i.e., so that the loss cost and net reinsurance cost provisions are based on the same modeled estimates of CAT losses.

For context, information regarding the cross-cited provisions of section 2644.4.8 is provided:

The definition of distressed areas in section 2644.4.8 identifies the high-risk wildfire-prone areas, as well as the certain properties insured by the FAIR Plan which insurers can commit to convert into the admitted market, for purposes of ratemaking.

Section 2644.4.8, subdivision (a)(1) identifies where insurers may find information on which areas are experiencing higher levels of wildfire risk and will be considered "distressed areas." This subdivision is reasonably necessary to prevent insurer confusion and provide certainty regarding which areas qualify as distressed areas for purposes of meeting insurer commitments. The Commissioner anticipates that by identifying the areas that qualify as distressed for purposes

of these regulations, this will also help address the growing problem of insurance unavailability in those areas.

Section 2644.4.8, subdivision (a)(1)(A) specifies that this subdivision will provide information on how the Commissioner will identify Undermarketed ZIP Codes and how the Commissioner will communicate which ZIP Codes are undermarketed. Section 2644.4.8, subdivision (a)(1)(A) further explains that the Commissioner will publish an initial bulletin specifying the ZIP Codes that are experiencing the greatest levels of residential insurance availability challenges as a result of increased wildfire risk – the Undermarketed ZIP Codes. Additionally, section 2644.4.8, subdivision (a)(1)(A) communicates that the Commissioner will periodically issue subsequent bulletins to update the list of Undermarketed ZIP Codes as conditions warrant, but no less frequently than once per year.

It is reasonably necessary for the Commissioner to publish an initial bulletin containing a list of Undermarketed ZIP Codes so that insurers will know the ZIP Codes in which they can write additional policies to meet their insurer commitments. It is reasonably necessary for the Commissioner to update, to the extent that conditions warrant, by subsequent bulletins the identification of Undermarketed ZIP Codes with specific regularity in order to respond to potential changes in the availability of qualified residential property insurance related to wildfire risk in the admitted market. The purpose of the updates is to ensure that the identified Undermarketed ZIP Codes reflect conditions within the admitted market which are fluid and can change based on complex interactions between various wildfire, land-use, and human-based systems, and because of the cumulative impact of decisions made individually by insurance companies offering qualified residential property insurance in California.

It is reasonably necessary for the Department to update the current Undermarketed ZIP Codes as new and different data is analyzed, and state-wide changes in the admitted market with respect to qualified residential property insurance are identified. The Department will also assess on an annual basis whether any such updates to the list are warranted based on the most recent data that is available to the Department.

It is reasonably necessary for the Department to use ZIP Codes as a method to define distressed areas because residential exposure data at the policy level by ZIP Code from admitted insurers and the FAIR Plan is already available to the Department. This makes ZIP Code boundaries the most adequate and efficient means to communicate Undermarketed ZIP Codes with insurers and the public.

Section 2644.4.8, subdivision (a)(1)(A) sets forth the first part of the Commissioner's definition of an Undermarketed ZIP Code. It specifies that an Undermarketed ZIP Code is a ZIP Code which at least partially overlaps a high or very high fire hazard severity zone and clarifies that the high or very high fire hazard severity zone will be taken from a current map published by the Department of Forestry and Fire Protection. It then signals that the ZIP Code must also meet other requirements by the use of a colon after the language "and in which ZIP Code either:".

It is reasonably necessary for the Commissioner to define Undermarketed ZIP Codes so that insurers will know which ZIP Codes in which they can write additional policies to meet their

insurer commitments. It is also reasonably necessary for the definition of Undermarketed Zip Codes to be correlated with areas of the state known to be higher-risk, wildfire-prone areas that are experiencing insurance unavailability.

Accordingly, it is also reasonably necessary to link the definition of Undermarketed ZIP Codes to fire hazard severity zones as identified on current maps published by the Department of Forestry and Fire Protection (Cal Fire) because of the logical and data-driven link between increased wildfire risk and geographic areas of the state known to be experiencing greater issues obtaining insurance coverage from admitted insurers in the voluntary market. Cal Fire is the subject matter expert on statewide wildfire risk. Cal Fire has the latest and best data on the most fire-prone severity zones, and it creates fire hazard maps that can be overlaid with ZIP Code boundaries. Section 2644.4.8, subdivision (a)(1)(A) communicates that the definition of Undermarketed ZIP Codes will rely on current Cal Fire maps, which is necessary to eliminate any confusion regarding which Cal Fire maps will be used for the purposes described in this subdivision.

By layering Cal Fire's high to very high fire hazard severity zones over ZIP Code maps, the Department is able to identify which ZIP Codes contain geographic areas experiencing high or very high wildfire risk. Using exposure data, the Department is then able to identify, of those ZIP Codes that contain high or very high wildfire risk, which ZIP Codes are experiencing the most significant decline in insurance availability.

If the Department did not approach defining Undermarketed ZIP Codes in the particular way described above, insurers' increased writing of residential property insurance would not necessarily correlate to areas of the state known to be higher-risk, wildfire-prone areas that are experiencing insurance unavailability.

Section 2644.4.8, subdivision (a)(1)(A)1. builds upon subdivision (a)(1)(A) in which Undermarketed ZIP Code is defined as a ZIP Code "which at least partially overlaps a high or very high fire hazard severity zone as shown on current maps published by the Department of Forestry and Fire Protection (Cal Fire)." The purpose of subdivision (a)(1)(A)1. is to communicate that the ZIP Code must also either meet the criteria of subdivision (a)(1)(A)1 or in a subsequent subdivision ((a)(1)(A)2.), in order to qualify as an Undermarketed ZIP Code.

Section 2644.4.8, subdivision (a)(1)(A)1. is the first of the two metrics that may be used to complete the definition of Undermarketed Zip Code. This subdivision sets forth that a ZIP Code is an Undermarketed ZIP code if, in addition to meeting the condition set forth in preceding subdivision (a)(1)(A) that the ZIP Code "at least partially overlaps a high or very high fire hazard severity zone as shown on current maps published by the Department of Forestry and Fire Protection (Cal Fire)," at least fifteen percent (15%) of the sum of the criteria listed in the following two subdivisions, (a)(1)(A)1.a. and (a)(1)(A)1.b., are insured by the FAIR Plan in that ZIP Code. Mathematically speaking, the only way to derive the FAIR Plan percentage in a ZIP Code is to use the numbers that result from the calculations in subdivisions (a)(1)(A)1. a. and (a)(1)(A)1.b..

The purpose of this language is to make specific the definition of Undermarketed ZIP Code and communicate how the Commissioner calculates the FAIR Plan percentage in a ZIP Code to determine if it is at or above 15%. It is reasonably necessary for the Commissioner to define Undermarketed ZIP Codes so that insurers will know the ZIP Codes in which they can write additional policies to meet their insurer commitments. It is also reasonably necessary for the definition of Undermarketed Zip Codes to be correlated with areas of the state known to be higher-risk, wildfire-prone areas that are experiencing insurance unavailability. The Commissioner has determined that the FAIR Plan is experiencing significant growth in these higher-risk, wildfire-prone areas that are experiencing admitted market insurance unavailability. Accordingly, it is reasonably necessary to use the 15% FAIR Plan threshold because it corresponds to the insurer's 85% commitment. If insurers commit to write qualifying residential property insurance policies in distressed areas such that their market share in the corresponding distressed ZIP Codes is at least 85% equivalent to their overall statewide market share, then the FAIR Plan concentration will not be able to exceed 15% in those areas.

The language in section 2644.4.8, subdivision (a)(1)(A)1. also addresses the problem of potential confusion or uncertainty as to how the Department is calculating the percentage of residential properties insured by the FAIR Plan in a particular ZIP Code so that the aforementioned determination can be made. This language also eliminates the possibility of any confusion regarding whether, if the FAIR Plan penetration in a ZIP Code is at or above 15%, that ZIP Code qualifies as an Undermarketed ZIP Code.

Section 2644.4.8, subdivision (a)(1)(A)1.a. and b. specify the two values that are added together to create the sum referenced in subdivision (a)(1)(A)1., the number of residential properties in the ZIP Code that are insured by the FAIR Plan and number of residential properties in the ZIP Code that are insured in the voluntary market by admitted insurers under a policy of qualifying residential property insurance.

As previously discussed, it is reasonably necessary for the Commissioner to define Undermarketed ZIP Codes so that insurers will know which ZIP Codes in which they can write additional policies to meet their insurer commitments. It is also reasonably necessary for the definition of Undermarketed Zip Codes to be correlated with areas of the state known to be higher-risk, wildfire-prone areas that are experiencing insurance unavailability. The Commissioner has determined that the FAIR Plan is experiencing significant growth in these higher-risk, wildfire-prone areas that are experiencing normal market insurance unavailability. Accordingly, the provisions in section 2644.4.8, subdivision (a)(1)(A)1.a. and b. are reasonably necessary to make specific the definition of Undermarketed ZIP Code and communicate how the Commissioner calculates the FAIR Plan percentage in a ZIP Code to determine if it is at or above 15%. If the Department did not include these provisions, confusion and uncertainty may exist regarding how the Commissioner defines Undermarketed ZIP Code.

The word "or" at the end of section 2644.4.8, subdivision (a)(1)(A)1.b. is reasonably necessary to communicate that, in addition to the criteria in section 2644.4.8, subdivision (a)(1)(A)1.a. and b., the subsequent subdivision provides another criterion that can be met to define an Undermarketed Zip Code.

Section 2644.4.8, subdivision (a)(1)(A)2. builds upon subdivision (a)(1)(A) in which Undermarketed ZIP Code is defined as a ZIP Code "which at least partially overlaps a high or very high fire hazard severity zone as shown on current maps published by the Department of Forestry and Fire Protection (Cal Fire)." The purpose of subdivision (a)(1)(A)2. is to communicate that the ZIP Code must also either meet the criteria in subdivision (a)(1)(A)2. or in the preceding subdivision ((a)(1)(A)1.), in order to qualify as an Undermarketed ZIP Code.

Subdivision (a)(1)(A)2. communicates the second of two metrics that may be used to complete the definition of Undermarketed Zip Code and requires the average premium of Coverage A (Coverage A, commonly referred to as Dwelling Coverage, covers the structure of the home) in a particular ZIP Code to be at least four dollars ($4.00) and the median income of the ZIP Code to be no higher than the 50th percentile for California. In other words, if the average premium of Coverage A is at least four dollars and the median income of the Zip Code is no higher than the 50th percentile for California and the ZIP Code "at least partially overlaps a high or very high fire hazard severity zone as shown on current maps published by the Department of Forestry and Fire Protection (Cal Fire)," then the ZIP Code qualifies as an Undermarketed Zip Code.

Using the average premium per $1,000 of coverage is a common and relatable measurement used by insurance regulators to create a common scale to compare relative cost of insurance products being written in a particular location on a consistent basis. It is reasonably necessary to focus on measuring the average premium per $1,000 of Coverage A as Coverage A represents the portion of the overall coverage amounts that is directly tied to fire risk, including wildfire risk, of residential structures.

It is reasonably necessary to set a threshold, such as the four-dollar ($4.00) threshold set here, above which Coverage A can be deemed to be significantly more expensive, so as to compare insurance in the market in that location or between locations. In this case, the threshold was established by analyzing the variability and the differences compared to the average premium per $1,000 of Coverage A. This metric is calculated by combining the premium from all the relevant policies insuring residential structures in a ZIP Code and dividing by the combined amount of structure coverage under Coverage A from those same policies in that ZIP Code.

Based on CDI data collected from insurance companies operating in California, the Commissioner has determined it is reasonably necessary to classify a ZIP Code as undermarketed if, in part, the average premium per $1,000 of Coverage A in that ZIP Code is at or above four dollars ($4.00), based upon two common statistical methodologies.

First, four dollars ($4.00) is roughly one standard deviation above the state-wide mean of the average premium per $1,000.00 of Coverage A within each ZIP Code in the state. In other words, one standard deviation means that the premium for $1,000 of Coverage A in nearly 16% of all ZIP Codes (and under standard assumptions, approximately 16% of policies covering residential structures across all ZIP Codes) on average would be more expensive than the $4 threshold; about 68% of all ZIP Codes (and under standard assumptions, 68% of all policies across all ZIP Codes) on average would be roughly between $2 and $4.

Second, and similarly, the $4 threshold also represents the 80th percentile, meaning that any ZIP Code where that metric is at $4 or above is in the top 20% of all ZIP Codes in the state. That means that those ZIP Codes above $4 would be among the 20 most expensive ZIP Codes in the state with respect to the average premium cost for $1,000 of Coverage A.

The Commissioner has determined it is reasonably necessary to set four dollars ($4.00) as the appropriate threshold level because it is roughly one standard deviation from the state-wide mean of the average premium per $1,000.00 of Coverage A.

It is also reasonably necessary to define Undermarketed ZIP Codes to include ZIP Codes where the average premium for residential structures is more expensive than the statewide mean and the median income of the ZIP Code is at or below the fiftieth (50th) percentile statewide, while meeting the requirements set forth in section 2644.4.8, subdivision (a)(A)(1), in order to prevent any potential for unintended consequences of specifying these Undermarketed ZIP Codes, by inadvertently excluding areas with lower-value, lower-income properties, and therefore potentially having an unfairly discriminatory impact on rates; therefore, the Commissioner is adding this provision to capture any such ZIP Codes to ensure against any potential for unfair discrimination.

Section 2644.4.8, subdivision (a)(1)(B) requires the Commissioner to publish an initial bulletin listing the names of the distressed counties to be used in insurer commitments. This is reasonably necessary because it addresses the problem of how insurers will be notified of the list of distressed counties as determined by the Commissioner. Publishing the list of distressed counties via bulletin provides a convenient, uniform way to notify insurers of the list of distressed counties, which insurers need to determine which counties they can write additional new policies in to meet their insurer commitments.

Additionally, section 2644.4.8, subdivision (a)(1)(B) requires the Commissioner to issue subsequent bulletins to update the list of distressed counties as conditions warrant but no less than once per year. It is reasonably necessary for the Commissioner to update, to the extent conditions warrant, by subsequent bulletins the identification of distressed counties with specific regularity in order to respond to potential changes in market conditions of qualified residential property insurance in the statewide admitted market related to wildfire risks and ensure that the identification of distressed counties responds to changing market conditions.

It is reasonably necessary to determine and compare the relative levels of wildfire risk to structures among counties to address the problem of determining which California counties are most likely to be higher-risk wildfire-prone areas. The Department does not collect comprehensive fire risk data, and therefore, the Department must rely on data and methodologies from external sources to assess comparative levels of wildfire risk.

The identification of both “Undermarketed ZIP Codes” and “distressed counties” is important for achieving a more holistic and accurate approach to identifying the areas most likely to be impacted by wildfire risks. Undermarketed ZIP Codes provide jurisdictional boundaries, and are established based on population densities, and they may not necessarily align with risks. By including “distressed counties” the text identifies the counties where high risk is common, and

helps reduce the likelihood of excluding certain areas that are likely facing similar risk conditions to those in other areas of the same county. In lower wildfire risk counties, ZIP Codes are more appropriate because they are a more granular approach.

The use of the term "structures" clarifies that section 2644.4.8, subdivision (a)(1)(B) addresses the wildfire risk to physical structures in a county, which is more aligned with how wildfire risk metrics are used to assess the risk of loss in a particular area when compared to the term dwellings.

Section 2644.4.8, subdivision (a)(1)(B) uses the "50th percentile" metric to better achieve the goal of this section, which is to identify the counties facing wildfire risk at a threshold that is likely to make insurers' historic loss data less predictive of projected losses. A higher percentile, such as the 60th percentile would be too narrow, capturing fewer of the counties that have seen substantial wildfire risk challenges, and therefore would not align with the objective of the distressed areas. A lower percentile, such as the 40th percentile, would have resulted in the inclusion of more counties with a lower percentage of structures determined to be at high or very high wildfire risk, which would make the distressed areas too broad and would not have achieved the objective of the distressed areas.

Section 2644.4.8, subdivision (a)(1)(B)(2) identifies certain properties currently insured by the FAIR Plan that admitted insurers in the voluntary market must write more of in order to presumptively demonstrate a change in their book of business. The Commissioner has determined that the FAIR Plan is experiencing significant growth in these higher-risk, wildfire-prone areas that are experiencing normal market insurance unavailability. Accordingly, it is reasonably necessary to include such properties in the types of properties that if insurers commit to writing more of they may be presumed to have demonstrated a need to consider the cost or benefits of reinsurance in their rates.

Section 2644.4.8, subdivision (a)(1)(B)(2) provides another category of qualified residential property insurance policies that an insurer may write to fulfill its insurer commitments. Section 2644.4.8, subdivision (a)(1)(B)(2) clarifies that in addition to qualified residential property insurance policies in distressed counties and Undermarketed ZIP Codes, insurers may write certain other qualified residential property insurance policies covering properties located outside of distressed areas to meet their insurer commitments, but only if those properties were insured by the FAIR Plan immediately prior to the policy written by the insurer as part of that insurer's fulfillment of their insurer commitment.

Section 2644.4.8, subdivision (a)(1)(B)(2) requires such properties to be classified as moderate to very high wildfire risk by the insurer making the commitment, and further clarifies that the policy must have been covered by the FAIR Plan "immediately prior" to the admitted insurer insuring it. The policy also must have been covered by the FAIR Plan after the date the insurer's rating plan containing its commitment was approved. The "immediately prior" language prevents the insuring of properties that were on the FAIR Plan at some other previous time counting towards fulfilling an insurer commitment. It is reasonably necessary to specifically target policies that are currently insured by the FAIR Plan because the Commissioner has

determined that such policies are more likely to be higher-risk, and therefore eligible to fulfill the commitments and achieve the goals of the Sustainable Insurance Strategy.

If a property had in the past been insured by the FAIR Plan, but not immediately prior to when the insurer that is making a commitment is providing coverage, then coverage for that property should not count towards the insurer's commitment because that property could have been in the interim insured by another admitted carrier which does not demonstrate increased risk for the applicant insurer as of the time the commitment was approved. This requirement is reasonably necessary for an insurer to demonstrate that committing to writing such a property is the type of underwriting commitment that demonstrated a need to consider the cost of benefits of reinsurance for ratemaking purposes.

It is also reasonably necessary to specify that the property must have been insured by the FAIR Plan subsequent to the approval date of the insurer's rating plan described in section 2644.25.3, subdivision (c) to ensure that the property was underwritten as part of the insurer's commitment and not a property the insurer underwrote prior to its commitment being approved.

(b) Statewide market share calculations for the purposes of this section 2644.25.3 will be determined as described in subdivision (b) of section 2644.4.8.

The purpose of subdivision (b) is to cross-cite to the description of statewide market share calculations in section 2644.4.8(b).

It is reasonably necessary for section 2644.25.3(b) to cross-cite to section 2644.4.8(b) because section 2644.25.3(b) needs to apply the same definitions to a commitment that is made pursuant to section 2644.25.3 as the definitions that are applied to a commitment that is made by an admitted insurer that has demonstrated a need to use CAT modeling. As discussed above, it is a requirement that insurers use the same CAT model(s) for the Standard NCOR as for their modeled CAT adjustments because within an insurer's rate application, the use of the same CAT model(s) for the Standard NCOR and modeled CAT adjustments ensures consistency within the ratemaking formula, i.e., so that the loss cost and net reinsurance cost provisions are based on the same modeled estimates of CAT losses.

For context, information regarding the cross-cited provisions of section 2644.4.8 is provided:

Section 2644.4.8, subdivision (b) describes how the Department calculates an estimate of statewide market share and explains that this number will be used as the denominator in calculating the statewide market share for each insurer. It is reasonably necessary to identify how these calculations are performed in order to ultimately determine insurer commitments in a consistent and transparent way.

Section 2644.4.8, subdivision (b)(1) explains that the Department will calculate an estimate of overall statewide market share, and how it will do so. It also advises that the resulting statewide market share estimate determined by the Department will be the denominator that each insurer must use to calculate its individual market share.

Section 2644.4.8, subdivision (b)(1) specifies that the Commissioner will publish the overall statewide market share estimate, the denominator in the calculation of each insurer's statewide market share, in a bulletin at least once per year. The Department will be responsible for calculating an estimate of the number of earned exposures of qualifying residential property insurance statewide, specifying how it will make that calculation, and identifying how and when insurers can expect to receive that information. This is reasonably necessary to communicate to insurers in a transparent manner that they themselves are not responsible for making this calculation. The Department will provide such information through a particular means at a particular frequency.

It is reasonably necessary to publish the Department-determined-denominator so that insurers know what denominator they must use to calculate their individual statewide market share. It is also necessary for the Department to rely on data collected from the most recent experience year available as that will most closely reflect the status of the insurance market; relying on older data poses a risk of setting requirements that substantially deviate from current market conditions and would fail to address the changing insurance market and consumer demands.

The number of earned exposure represents the number of structures insured by an insurer in proportion to the total amount of months they were insured over a 12-month period. The Department must establish a baseline to measure insurer commitments and the cut-off year of 2023 is used because it will be the most current and complete information the Department will have to set that baseline by adding all the reported earned exposures from the relevant admitted insurers over the 12-month period.

It is reasonably necessary to use earned exposures as the measuring unit because using any other alternative measurable units may result in inaccuracies, inconsistencies, and deficiencies that limit the ability to use other alternative measurable units as a baseline to monitor commitments.

Additionally, earned exposures reflect both the number of policies and the period of time the risk has been on the insurer's book of business, so unlike other methods it has both count and time elements. Earned exposures also reflect the amount of penetration an insurer has in terms of the number of homes for which it provided insurance in a certain period. It is necessary to use earned exposures versus a point in time policy-count because policies may be cancelled and/or written on the last day of the counted time period. Thus, the regulation specifies using earned exposures because they represent the best data available to the Department as of the time of this rulemaking. Earned exposures are also necessary to compare the data reported by insurers for ratemaking purposes. Insurers report their earned exposures in rate applications, thus it is the best method for comparison of insurers' penetration in distressed areas over time. Finally, earned exposures provide a consistent, verifiable, and commonly known metric and commonly known measurement.

The above statements regarding the necessity of the use of "earned exposures" applies to all instances in which the term is used in the regulation text.

Section 2644.4.8, subdivision (b)(1) also identifies the numerator that insurers must use to calculate their individual market share. The individual market share of each participating insurer is one of the factors that each participating insurer must use in the equation to determine its insurer commitments. Without this provision, insurers will not know what calculations to perform to determine their insurer commitments. It is reasonably necessary to identify these calculations in order to determine insurer commitments in a consistent way that demonstrates the likelihood that an insurer's historic loss data will not accurately reflect its projected losses such that catastrophe modeling should be used. It is also reasonably necessary to use earned exposures of qualified residential property insurance policies because the numerator is the same unit of measurement as the denominator.

The purpose of using the most recent twelve (12) month period is to provide uniformity and to match the 12-month period in the denominator. Using a 12-month period to measure earned exposures is necessary since qualified residential property insurance policies are generally issued for a term of 12 months; thus, a 12-month period is needed to accurately measure if any particular risk was insured for the entire term or for a fraction thereof. Since an insurer's commitment will be made at the time of the rate filing, the insurer's market share at the time of such filing requires an insurer to count the total amount of earned exposures of qualified residential property insurance policies that are commensurate with their most recent 12-month period used in the recorded period of the rate template. Use of an alternative 12-month period other than the most recent would not accurately reflect or measure the total amount of time each and every risk has been on the insurer's book of business as of the time of the filing and consequently would not accurately reflect the expected cumulative risk for the duration of the newly approved rate.

It is also necessary for the Department to rely on data collected from the most recent experience year available as that will most closely reflect the status of the insurance market; relying on older data poses a risk of setting requirements that substantially deviate from current market conditions and would fail to address the changing insurance market and consumer demands.

Finally, section 2644.4.8, subdivision (b)(1) explains the method of calculating an individual insurer's statewide market share using the numerator and the denominator set forth in subdivision (b)(1). Calculating the insurer's statewide market share is reasonably necessary to help determine how many new policies an insurer must commit to write in order to be presumed to have demonstrated a need to use catastrophe modeling in their ratemaking because their historic loss data may be less predictive for ratemaking purposes. It is reasonably necessary to provide a uniform equation so that all insurers that agree to increase writing new business or maintain existing business in higher-risk wildfire-prone areas in order to presumptively demonstrate a need to use catastrophe modeling in their ratemaking will be operating on a level playing field.

It is reasonably necessary to use thousandth place when calculating various ratios to account for certain insurers, including those that represent less than 0.5% of the insurance market. If rounding to the nearest hundredth, some of these insurers that currently write between $10 and $50 million in premium in distressed areas would be calculated to have 0% market share and thus would be unable to calculate an insurer commitment. Insurers writing less than $10 million

are considered low volume and thus exempt from an insurer commitment. Calculating certain ratios to the thousandth place, for example, would allow all insurers, regardless of size, to determine their commitment more accurately.

Section 2644.4.8, subdivision (b)(2) explains how the Department will estimate the combined number of earned exposures of qualified residential property insurance across all distressed areas in the state from either the voluntary market or the FAIR Plan that would represent the total estimated number of qualified residential property insurance policies available for all insurers to fulfill their commitment. The total number of statewide earned exposures for residential structures inside distressed areas is determined by combining the number of earned exposures in distressed areas written by admitted insurers with the number of earned exposures in distressed areas written by the FAIR Plan. Section 2644.4.8, subdivision (b)(2) furthers explains that the resulting sum will be used as a multiplication factor in a subsequent calculation to determine a residential insurer's commitment inside distressed areas of the state.

This calculation is reasonably necessary for the Department and all insurers to determine how many additional policies in distressed areas each insurer must write in order to be presumed to have demonstrated a need to consider the cost or benefits of reinsurance for ratemaking purposes. The inclusion of policies from both the voluntary market and the FAIR Plan as policies that the insurer may write to fulfill the insurer's commitment is intentional. The Commissioner has determined that the FAIR Plan is experiencing significant growth in these higher-risk, wildfire-prone areas that are experiencing admitted market insurance unavailability. Accordingly, if the regulations only allowed qualified residential property insurance policies from the voluntary market to fulfill the insurer commitment, it would not be optimized to capture all possible relevant risk exposures to determine whether an insurer's historic loss data is likely to be inaccurate for use in ratemaking. It is therefore reasonably necessary to include the number of qualified residential property insurance policies available from the FAIR Plan in order to accurately calculate the estimated total number of qualified residential property insurance policies available in distressed areas for all insurers that make insurer commitments.

Section 2644.4.8, subdivision (b)(2) also communicates that the calculation will be made based on the most recent experience-year dataset reporting and that there will be an initial evaluation period of said data ending on December 31, 2023.

The reason an initial evaluation period is used is to establish a baseline to measure insurer commitments and the cut-off year of 2023 is used is because it will be the most current information the Department will have to establish that baseline. The Department only collects data retroactively, and it is unreasonable and burdensome to require both the Department and insurers to produce real time or near-real time data. It is reasonably necessary for the Department to rely on data from the most recent experience year collected as that will most closely reflect the status of the insurance market; relying on older data poses a risk of setting requirements that substantially deviate from current market conditions and would fail to address the changing insurance market and consumer demands.

Section 2644.4.8, subdivision (b)(2) requires the Commissioner to publish a bulletin that includes the estimate of statewide distressed areas of qualified residential property insurance

policies so that participating insurers will know what that estimate is to calculate their insurer commitment. The Department's estimate will be used by insurers as a multiplication factor in the equations they must perform to determine their insurer commitments under section 2644.25.3(d)(1).

Section 2644.4.8, subdivision (b)(2) further requires the bulletin advising insurers of the Department's estimate of the statewide distressed areas earned exposures to be published no less frequently than one pear year to respond to potential changes in the estimated total number of statewide distressed areas qualified residential property insurance policies. The purpose of the updates is to ensure that the numbers keep abreast of market conditions within the admitted market. These market conditions are fluid and can change based on complex interactions between various environmental and human-based systems, and because of the cumulative impact from individual decisions by insurance companies offering qualified residential property insurance in California.

It is reasonably necessary for the Department to update the current statewide distressed areas earned exposures once updated data is collected and analyzed to monitor statewide changes in the distressed areas with respect to qualified residential property insurance. As it may take more than one year for noticeable changes to qualified residential property insurance policy numbers in distressed areas and additional time for the Department to collect the relevant data that reflects those changes, the Department is unlikely to be able to issue a bulletin with updated information at more frequently than once per year. Any more frequent notifications or updates would require the Department and insurers to undergo burdensome and unnecessary real time or near-real time data collection efforts. The publishing of the bulletin addresses the problem of how the Department will communicate to insurers the multiplication factor to be used for the insurer commitment calculations based on the statewide distressed areas qualified residential property insurance policy earned exposures. It is reasonably necessary to communicate this information by bulletin because a bulletin is a uniform, transparent, one-time, resource-conserving vehicle for the communication of this information. It would be burdensome and unnecessary to require the Department to communicate this individually to all insurers regardless of whether they intend to use catastrophe modeling for rate filing purposes and since contact information for individual insurers often frequently changes.

The number of earned exposure represents the number of structures insured by an insurer in proportion to the total amount of months they were insured over a 12-month period. The Department must establish a baseline to measure insurer commitments and the cut-off year of 2023 is used because it will be the most current information the Department will have to set that baseline by adding all the reported earned exposures from the relevant admitted insurers over the 12-month period.

> (c) An insurer shall, as part of a complete rate application filing made pursuant to section 2648.4, submit an insurer commitment as set forth in subdivision (d), (e) and/or (j) of this section.

The purpose of subdivision (c) is to explain that an insurer that wants to consider the cost or benefits of reinsurance for ratemaking purposes must submit an insurer commitment as part of a

complete rate application filing pursuant to section 2648.4 (the complete rate application regulation), and to specify that the commitment must be made as set forth in subdivisions (d), (e) and/or (j) of section 2644.25.3.

The insurer commitments shall be filed as part of a complete rate application because it is the insurer's commitment to increase risk in their future book of business. When insurers make a commitment, they presumptively demonstrate a need to consider the cost or benefits of reinsurance in order to calculate a rate that is commensurate with the associated increased risk of loss and costs, and request that rate in the application. Requiring insurers to submit their commitments separately from their complete rate applications would be less efficient for both the Department and insurers, and would likely result in confusion. It is reasonably necessary to request that insurers file any insurer commitments with the complete rate application that relies upon the calculation in subdivision (b) of section 2644.25.1 so that the insurer commitments are connected to, and documented within, the complete rate application that seeks to consider the cost or benefits of reinsurance.

Subdivision (c) addresses the current insurance crisis by allowing insurers that write new policies in wildfire-prone areas of the state to consider the cost or benefits of reinsurance in its ratemaking, which will in turn allow insurers to project rates more appropriate to the increased risks they commit to undertake, and thus help address the current insurance availability crisis.

(d) Insurer commitments with respect to qualifying residential property insurance.

The purpose of subdivision (d) is to establish the commitments an insurer must undertake with respect to qualifying residential property as opposed to commercial property insurance.

It is reasonably necessary to have different criteria and separate commitments for residential and commercial insurance because commercial insurance policies frequently insure multiple structures in separate locations of varying types and uses, unlike residential policies whose coverage, premiums, and other conditions are premised on a primary structure located in a single parcel that's used solely for habitational purposes. Furthermore, commercial insurance policies cover assets and losses that are not tied to habitational uses, such as manufacturing facilities and crop loss indemnity coverages. In addition, the Department collects different types of data and at different time frames and frequencies from commercial insurance carriers compared to residential insurance carriers. Thus, combining residential and commercial policies would distort the commitments for insurance companies that choose to specialize in any particular market segment or insurance product line.

The insurer shall commit in writing to achieving no later than two years (730 days) after the approval of its rate filing (the insurer's "performance date" hereinafter), or

maintaining, and then subsequently maintaining, the insurer's earned exposure commitment in the distressed areas of the state as follows:

The purpose of subdivision (d) is to identify that the insurer commits in writing to achieving or maintaining, and subsequently maintaining its commitment within two years of its rate filing.

Subdivision (d) identifies that an insurer shall make the commitment described in this subdivision in writing. It is reasonably necessary that the insurer make their commitment in writing to document the commitment and to enable the Department to examine insurer compliance.

Subdivision (d) also sets forth a two-year time frame in which an insurer must achieve its commitment. The identified time frame is reasonably necessary to address the problem of insurers not knowing how long they have to meet their commitments and also addresses the problem of providing a reasonable time frame for insurers to meet their commitments. It would be difficult for insurers to immediately increase their market share in distressed areas and this time frame provides for a managed and likely more durable increase in distressed areas for consumers.

Subdivision (d) recognizes that some insurers may have already reached the commitment standard and allows them to commit to maintaining their earned exposure commitment in the distressed areas of the state.

Subdivision (d) also makes clear that an insurer that makes a commitment in order to consider the cost or benefits of reinsurance in its ratemaking must continue to maintain that commitment in order to continue considering the cost or benefits of reinsurance in its ratemaking. It is reasonably necessary to require that an insurer maintain their commitment to writing in the distressed areas in order to achieve the goals of the Sustainable Insurance Strategy in a lasting and meaningful way. Reinsurance is the primary strategy many companies use to write and expand coverage in higher risk parts of California and across the country. As noted above, many companies evaluate their climate risks alongside their reinsurance contracts and as insured natural disaster losses have increased, companies must purchase more reinsurance in order to cover those losses. Because reinsurance is an expense incurred by insurance companies as a cost of writing property catastrophe risks, and the cost of purchasing adequate reinsurance has been increasing with the increase of natural disasters, it makes sense that in order to continue receiving the net cost of reinsurance in property insurance rates companies need to continue to maintain their writings. The two go hand-in-hand. Without a commitment to maintain the increased writings in the distressed areas, companies will simply receive the benefits of the net cost of reinsurance in their rates and the goal of encouraging carriers to re-enter and expand their business in the California property market will be lost. Without a commitment to maintain, we may even see a reversion to the availability crisis we are experiencing now.

It is reasonably necessary to specify that there are two different earned exposure commitments that may be made to prevent against potential insurer confusion or misinterpretation of what an insurer commitment must include.

(1) Eighty-five percent standard.

The purpose of subdivision (d)(1) is to establish one of two standards an insurer may choose as its commitment in order to be presumed to have demonstrated a need to consider the cost or benefits of reinsurance in its ratemaking.

It is reasonably necessary to specifically discuss each standard in order for insurers to understand what each requires and identify which standard applies to them, should they choose to make an insurer commitment to increase or maintain their earned exposures in distressed areas of the state.

(A) The insurer shall commit to write in distressed areas a number of policies that is no less than the product of (1) the insurer's statewide market share, as calculated pursuant to subdivision (b)(1) of section 2644.4.8, (2) 0.85, and (3) the total number of statewide distressed areas earned exposures pursuant to subdivision (b)(2) of section 2644.4.8; or

The purpose of subdivision (d)(1)(A) is to explain the requirement that if an insurer chooses the eighty-five percent (85%) standard then it commits to write in distressed areas of the state a number of policies equivalent to no less than 85% of that insurer's statewide market share. For example, if an insurer's statewide market share is 10%, then that insurer would need to commit to write 8.5% of the total number of statewide distressed areas earned exposures pursuant to section 2644.4.8, subdivision (b)(2) inside distressed areas. As discussed above, the total number of statewide earned exposures for residential structures inside distressed areas is determined in section 2644.4.8, subdivision (b)(2) by combining the number of earned exposures in distressed areas written by admitted insurers with the number of earned exposures in distressed areas written by the FAIR Plan). The number of earned exposures represents the number of structures insured by an insurer in proportion to the total amount of months they were insured over a 12-month period. If there were 1,000,000 such policies in distressed areas, then that insurer would need to write 85,000 policies in distressed areas, which could be met by combining their existing policies with new ones they write.

To determine the number of policies that equals their 85%, insurers must multiply their statewide market share (calculated as set forth in section 2644.4.8, subdivision (b)(1)) by 0.85 to determine the number that represents 85% of that market share. To calculate their insurer commitment in distressed areas, insurers must multiply the resulting product by the number of statewide earned exposures for residential structures inside distressed areas as published by the Department in accordance with section 2644.4.8, subdivision (b)(2). In other words, multiplying the figures represented in (1) x (2) x (3), as referenced in this subdivision, equals the minimum number of policies for residential structures an insurer would need to commit to write in distressed areas such that they represent 85% of that insurer's statewide market share.

Subdivision (d)(1)(A) is additionally intended to address the problem of inaccurate rate-setting in the face of increasing risks, because of climate change impacts and other previously discussed factors, for those insurers who commit to increasing their underwriting in higher-risk areas of the

state. Ultimately, this also addresses the issue of the lack of residential insurance availability in the distressed areas.

In setting the 85% standard, the Department looked at the most recent insurer data reported to the Department and determined that about 16% of statewide residential exposures were in distressed areas and about half of admitted insurers were already writing at least 85% of their statewide market share in distressed areas. Given that half of insurers already write 85% of their statewide market share of residential exposures in distressed areas, the Department determined that 85% was a reasonable standard for a substantial number of the other half to try to meet in order to be presumed to have demonstrated a need consider the cost or benefits of reinsurance in rate making, especially given that a significant number of insurers are currently at approximately 80%.

(B) In the event the insurer already meets or exceeds the eighty-five percent standard set forth above in subdivision (d)(1)(A) of this section at the time of its rate application, the insurer shall commit to maintaining at least the same number of earned exposures in the distressed areas as it reported in the rate application filing pursuant to subdivision (c) of this section.

The purpose of subdivision (d)(1)(B) is to make clear that an insurer that is already writing 85% of its market share in distressed areas, as set forth in subdivision (d)(1)(A), is committing to maintain that market share in the distressed areas.

Subdivision (d)(1)(B) allows insurers, whose distressed areas market share demonstrates greater risk exposure, to maintain the same market share without requiring them to write additional policies in order to consider the cost or benefits of reinsurance in ratemaking. This acknowledges the fact that these insurers are already carrying a significant market share in distressed areas, and that this market share subjects them to greater risk exposure. Insurers within this subdivision will commit to maintaining their current market share, which meets the 85% standard, and are presumed to have demonstrated a need to consider the cost or benefits of reinsurance for ratemaking purposes.

It is reasonably necessary to provide a mechanism to consider the cost or benefits of reinsurance in ratemaking for insurers that are committing to maintaining policies that are subject to greater risk exposure in distressed areas because it recognizes the existing financial burden on these insurers that are already writing a significant share of the qualified residential property insurance policies in distressed areas. The ability of rates to more accurately reflect the risk of writing in these distressed areas will allow the insurer a greater ability to set its rates more accurately and thus enable it to maintain the commitment to expanded writing in distressed areas, and/or taking out of the FAIR Plan more policies insuring properties impacted by heightened wildfire risk. Ultimately, these insurers will continue to maintain their number of policies despite the anticipated increase in the number of policies written in distressed areas due to increased competition and market penetration by other insurers. Overall, there will be more policies in

distressed areas as the total number of qualified residential property insurance policies in distressed areas would have increased overall.

(2) Five percent increment.

Subdivision (d)(2) establishes the second of two standards an insurer may choose as its commitment in order to be presumed to have demonstrated a need to consider the cost or benefits of reinsurance in its ratemaking. This standard recognizes that each insurer has a different makeup of written policies and therefore the standard for allowing the consideration of the cost or benefits of reinsurance in ratemaking in higher risk areas needs to be applicable to the different starting points of admitted insurers. For insurers that were significantly lower than the 85% standard, and for whom increasing to 85% would be burdensome or create financial considerations, it was reasonably necessary for the Department to provide an alternative standard.

> After the approval of its rate filing (the insurer's "performance date" hereinafter), the insurer may instead commit to writing additional policies as specified in subdivision (d)(3) in the voluntary market inside the distressed areas of the state such that, on the performance date, the insurer has increased its number of earned exposures inside the distressed areas by at least the number of policies equal to five percent (5%) of its earned exposures in the distressed areas of the state within the most recent 12 month period used in its recorded period as submitted in the insurer's rate application pursuant to subdivision (c) of this section. Upon meeting the initial five percent (5%) increment, the insurer shall commit in writing in each subsequent two year (730 days) period to writing additional policies as specified in subdivision (d)(3) in the voluntary market inside the distressed areas of the state such that it continues to increase its number of earned exposures inside the distressed areas by at least the number of policies equal to an additional five percent (5%) of the insurer's earned exposures in the distressed areas of the state until it meets or exceeds the eighty-five percent standard set forth above in subdivision (d)(1)(A) of this section.

The purpose of subdivision (d)(2) is to set a five percent (5%) increment standard that an insurer may commit to write in distressed areas. This subdivision explains that insurers that choose to make this commitment will have to continue to increase their market share by 5% until they meet the 85% standard.

For an insurer currently writing a lower percentage of their statewide market share in distressed areas, it could be overly burdensome and potentially create financial concerns to require them to increase their share by more than 5%. The Department anticipates that requiring an insurer to increase the amount of qualified residential property insurance policies they write in distressed areas by 5% is unlikely to substantially increase the probability of financial distress, but it would increase the cost of doing business in these distressed areas thus it is reasonable to consider the cost or benefits of reinsurance. Similar to above, this commitment provides expanded writings in distressed areas and/or taking out of the FAIR Plan more policies insuring properties impacted

by heightened wildfire risk. These actions will provide greater availability of policies in distressed areas, from a broader array of companies, which will ultimately promote greater stability in the insurance marketplace.

The requirement to continue the 5% growth after meeting the initial 5% increment, until the 85% standard is reached, is reasonably necessary because it recognizes that allowing the consideration of the cost or benefits of reinsurance in ratemaking allows insurers to more accurately price their policies, thus allowing for more sustainable growth in the distressed areas.

The Department provided a two-year time frame in which an insurer must achieve its subsequent 5% growth commitments to not only allow for symmetry in the initial commitment timeframe, but to also allow for managed, and likely more durable, increase in distressed areas for consumers. The two-year time frame is reasonably necessary to address the problem of insurers not knowing how long they have to meet their additional 5% growth commitments, and it is a reasonable time frame for insurers to meet their growth commitments in a sustainable and financial responsible way.

(3) In the event that one or more of the bulletins described in subdivision (a) of section 2644.4.8 that is or are referred to in an insurer's approved rate application pursuant to subdivision (c) of this section (the insurer's "starting bulletin or bulletins" hereinafter) have been updated since the time the application was filed, then the insurer may satisfy its insurer commitment according to the same procedures as subdivisions (d)(3)(A) and (d)(3)(B) of section 2644.4.8.

The purpose of subdivision (d)(3) is to clarify what bulletin an insurer can use to meet its commitment if the bulletin(s) described in section 2644.4.8, subdivision (a), that were in effect when the insurer made its rate filing, pursuant to subdivision (c) of section 2644.25.3, are updated before the insurer fulfills its commitment. This subdivision also cross-cites to section 2644.4.8(d)(3)(A) and (d)(3)(B).

It is reasonably necessary to clarify which bulletins may be used to avoid insurer confusion that may occur regarding whether they are expected to use their "starting bulletin," as described above, or subsequently published bulletins to fulfill their insurer commitment.

Subdivision (d)(3) clarifies that, in the event that one or more of the bulletins described in subdivision (a) of section 2644.4.8 that is or are referred to in an insurer's approved rate application pursuant to subdivision (c) of section 2644.25.3, that bulletin(s) will be referred to as the insurer's "starting bulletin or bulletins." It is reasonably necessary to provide a name for the bulletin(s) that is or are referred to in an insurer's approved rate application to differentiate between the starting bulletin or bulletins and subsequent bulletin(s). This provision also identifies that the subsequent subdivisions will elaborate on how an insurer may satisfy its insurer commitment in the effect that the bulletin(s) described in subdivision (a) of section 2644.4.8 is/are updated prior to the insurer fulfilling its insurer commitment. This language is reasonably necessary to clarify the different ways insurers may comply with the requirements related to fulfilling insurer commitments.

It is reasonably necessary for section 2644.25.3(d)(3) to cross-cite to section 2644.4.8(a) and 2644.4.8(d)(3)(A) and (d)(3)(B) because section 2644.25.3(d)(3) needs to apply the same requirements to a commitment that is made pursuant to section 2644.25.3 as the requirements that are applied to a commitment that is made by an admitted insurer that has demonstrated a need to use CAT modeling. As discussed above, it is a requirement that insurers use the same CAT model(s) for the Standard NCOR as for their modeled CAT adjustments because within an insurer's rate application, the use of the same CAT model(s) for the Standard NCOR and modeled CAT adjustments ensures consistency within the ratemaking formula, i.e., so that the loss cost and net reinsurance cost provisions are based on the same modeled estimates of CAT losses.

<u>For context, information regarding the cross-cited provisions of section 2644.4.8 is provided</u>:

Section 2644.4.8, subdivision (d)(3)(A) allows an insurer to fulfill its commitment to write policies in distressed areas by using the distressed areas identified in the insurer's starting bulletin or bulletins and/or in any subsequently updated bulletin during the time in which an insurer is fulfilling its insurer commitment. If this were not allowed, then an insurer would be limited to fulfilling its commitment based on the definition of distressed areas in effect at the time it made its commitment which could delay increased writings in newly distressed areas that are included in subsequently published bulletins. To protect against that delay, it is reasonably necessary to allow insurers to utilize distressed areas identified in the insurer's starting bulletin and/or in any subsequently updated bulletin.

Allowing an insurer to use any bulletin in effect while the insurer is fulfilling its commitment is reasonably necessary to meet changing market conditions. This rule broadens the number of policies that may be used to meet insurer commitments and broadens the number of consumers who may be helped by this section.

Section 2644.4.8, subdivision (d)(3)(B) addresses how insurers that already write 85% of their market share in distressed areas and commit to maintaining at least the same number of earned exposures in the distressed areas may utilize bulletins described in section 2644.4.8, subdivision (a) to fulfill their insurer commitment. This subdivision clarifies that those insurers may fulfill their commitment by using any bulletin(s) in effect during the time in which that insurer is fulfilling its insurer commitment. If this were not allowed, then an insurer would be limited to fulfilling its commitment based on the distressed areas identified in bulletin(s) in effect at the time it made its commitment. Such a rule would mean that an insurer could not fulfill its commitment based on areas subsequently defined as distressed and would prevent insurers from meeting their commitments by offering insurance coverage in newly identified distressed areas. This would mean that although an area was defined as distressed, the insurer could not use it to meet its commitment because that area was not defined as distressed at the time the insurer first made its commitment.

Allowing an insurer to use any bulletin in effect while the insurer is fulfilling its commitment is reasonably necessary to meet changing market conditions. This rule broadens the number of policies that may be used to meet insurer commitments

(4) The additional policies written in order to satisfy the requirement of subdivision (d) of this section shall include only the additional policies described in subdivision (d)(4) of section 2644.4.8.

The purpose of subdivision (d)(4) is to clarify which policies may be used to satisfy insurer commitments which eliminates any ambiguity regarding what types of policies insurers may write to fulfill commitments. Subdivision (d)(4) cross-cites to section 2644.4.8(d)(4) to maintain consistency in the description of eligible policies.

It is reasonably necessary to specify what types of policies insurers can count towards meeting their commitment to protect against insurers including policies that do not satisfy the requirements of subdivision (d) in their Wildfire Risk Portfolio Register.

It is reasonably necessary for section 2644.25.3(d)(4) to cross-cite to section 2644.4.8(d)(4) because section 2644.25.3(d)(4) needs to apply the same requirements to a commitment that is made pursuant to section 2644.25.3 as the requirements that are applied to a commitment that is made by an admitted insurer that has demonstrated a need to use CAT modeling. As discussed above, it is a requirement that insurers use the same CAT model(s) for the Standard NCOR as for their modeled CAT adjustments because within an insurer's rate application, the use of the same CAT model(s) for the Standard NCOR and modeled CAT adjustments ensures consistency within the ratemaking formula, i.e., so that the loss cost and net reinsurance cost provisions are based on the same modeled estimates of CAT losses.

For context, information regarding the cross-cited provisions of section 2644.4.8 is provided:

Section 2644.4.8, subdivision (d)(4)(A) clarifies that additional policies of qualifying residential property insurance insuring properties in distressed areas of the state are among the policies specified to meet the requirements subdivision (d). This subdivision further communicates, by the use of "and/or," that the subdivision (d)(4)(B) provides another category of policies that insurers may use to meet their commitments.

Section 2644.4.8, subdivision (d)(4)(B) clarifies that additional policies of qualifying residential property insurance insuring properties that the insurer has classified as moderate to very high wildfire risk and that immediately prior to the insurer's insuring them, on a date subsequent to the approval of its rate application described in subdivision (c), had been covered under the FAIR Plan, are among the policies specified to meet the requirements of subdivision (d). This subdivision also clarifies that even though other sections indicate that a commitment to write new policies must be fulfilled by writing policies in Undermarketed ZIP Codes and/or distressed counties, an insurer may also fulfill its insurer commitment by writing properties with moderate to very high wildfire risk that were insured in the FAIR Plan immediately prior to the insurer's insuring them as set forth in section 2644.4.8(d)(4)(B). This subdivision is reasonably necessary to make explicit that policies described in section 2644.4.8(d)(4)(B) qualify as policies that may be used to fulfill insurer commitments.

(e) Insurer commitments with respect to commercial property insurance shall be made in the same manner as subdivision (f) of section 2644.4.8. Upon meeting the initial five percent (5%), as described in subdivision (f)(2) of section 2644.4.8, the insurer shall commit in writing in each subsequent two year (730 days) period to writing additional policies such that it insures, and maintains, additional properties in eligible ZIP codes whose total insurable value is, in the aggregate, at least equal to five percent (5%) of the sum of the total insurable value of its insured properties in all the eligible ZIP codes, taken as a whole, until it has made a total of three (3) five percent (5%) commitments in order to consider the cost or benefits of reinsurance as permitted by subdivision (b) of section 2644.25.1.

The purpose of subdivision (e) is to make clear that commercial property insurance commitments are made in the same manner as described in section 2644.4.8, subdivision (f), and in order to consider the cost or benefits of reinsurance, a commercial insurer must commit to subsequently increase and maintain its commitments by 5% every two years until it has made a total of three commitments.

Subdivision (e) specifically references "commercial property insurance" to make clear that these commitments are different than those made for qualifying residential property insurance. It is reasonably necessary to have different criteria and separate commitments for residential and commercial insurance because commercial insurance policies frequently insure multiple structures in separate locations of varying types and uses, unlike residential policies whose coverage, premiums, and other conditions are premised on a primary structure located in a single parcel that's used solely for habitational purposes. Furthermore, commercial insurance policies cover assets and losses that are not tied to habitational uses, such as manufacturing facilities and crop loss indemnity coverages. In addition, the Department collects different types of data and at different time frames and frequencies from commercial insurance carriers compared to residential insurance carriers. Thus, combining residential and commercial policies would distort the commitments for insurance companies that choose to specialize in any particular market segment or insurance product line.

It is reasonably necessary for section 2644.25.3(e) to cross-cite to section 2644.4.8(f), to the extent it can, because section 2644.25.3(e) needs to apply the same requirements to a commitment that is made by a commercial property insurer, pursuant to section 2644.25.3, as the requirements that are applied to a commitment that is made by an admitted commercial property insurer that has demonstrated a need to use CAT modeling. As discussed above, it is a requirement that insurers use the same CAT model(s) for the Standard NCOR as for their modeled CAT adjustments because within an insurer's rate application, the use of the same CAT model(s) for the Standard NCOR and modeled CAT adjustments ensures consistency within the ratemaking formula, i.e., so that the loss cost and net reinsurance cost provisions are based on the same modeled estimates of CAT losses.

Subdivision (e), however, makes clear that the commitment made by a commercial property insurer in section 2644.4.8(f)(2) must be maintained in order to continue receiving the cost or benefits of reinsurance as permitted by subdivision (b) of section 2644.25.1. It is reasonably

necessary to require that an insurer maintain their commitment to writing in the distressed areas in order to achieve the goals of the Sustainable Insurance Strategy in a lasting and meaningful way. Reinsurance is the primary strategy many companies use to continue to write and expand coverage in higher risk parts of California and across the country. As noted above, many companies evaluate their climate risks alongside their reinsurance contracts and as insured natural disaster losses have increased, companies must purchase more reinsurance in order to cover those losses. Because reinsurance is an expense incurred by insurance companies as a cost of writing property catastrophe risks, and the cost of purchasing adequate reinsurance has been increasing with the increase of natural disasters, it makes sense that in order to continue receiving the net cost of reinsurance in property insurance rates companies need to continue to maintain their writings. The two go hand-in-hand. Without a commitment to maintain the increased writings in the distressed areas, companies will simply receive the benefits of the net cost of reinsurance in their rates and the goal of encouraging carriers to re-enter and expand their business in the California property market will be lost. Without a commitment to maintain, we may even see a reversion to the availability crisis we are experiencing now.

Additionally, the commercial commitment requires commercial insurers to make subsequent 5% commitments every two years until it has made a total of three commitments. It is reasonably necessary to require additional commitments to encourage insurers to continue expanding in areas of the state where wildfire hazard is high or very high. In order to achieve the goals of the Sustainable Insurance Strategy continued expansion is paramount in order to address the insurance availability issues the state is currently facing. Allowing for the consideration of the cost or benefits of reinsurance recognizes that an insurer that makes these additional commitments is increasing its overall risk exposure and will need to purchase more reinsurance, thus increasing their costs of writing business in the distressed areas.

For context, information regarding the cross-cited provisions of section 2644.4.8 is provided:

Section 2644.4.8, subdivision (f)(1) provides information on how the Commissioner will identify ZIP Codes where significant wildfire risk is reported to have impacted commercial insurance availability and how the Commissioner will communicate such ZIP Codes. It is reasonably necessary to specify how eligible ZIP Codes are identified to provide transparency regarding the wildfire risk-related criteria used by the Department to create the list.

It is reasonably necessary to link the eligible ZIP Codes for commercial commitments to fire hazard severity zones published by the Department of Forestry and Fire Protection (Cal Fire) because of the logical and data-driven link between high levels of wildfire risk and higher levels of insurance unavailability.

Cal Fire is the subject matter expert on statewide wildfire risk with the latest and best data on the most fire-prone severity zones and creates fire hazard maps that can be overlaid over ZIP Code boundaries. By overlaying Cal Fire's high to very high fire hazard severity zones with ZIP Code maps, the Department is able to link those ZIP Codes that contain high or very high wildfire risk. It is reasonably necessary to focus on ZIP Codes with the highest levels of fire hazard risk as it is

reasonable to correlate that the same underlying factor for higher risk exposures in the residential sector will also be a factor in the commercial sector.

Section 2644.4.8(f)(1) also communicates that the Commissioner will periodically issue subsequent bulletins to update the list of Undermarketed ZIP Codes as conditions warrant but no less frequently than once per year.

It is reasonably necessary for the Commissioner to publish an initial bulletin containing a list of eligible ZIP Codes so that insurers will know which ZIP Codes in which they can write additional policies to meet their insurer commitments. It is reasonably necessary for the Commissioner to update, to the extent that conditions warrant, by subsequent bulletins the identification of eligible ZIP Codes with specific regularity in order to respond to potential changes in the admitted market. The purpose of the updates is to ensure that the identified eligible ZIP Codes reflect high or very high fire hazard severity zones, as shown on the most current map published by Cal Fire.

Section 2644.4.8, subdivision (f)(2) identifies the insured exposure requirement for insurers who elect to make insurer commitments with respect to commercial property insurance. The provision specifies that such insurer commitment must be made in writing and that the insurer commitment may only be submitted as part of a rate application filing. It is reasonably necessary that the insurer make their commitment in writing to document the commitment and to enable the Department to examine insurer compliance. It is also reasonably necessary to identify how an insurer can submit an insurer commitment to the Department.

Subdivision (f)(2) also specifies what the insurer is committing to achieve, in this case a five percent (5%) increment of its total insurable value in eligible ZIP codes as of the end of the most recent 12-month period used in its recorded period. It is reasonably necessary to clarify this information as it differs from insurer commitments made with respect to qualified residential property insurance.

The Department selected total insurable value (TIV) as a reasonable proxy for both increasing the number of policies and coverage provided by commercial policies. Increases in overall coverage amounts may increase an insurer's overall risk exposure, especially with respect to the limits imposed by FAIR Plan policies, by providing higher levels of coverage under existing policies; an insurer could also meet their new higher TIV target by writing and covering new commercial structures or assets. It is reasonably necessary to allow an insurer that is increasing its overall risk exposure to consider the cost or benefits of reinsurance for ratemaking purposes because they will need to purchase more reinsurance and their costs for increased writing in the distressed areas will increase.

Section 2644.4.8, subdivision (f)(2) also sets forth a two-year time frame in which an insurer must achieve its commitment. The identified time frame is reasonably necessary to address the problem of insurers not knowing how long they have to meet their commitments and also addresses the problem of providing a reasonable time frame for insurers to meet their commitments. It would be difficult for insurers to immediately increase their market share in

distressed areas and this time frame provides for a managed and likely more durable increase in distressed areas for consumers.

Section 2644.4.8, subdivision (f)(3) clarifies what bulletin an insurer can use to meet its commitment if the bulletin(s) that were referred to in an insurer's approved rate application are updated before the insurer fulfills its commitment. It is reasonably necessary to clarify which bulletins may be used to avoid insurer confusion that may occur regarding whether they are expected to use their "initial bulletin," as described above, or subsequently published bulletins to fulfill their insurer commitment.

Section 2644.4.8, subdivision (f)(3) clarifies that, in the event that one or more of the bulletins described in section 2644.4.8(f)(1) that is or are referred to in an insurer's approved rate application, that bulletin(s) will be referred to as the insurer's "initial bulletin." It is reasonably necessary to provide a name for the bulletin(s) that is or are referred to in an insurer's approved rate application to differentiate between the initial bulletin or bulletins and subsequent bulletin(s). This subdivision allows an insurer to fulfill its commitment to write policies in eligible ZIP Codes by using the eligible ZIP Codes identified in the insurer's initial bulletin or bulletins and/or in any subsequently updated bulletin during the time in which an insurer is fulfilling its insurer commitment. If this were not allowed, then an insurer would be limited to fulfilling its commitment based on the definition of eligible ZIP Codes in effect at the time it made its commitment which could delay increased writings in newly distresses areas that are included in subsequently published bulletins. To protect against that delay, it is reasonably necessary to allow insurers to utilize eligible ZIP Codes identified the insurer's starting bulletin and/or in any subsequently updated bulletin.

Allowing an insurer to use any bulletin in effect while the insurer is fulfilling its commitment is reasonably necessary to meet changing market conditions. This rule broadens the number of policies that may be used to meet insurer commitments and broadens the number of consumers who may be helped by this section.

Section 2644.4.8, subdivision (f)(4) identifies what an insurer must do if it is unable to meet the requirement described in section 2644.4.8(f)(2).

> (f) An insurer shall document the fulfilment and maintenance of its insurer commitment as described in subdivision (g) of section 2644.4.8, with the exception of the application of the subdivision (g)(3)(C).

The purpose of subdivision (f) is to identify that an insurer must document the fulfillment of its commitment, and it must do so in the same way that is required in section 2644.4.8(g), with the exception of 2644.4.8(g)(3)(C).

If the Department does not include this section in the proposed regulation text, it may not be clear to insurers, and other interested parties, that the Department requires an insurer to keep track of various data points as it progresses towards fulfilling its commitment, that such

information should be tracked in a specific format, and that documentation should occur at a particular frequency. If the Department does not specify what an insurer that files a rate application pursuant to subdivision (c) of section 2644.25.3 shall do to document the fulfillment of its commitment, the Department would not be able to measure insurer compliance in a consistent and uniform manner. It is reasonably necessary to identify how a compliant insurer documents the fulfillment of its commitment in order to clarify and specify what an insurer is expected to do in advance of their compliance being examined. It is reasonably necessary to include this subdivision to allow the insurer the opportunity to (1) identify any confusion or concern regarding the actions the Departments requires the insurer to take, and (2) offer alternatives regarding other way the Department might require insurers to document the fulfillment of its insurer commitment.

It is reasonably necessary for section 2644.25.3(f) to cross-cite to the documentation requirements in section 2644.4.8(g), to the extent it can, because section 2644.25.3(f) needs to apply the same requirements to a commitment that is made pursuant to section 2644.25.3 as the requirements that are applied to a commitment that is made by an admitted insurer that has demonstrated a need to use CAT modeling. As discussed above, it is a requirement that insurers use the same CAT model(s) for the Standard NCOR as for their modeled CAT adjustments because within an insurer's rate application, the use of the same CAT model(s) for the Standard NCOR and modeled CAT adjustments ensures consistency within the ratemaking formula, i.e., so that the loss cost and net reinsurance cost provisions are based on the same modeled estimates of CAT losses.

The exception of the application of 2644.4.8(g)(3)(C) is reasonably necessary because this part of section 2644.4.8 provides the time limits that insurers must maintain their commitments for purposes of using catastrophe modeling. Insurers that make commitments to consider the cost or benefits of reinsurance in ratemaking are required to maintain their commitments to writing in the distressed areas, as is clear in subdivisions (d) and (e). It is reasonably necessary to require that an insurer maintain its commitment to writing in the distressed areas in order to achieve the goals of the Sustainable Insurance Strategy in a lasting and meaningful way. Reinsurance is the primary strategy many companies use to continue to write and expand coverage in higher risk parts of California and across the country. As noted above, many companies evaluate their climate risks alongside their reinsurance contracts and as insured natural disaster losses have increased, companies must purchase more reinsurance in order to cover those losses. Because reinsurance is an expense incurred by insurance companies as a cost of writing property catastrophe risks, and the cost of purchasing adequate reinsurance has been increasing with the increase of natural disasters, it makes sense that in order to continue receiving the net cost of reinsurance in property insurance rates companies need to continue to maintain their writings. The two go hand-in-hand. Without a commitment to maintain the increased writings in the distressed areas, companies will simply receive the benefits of the net cost of reinsurance in their rates and the goal of encouraging carriers to re-enter and expand their business in the California property market will be lost. Without a commitment to maintain, we may even see a reversion to the availability crisis we are experiencing now.

For context, information regarding the cross-cited provisions of section 2644.4.8 is provided:

Section 2644.4.8, subdivision (g) identifies that the insurer is responsible for creating and maintaining a "wildfire risk portfolio." The purpose of this language is to make clear that the onus is on the insurer to create and maintain this document. This language identifies how the Department will refer to the document insurers will use to memorialize the fulfillment of their commitments. This paragraph also specifies that an insurer must add an insured property to that insurer's wildfire risk portfolio once certain information is documented by the insurer. The requirement to add the insured property to the wildfire risk portfolio is triggered by the insurer's documentation of the insured property's location (address) and, if applicable, prior FAIR Plan coverage status.

By placing the responsibility for creating the document on the insurer, the Department avoids being overly prescriptive in how the insurer must document its records and allows the insurer to create a tracking system that documents the information the Department needs to examine insurer compliance in a way that works for that particular insurer. Allowing insurers this flexibility will avoid unnecessarily increasing insurer expenses which can potentially negatively impact consumers through increased premiums. Requiring that an insured property be added to the insurer's wildfire risk portfolio once certain information is known clarifies how frequently the wildfire risk portfolio must be updated. Specifying that the requirement to update the wildfire risk portfolio is triggered by the document of by the insurer's documentation of the insured property's location (address) and, if applicable, prior FAIR Plan coverage status avoids potential confusion regarding when an insured property must be added to an insurer's wildfire risk portfolio. Specifying when the wildfire risk portfolio must be updated ensures that the insurer will maintain its records in a timely manner.

It is reasonably necessary to identify the insurer is required to create and maintain their wildfire risk portfolio, and to provide that generic name for the required tracking document, to communicate to the insurer that the Department is not responsible for providing the document; nor will it keep track or calculate the insurer's fulfillment of the insurer's commitment for them. It is reasonably necessary to name the document so that every insurer who files a rate application pursuant to subdivision (c) of section 2644.25.3 will understand what the Department means when that name is used in reference to the fulfillment of the insurer's commitment. It is reasonably necessary to specify when an insurer must update its wildfire risk portfolio to ensure that insurers are maintaining their records in a timely manner. Timely maintenance of the wildfire risk portfolio will allow insurers to closely monitor whether they are making reasonable progress in fulfilling their commitment. Such timely maintenance will also ensure that insurers are able to respond to the Department in a reasonably short amount of time, should the Department have need to request information regarding the insurer's progress towards fulfilling its commitment.

Section 2644.4.8, subdivision (g)(1) identifies that distinctions exist between how an insurer must document the fulfillment of a commitment made with respect to qualifying residential property insurance versus how an insurer must document the fulfillment of a commitment made with respect to commercial property insurance. This subdivision also serves to identify that

insurers should refer to this area of the text for direction on how to document the fulfillment of any commitment it makes with respect to qualifying residential property insurance.

Because insurers may make commitments with respect to qualifying residential property insurance or with respect to commercial property insurance, or potentially with respect to both, this subdivision avoids any potential confusion regarding how an insurer must document the fulfillment of any commitment it makes in filing a rate application pursuant to subdivision (c) of section 2644.25.3.

It is reasonably necessary to identify that requirements regarding how to document the fulfillment of any insurer commitment vary depending on whether the commitment is made with respect to qualifying residential property insurance or with respect to commercial property insurance to ensure that insurers are properly documenting the fulfillment of any commitment it makes in filing a rate application pursuant to subdivision (c) of section 2644.25.3. It is reasonably necessary to communicate what the Department requires in advance of when the required action will take place so that the insurer is prepared and ready to take appropriate and compliant action in documenting the fulfillment of its insurer commitment. It is reasonably necessary to specify what information an insurer must document in order for the insurer to track and measure its progress towards fulfillment. It is reasonably necessary to require an insurer to track specific information in order for the Department to measure whether the insurer is successful in fulfilling its insurer commitment.

Section 2644.4.8, subdivision (g)(1)(A) clarifies that section 2644.4.8, subdivision (g)(3) also applies to the documentation of the fulfillment of insurer commitments made with respect to qualifying residential property insurance. This subdivision clarifies that the wildfire risk portfolio is a document that the insurer is responsible for creating and maintaining. Subdivision (g)(1)(A) also specifies what the insurer is required to do when documenting the fulfillment of an insurer commitment made with respect to qualifying residential property insurance, including what information must be documented in the insurer's wildfire risk portfolio.

Section 2644.4.8, subdivision (g)(1)(A) intends to address potential insurer confusion and potentially insufficient or inconsistent documentation of an insurer's fulfillment of its insurer commitment. Because subdivision (g)(1) is specific to insurer commitments made with qualifying residential property insurance, insurers that have made such commitments could potentially think they must only comply with subdivision (g)(1), so clarifying that indeed they must also comply with subdivision (g)(3), which applies to commitments made with respect to both qualifying residential property insurance and commercial property insurance, avoids any misunderstanding of what the Department requires of insurers. If the Department does not include subdivision (g)(1)(A), insurers may not document the fulfillment of their insurer commitments consistently which would make examining insurance compliance challenging, or potentially impossible, for the Department.

It is reasonably necessary to specify that insurers that have made commitments with respect to qualifying residential property insurance must also comply with subdivision (g)(3), in addition to subdivision (g)(1), so that insurers are clear on how they must document the fulfillment of their insurer commitment. It is reasonably necessary to identify that the insurer is required to create

and maintain their wildfire risk portfolio to communicate to the insurer that the Department is not responsible for providing the document, nor will it keep track or calculate the insurer's fulfillment of the insurer's commitment for them. It is reasonably necessary to require insurers to record the date the property was added to the portfolio to document that the insurer is adding the property to the wildfire risk portfolio as required by subdivision (g). It is reasonably necessary to require insurers to record the address of the property, including the ZIP Code, in order to document that the insured property is located within a distressed area as discussed in section 2644.4.8, subdivision (a)(1). It is reasonably necessary to require insurers to record the county in which the property is situated, if the property is being added to the portfolio solely on the basis that it lies within a distressed county but not any Undermarketed ZIP Code, in order to document that the insured property is located within a distressed area as discussed in section 2644.4.8, subdivision (a)(2). It is reasonably necessary to require insurers to record the inception date of the policy in order to document that the insurer began insuring that policy after the rate filing made pursuant to subdivision (c) of section 2644.25.3 was approved. It is reasonably necessary to require insurers to record the termination date of the policy, if the policy has terminated, to document that the insurer continued to write the qualifying residential property insurance through the end of the policy term.

Section 2644.4.8, subdivision (g)(1)(B) specifies what information may be used by insurers to document properties insured by FAIR Plan policies that are to be insured by an insurer to fulfill its insurer commitment, as discussed in section 2644.4.8, subdivision (a)(2). This subdivision clarifies that, on or after the effective date of this section, a property must be insured by the FAIR Plan immediately preceding an insurer issuing a policy to ensure that property for that property to be counted as a property described in subdivision (a)(2). This subdivision clarifies that the insurer must document and retain one or both of the items described in the next two provisions. This subdivision specifies that insurers may not add qualifying properties to its wildfire risk portfolio until after this section is effective.

The goal of this subdivision is to avoid insurers potentially documenting what properties may be counted as the properties discussed in section 2644.4.8, subdivision (a)(2) incorrectly, and the potential inconsistent or incorrect inclusion of properties insured by the FAIR Plan in insurers' wildfire risk portfolio. By specifying "immediately prior," this subdivision provides clarity and prevents insurer confusion regarding when a property's prior FAIR Plan coverage is relevant towards fulfilling the insurer's commitment. The subdivision also provides clarity and consistency by specifying how insurers may document prior FAIR Plan coverage. Insurer confusion is avoided by specifying that insurers may not add qualifying properties to their wildfire risk portfolio until after this section is effective. The subdivision also specifies how an insurer demonstrates that it appropriately identified and documented the prior FAIR Plan coverage of an insured policy by requiring that the insurer retain the information the insurer used to make its determination of the prior FAIR Plan coverage.

It is reasonably necessary to clarify how to document that a property insured by the insurer in an effort to fulfill its insurer commitment meets the requirements discussed in section 2644.4.8, subdivision (a)(2). It is reasonably necessary to specify when a property's prior FAIR Plan coverage is relevant to ensure that insurers are targeting the intended properties when issuing policies in an effort to fulfill their insurer commitment. It is reasonably necessary to require that

a policy be insured by the FAIR plan immediately prior to the issuance of a policy insuring that property by the insurer seeking to add that property to its portfolio in order to ensure rating accuracy. It is reasonably necessary to specify what information may be used to document prior FAIR Plan coverage so that an insurer understands how the Department will be measuring compliant documentation of the fulfillment of an insurer's commitment. Because the Department will expect to be able to review the documentation the insurer used to determine that the FAIR Plan insured the property in question immediately prior to the inception a property insurance policy issued by the insurer seeking to add the property to its portfolio, it is reasonably necessary to state that the insurer must keep that documentation on file.

Section 2644.4.8, subdivision (g)(1)(B)1. specifies one of the forms of documentation that insurers may use to verify and document that a property was insured by the FAIR Plan immediately preceding the insurer issuing a policy for that property. By permitting insurers to verify that immediately preceding prior FAIR Plan coverage, the Department avoids placing the burden producing required documentation solely on insurers or insureds. It is reasonably necessary to include carrier discovery reports as one method through which insurers may verify and document the immediately preceding prior FAIR Plan as this report is an objective, accurate way to document the insurance history of a property and it is a report that insurers already regularly produce in the course of the underwriting process. It is reasonably necessary to include carrier discovery reports as one method through which insurers may verify and document the immediately preceding prior FAIR Plan coverage because it offers a verification mechanism that allows insurers to complete the verification and that does not place the burden of documentation entirely on the consumer.

Section 2644.4.8, subdivision (g)(1)(B)2. identifies additional ways in which insurers may verify and document that a property was insured by the FAIR Plan immediately prior to the insurer issuing a policy for that property. By permitting multiple additional methods through which insurers can verify that prior FAIR Plan coverage, the Department avoids placing the burden of producing required documentation solely on insurers or insureds. Allowing these additional methods allows insurers a reasonable measure of flexibility to determine which verification method is most efficient. It is reasonably necessary to include these additional methods because they are documents that are readily available and include the information necessary to verify compliant FAIR Plan coverage. It is reasonably necessary to include multiple documentation options that can satisfactorily verify timely FAIR Plan coverage to provide insurers with reasonable compliance options.

Section 2644.4.8, subdivision (g)(2) sets forth additional requirements for documenting commercial commitments. It is reasonably necessary to require insurers making a commercial insurer commitment to retain in a Register the information necessary for the Department to ascertain whether the insurer has fulfilled its commitment.

Section 2644.4.8, subdivision (g)(2) identifies that distinctions exist between how an insurer must document the fulfillment of a commitment made with respect to commercial property insurance versus how an insurer must document the fulfillment of a commitment made with respect to qualifying residential property insurance. This subdivision identifies that insurers should refer to this area of the text for direction on how to document the fulfillment of any

commitment it makes with respect to commercial property insurance. This subdivision specifies that insurers may not add qualifying properties to its wildfire risk portfolio until after this section is effective. Section 2644.4.8, subdivision (g)(2) clarifies that section 2644.4.8, subdivision (g)(3) also applies to the documentation of the fulfillment of insurer commitments made with respect to commercial property insurance. This subdivision clarifies that the wildfire risk portfolio is a document that the insurer is responsible for creating and maintaining.

Because insurers may make commitments with respect to qualified residential property insurance or with respect to commercial property insurance, or potentially with respect to both, this subdivision avoids any potential confusion regarding how an insurer must document the fulfillment of any commitment it makes in filing a rate application pursuant to subdivision (c) of section 2644.25.3. This subdivision intends to address potential insurer confusion and potentially insufficient or inconsistent documentation of an insurer's fulfillment of its insurer commitment.

Because section 2644.4.8, subdivision (g)(2) is specific to insurer commitments made regarding commercial property insurance, insurers that have made such commitments could potentially think they must only comply with section 2644.4.8, subdivision (g)(2), so it is reasonably necessary to clarify that they must also comply with section 2644.4.8, subdivision (g)(3), which applies to commitments made with respect to both qualifying residential property insurance and commercial property insurance, and avoids any misunderstanding of what the Department requires of insurers. If the Department does not include section 2644.4.8, subdivision (g)(2), insurers may not document the fulfillment of their insurer commitments consistently which would make examining insurance compliance challenging, or potentially impossible, for the Department.

It is reasonably necessary to identify that requirements regarding how to document the fulfillment of any insurer commitment vary depending on whether the commitment is made with respect to commercial property insurance or with respect to qualifying residential property insurance to ensure that insurers are properly documenting the fulfillment of any commitment they make in filing a rate application pursuant to subdivision (c) of section 2644.25.3. It is reasonably necessary to communicate what the Department requires in advance of when the required action will take place so that the insurer is prepared and ready to take appropriate and compliant action in documenting the fulfillment of its insurer commitment. It is reasonably necessary to specify what information an insurer must document in order for the insurer to track and measure its progress towards fulfillment. It is reasonably necessary to require an insurer to track specific information in order for the Department to measure whether the insurer is successful in fulfilling its insurer commitment.

It is reasonably necessary to identify the insurer is required to create and maintain their wildfire risk portfolio to communicate to the insurer that the Department is not responsible for providing the document, nor will it keep track or calculate the insurer's fulfillment of the insurer's commitment for them. It is reasonably necessary to require insurers to record the date the property was added to the portfolio to document that the insurer is adding the property to the wildfire risk portfolio as required by section 2644.4.8, subdivision (g). It is reasonably necessary to require insurers to record the address of the property, including the ZIP Code, in order to

document that the insured property is located within a distressed area as discussed in section 2644.4.8, subdivision (a)(1).

It is also reasonably necessary to require insurers to record the inception date of the policy in order to document that the insurer began insuring that policy after the rate filing made pursuant to subdivision (c) of section 2644.25.3 was approved. It is reasonably necessary to require insurers to record the total number of exposures insured under each policy because, since there could be multiple buildings insured under a single policy, the insurer must identify how many properties are on the policy, as well as properties' total insurable value in order to document the extent to which writing the policy advances the insurers fulfillment of the insurer commitment described in section 2644.4.8, subdivision (f)(2). It is reasonably necessary to require insurers to record the termination date of the policy, if the policy has terminated, to document that the insurer continued to write the qualifying residential property insurance through the end of the policy term.

Section 2644.4.8, subdivision (g)(3) sets forth the requirements for a Wildfire Risk Portfolio register that are common to both residential and commercial insurers.

Section 2644.4.8, subdivision (g)(3) identifies documentation requirements that apply to both commitments made with respect to qualifying residential property insurance as well as commitments made with respect to commercial property insurance.

This subdivision avoids any potential confusion regarding how an insurer must document the fulfillment of any commitment it makes in filing a rate application pursuant to subdivision (c) of section 2644.25.3 by specifying the documentation requirements that apply regardless of whether the insurer commitment is made with respect to qualifying residential property insurance or commercial insurance.

It is reasonably necessary to identify the documentation requirements that apply to the fulfillment of any insurer commitment, regardless of whether the commitment is made with respect to qualifying residential property insurance or with respect to commercial property insurance, to ensure that insurers are properly documenting the fulfillment of any commitment they make in filing a rate application pursuant to subdivision (c) of section 2644.25.3. It is reasonably necessary to communicate what the Department requires in advance of when the required action will take place so that the insurer is prepared and ready to take appropriate and compliant action in documenting the fulfillment of its insurer commitment.

Section 2644.4.8, subdivision (g)(3)(A) identifies that the Wildfire Risk Portfolio Register must be a digital file in which all required documentation data points can be sorted.

Identifying that the Department requires the digital file to allow data sorting ensures that insurers will format the Wildfire Risk Portfolio Register in a way that allows the Department to examine and review their documentation but allows some flexibility so that insurers may create and maintain the wildfire risk portfolio in the manner that is most efficient and complementary to their existing computer systems.

It is reasonably necessary to require that the Wildfire Risk Portfolio Register be a sortable digital file to allow the Department to examine insurer records and measure insurer performance and compliance effectively and efficiently.

Section 2644.4.8, subdivision (g)(3)(B) identifies that insurers must maintain certain supporting documentation, and specifies the manner in which that documentation must be stored following the approval of an insurer's rate application renouncing the insurer's insurer commitment. Section 2644.4.8, subdivision (g)(3)(B) addresses the potential problem of insurers not retaining all of the information and documentation necessary for the Department to review and measure their compliance with this section. It is reasonably necessary to identify that insurers must maintain specific documentation in connection to their Wildfire Risk Portfolio Register in order to clarify and specify what an insurer is expected to do in advance of their compliance being examined.

(g) A modification of an insurer commitment shall be governed as described in subdivision (h)(1) of section 2644.4.8.

The purpose of subdivision (g) is to identify that this subdivision specifies how an insurer may modify an insurer commitment, and cross-cites to section 2644.4.8(h)(1).

It is reasonably necessary for section 2644.25.3(g) to cross-cite to the modification requirements in section 2644.4.8(h)(1) because section 2644.25.3(g) needs to apply the same requirements to a commitment that is made pursuant to section 2644.25.3 as the requirements that are applied to a commitment that is made by an admitted insurer that has demonstrated a need to use CAT modeling. As discussed above, it is a requirement that insurers use the same CAT model(s) for the Standard NCOR as for their modeled CAT adjustments because within an insurer's rate application, the use of the same CAT model(s) for the Standard NCOR and modeled CAT adjustments ensures consistency within the ratemaking formula, i.e., so that the loss cost and net reinsurance cost provisions are based on the same modeled estimates of CAT losses.

For context, information regarding the cross-cited provisions of section 2644.4.8 is provided:

Section 2644.4.8, subdivision (h)(1) identifies that is reasonably necessary to clarify the circumstances under which modification may be made in order to communicate how an insurer may take appropriate action. As a result of volatility in the property insurance market, an insurer may experience a significant decline in market share which renders it original commitments overly burdensome. It is reasonably necessary to allow for a recalculation of commitments in this circumstance to enable insurers to enter an insurer commitment that is based on the insurer's current market share.

Section 2644.4.8, subdivision (h)(1)(A) specifies how a residential insurer that has lost 5% or more of its market share, as calculated pursuant to section 2644.4.8, subdivision (b)(1) may modify an insurer commitment. It is reasonably necessary to allow an insurer to modify its insurer commitment in the event it has lost at least 5% of its market share, as calculated pursuant

to 2644.4.8(b)(1) of this section, as the quotient that resulted from that calculation would no longer be accurate or valid.

Section 2644.4.8, subdivision (h)(1)(B) specifies how a residential insurer whose performance met or exceeded the applicable standard or requirement at the time of an initial rate application filing may modify its commitment. It is reasonably necessary to specify that an insurer modify its commitment to reflect the diminution of the insurer's statement market share but that modification may not reduce further than the eighty-five percent standard set forth in subdivision (d)(1)(B) of this section so that an insurer described by section 2644.4.8, subdivision (h)(1)(B) is aware of how it may comply with this section.

Section 2644.4.8, subdivision (h)(1)(C) describes how insurer commitments made with respect to commercial property insurance may be modified. The purpose of this subdivision is to identify that a commercial insurer may reduce its commitment by no more than the decline in its total insurable value reported in the original rate application filing if that insurer is unable to timely meet the requirement in section 2644.4.8, subdivision (f)(2) and seeks to modify its insurer commitment. This provision is reasonably necessary because, without such a provision, insurers may be unable or unwilling to make commitments due to uncertainty regarding whether they can fulfill their commitments if adverse market conditions cause the insurer to lose market share.

(h) If at any time an insurer fails to fulfill its insurer commitment, or within a period of two years after the approval of its original application, or at any point thereafter, fails to make reasonable progress toward timely fulfilling its insurer commitment, then the insurer shall immediately submit a new rate application renouncing its insurer commitment as described in subdivision (d) or (e) of this section. In this case, the new rate application shall not consider the costs or benefits of reinsurance as permitted by subdivision (b) of section 2644.25.1.

The purpose of subdivision (h) is to identify what action an insurer should take if that insurer fails to make reasonable progress toward timely fulfilling its insurer commitment.

Subdivision (h) makes clear that if an insurer fails to make reasonable progress toward timely fulfilling its insurer commitment then it must submit a new rate application that renounces its insurer commitment as described in subdivision (d) or (e) of this section. When the new rate application is submitted the insurer shall not consider the cost or benefits of reinsurance as permitted by section 2644.25.1(b). This subdivision is reasonably necessary to address the problem of an insurer not knowing what actions to take if it fails to meet its commitment as described in subdivision (d) or (e) of this section.

(i) An insurer that obtained approval to consider the cost or benefits of reinsurance in its original application shall file one of the attestations described in subdivision (i)(1) and (2) of section 2644.4.8 in every subsequent rate application.

The purpose of subdivision (i) is to make clear that insurers that are considering the cost or benefits of reinsurance need to make specific attestations, and it cross-references to section 2644.4.8.

Subdivision (i) identifies that all insurers that obtain approval to consider the cost or benefits of reinsurance are required to file an attestation in every rate application it subsequently files. This subdivision identifies that there are multiple types of attestation that an insurer may potentially file, and that the various types of required attestations are described in section 2644.4.8, subdivision (i)(1) and (2). It is reasonably necessary to clarify that there are different ways in which insurers may comply with this section and the onus is on the insurer to review the specified types of insurer attestations described in subsequent provisions and file the insurer attestation that accurately describes the status of that insurer's fulfillment of its commitment. This addresses the problem of the insurer making a subsequent rate filing without advising the Commissioner that it is taking reasonable steps to fulfill its insurer commitments or that it has, in fact, fulfilled its insurer commitments.

The requirement that an insurer make ongoing attestations makes clear that this requirement continues as long as an insurer considers the cost or benefits of reinsurance in its rates. It is reasonably necessary to require an insurer to file an attestation in each rate filing an insurer makes so that the Commissioner knows if the insurer has made progress towards fulfilling, or has fulfilled, its insurer commitment to write more policies in the distressed areas and/or more policies formerly written by the FAIR Plan, in order to presumptively demonstrate a need to consider the cost or benefits of reinsurance for ratemaking purposes.

It is reasonably necessary for section 2644.25.3(i) to cross-cite to the attestations in section 2644.4.8(i)(1) and (2) because section 2644.25.3(i) needs to apply the same requirements to a commitment that is made pursuant to section 2644.25.3 as the requirements that are applied to a commitment that is made by an admitted insurer that has demonstrated a need to use CAT modeling. As discussed above, it is a requirement that insurers use the same CAT model(s) for the Standard NCOR as for their modeled CAT adjustments because within an insurer's rate application, the use of the same CAT model(s) for the Standard NCOR and modeled CAT adjustments ensures consistency within the ratemaking formula, i.e., so that the loss cost and net reinsurance cost provisions are based on the same modeled estimates of CAT losses.

<u>For context, information regarding the cross-cited provisions of section 2644.4.8 is provided</u>:

Section 2644.4.8, subdivision (i)(1) describes that an insurer that has fulfilled, or is taking reasonable steps to fulfill, its insurer commitment must so attest. The attestation addresses the problem of an insurer making a commitment to write more policies in order to presumptively demonstrate a need to consider the cost or benefit of reinsurance in ratemaking and then failing to notify the Commissioner that it has fulfilled or is taking reasonable steps to fulfill its insurer commitment. It is reasonably necessary for an insurer to make an attestation regarding its insurer commitments so that the Commissioner is kept informed of the status of insurer commitments.

Section 2644.4.8, subdivision (i)(2) requires an insurer to attest that any rate filing in which an insurer modifies its original commitment has been approved and clarifies that an insurer must file

an attestation even if it has modified its original insurer commitment. This section further clarifies that the attestation for a modified commitment is otherwise the same as an attestation for an original commitment – the insurer must attest that it has fulfilled or, is taking reasonable steps to fulfill, its modified insurer commitment. This section further clarifies that if an insurer modifies its original commitment, its attestation need only address its modified commitment. It is reasonably necessary for an insurer to make an attestation regarding any modified insurer commitments so that the Commissioner is kept informed of the status of modified insurer commitments and can monitor whether new policies are being written, as promised, in the distressed areas and for certain properties formerly in the FAIR Plan, in order for the insurer to presumptively demonstrate a need to consider the cost or benefit of reinsurance for ratemaking purposes.

(j) Any contrary provision of this section notwithstanding, if for any of the reasons stated in subdivision (j)(1) of section 2644.4.8, an insurer is unable, in good faith, to make a commitment as set forth in subdivisions (d) or (e) of this section, then an insurer may propose an alternative commitment in a complete rate application filing made pursuant to subdivision (c) of this section, as described in subdivision (j)(2) of section 2644.4.8.

The purpose of subdivision (j) is to provide flexibility to allow insurers to propose, and the Department to review, alternative commitments for insurers who have unique circumstances that make the insurer commitments set forth in subdivision (d) or (e) impractical. This section cross-cites to section 2644.4.8(j)(1) and (2).

One of the main goals of the Sustainable Insurance Strategy is to increase the availability of insurance in the distressed areas, therefore, it is reasonably necessary to allow for an alternative commitment to address the problem of insurers that would like to make a commitment to write more policies for properties previously covered by the FAIR Plan and write more policies in distressed areas but are unable to meet the specific commitments set forth in the regulation. In allowing for alternative commitments the Department achieves this goal by providing flexibility for insurers who can show that they are not reasonably able to meet the commitments set forth in subdivision (d) or (e) but can nevertheless commit to a reasonable alternative.

Subdivision (j) also clarifies that alternative commitments are not generally available, and that an insurer must demonstrate that it is unable to make a commitment pursuant to subdivision (d) or (e). This is reasonably necessary because it is anticipated that reviewing proposed alternative commitments will be resource intensive and time consuming for the Department and limiting the number of alternative commitments will assist the Department in efficiently reviewing rate applications.

The Department has anticipated that the use of alternative commitments is appropriate for insurers that write flood and are seeking the cost or benefits of reinsurance in their rate filing. The Department has identified that about 1.5% of homes in California have flood insurance, which is approximately 200,000 policies, meaning that while the Department sees flood as an important peril and line to include in these regulatory reforms, we know that insurance

companies that write this business cannot meaningfully meet the commitments described in subdivisions (d) and (e), and therefore would have to seek an alternative commitment.

It is reasonably necessary for section 2644.25.3(j) to cross-cite to the alternative commitment requirements in section 2644.4.8(j)(1) and (2) because section 2644.25.3(j) needs to apply the same requirements to a commitment that is made pursuant to section 2644.25.3 as the requirements that are applied to a commitment that is made by an admitted insurer that has demonstrated a need to use CAT modeling. As discussed above, it is a requirement that insurers use the same CAT model(s) for the Standard NCOR as for their modeled CAT adjustments because within an insurer's rate application, the use of the same CAT model(s) for the Standard NCOR and modeled CAT adjustments ensures consistency within the ratemaking formula, i.e., so that the loss cost and net reinsurance cost provisions are based on the same modeled estimates of CAT losses.

For context, information regarding the cross-cited provisions of section 2644.4.8 is provided:

Section 2644.4.8, subdivision (j)(1) itemizes the circumstances that could potentially support a filing for an alternative commitment. It is reasonably necessary to limit the use of alternative commitments to give effect to the goals of this regulation and to enable the Department to process rate applications efficiently.

Section 2644.4.8, subdivision (j)(2) identifies that a rate application filing that is making an alternative commitment must include a statement that provides the information specified in section 2644.4.8, subdivisions (j)(2)(A) and (j)(2)(B). As discussed above, the Commissioner has concluded that insurers that commit to write additional new business and increase the availability of property insurance in high-risk wildfire-prone areas will be presumed to have demonstrated a need to consider the cost or benefits of reinsurance in their rate calculations. For the Department to process rate applications efficiently, it is reasonably necessary to require insurers who are seeking an alternative commitment to provide the Department with analysis to support a conclusion that the alternative commitment would further the goals of this regulation.

(k) Nothing in this section shall be construed as limiting, in any way, an insurer's ability to offer qualifying residential property insurance or commercial property insurance in this state.

The purpose of subdivision (k) is to clarify that an insurer's ability to offer qualifying residential property insurance or commercial property insurance in this state is not constrained in any way by this section. It is reasonably necessary to include subdivision (k) to eliminate any potential ambiguity regarding the effect of this section on whether an insurer is permitted to offer certain types of insurance in the event that they decide to forgo making commitments.

(*l*) If any provision or clause of this section or the application thereof to any person or situation is held invalid, such invalidity shall not affect any other provision or application of this section which can be given effect without the invalid provision

or application. To this end, the provisions of this section are hereby declared to be severable.

The purpose of subdivision (l) is to declare that the provisions of this section are severable. It is reasonably necessary to specify that the provisions of this section are severable to ensure that the Commissioner is able to implement the regulatory framework designed to provide insurers that commit to writing additional new policies, or maintain existing policies at a certain level, in higher-risk wildfire-prone areas with the ability to consider the cost or benefits of reinsurance to set more accurate rates, which in turn will help support greater availability of insurance in California.

Amend section 2644.27, subdivision (f)

The Department proposes to amend section 2644.27(f) for the specific purpose of adding an opportunity to make a variance request from the use of the Standard NCOR.

(11) That the Standard NCOR, as defined in section 2644.25.2(j), does not accurately reflect the company's actual reinsurance costs, and does not produce an actuarially sound result.

The purpose of the amendment to section 2644.27(f) is to provide a variance if the Standard NCOR does not accurately reflect the company's actual reinsurance costs, and does not produce an actuarially sound result.

Actuarial soundness provides an appropriate basis for determining whether a variance can be requested. Actuarial soundness as a basis is consistent with section 2644.25.1 (b), (e), and (h) for the Standard NCOR (i.e., the Commissioner's promulgation of the insurer/coverage groups, loss probability layers, and level of application / methodology to combine results).

Actuarial Standard of Practice (ASOP) 29 on Expense Provisions for Prospective Property/Casualty (P&C) Risk Transfer and Risk Retention, as well as ASOP 23 on Data Quality are relevant to the Standard NCOR.

ASOP 29 applies to actuaries when developing or reviewing insurer expense provisions, including for the cost of reinsurance. It requires actuaries to consider the net effect of reinsurance premiums (the amount to be paid to the reinsurer, including reinstatement premiums), anticipated reinsurance recoveries, and other relevant details (e.g., ceding commissions or allowances, contract terms that provide for retrospective premium or commission adjustments, etc.)

The Standard Net Cost of Reinsurance (NCOR) methodology relies on an analysis of the above information at an industry level, using data derived from data calls that the CDI conducts relating to reinsurance placement. The use of multiple Standard NCOR parameter sets allows for the estimated reinsurance costs within an insurer/coverage group to better align with the actual reinsurance costs of insurers placed in that group.

However, the Standard NCOR may not sufficiently represent a specific insurer's costs due to individual characteristics of the insurer and/or its programs, reinsurance structure, pooling arrangements, etc. Reinsurance contracts between an individual insurer and their reinsurers are tailored to meet the insurer's reinsurance needs based on their specific portfolio of policies. Thus, it is necessary to provide a variance process for insurers to ensure the actuarial soundness of their NCOR provision.

Further, the Standard NCOR methodology involves the application of the Standard NCOR parameters, which are derived from industry data, to an individual insurer's expected loss data generated from one or more catastrophe models for specific loss probability layers. ASOP 23 on Data Quality applies to actuaries when using data in performing actuarial services, including when using in-force policy data as inputs to catastrophe models.

(A) Any such request for variance shall be accompanied by a proposed net cost of reinsurance provision that is calculated based on the insurer's executed reinsurance agreements with supporting documentation, including but not limited to, complete copies of the reinsurance agreements with signatures and no redactions.

The purpose of (A) is to make clear that any variance request must include a proposed NCOR provision that is calculated based on executed reinsurance agreements and supported by complete copies of the reinsurance contracts.

The Casualty Actuarial Society (CAS) Statement of Principles Regarding P&C Insurance Ratemaking states that a rate should provide for all costs associated with the transfer of risk. Since reinsurance is a cost associated with risk transfer, if the Standard NCOR does not produce an actuarially sound result, an alternative NCOR provision should be used. As variances are non-prescriptive by their nature, the insurer should propose, calculate, and support their NCOR provision.

In order to review a proposed NCOR provision, the Department will need complete copies of the reinsurance contracts without redactions as support. Since there may be multiple versions of reinsurance contracts (e.g., draft versus executed/signed), the regulation specifies which version is required as support.

(B) Reinsurance agreements shall be allowed in the proposed net cost of reinsurance provision calculation only if: (1) the reinsurance agreement was entered into in good faith in an arms-length transaction and at fair market value for the coverage provided, and (2) the reinsurance meets the statement credit requirements of sections 2303 through 2303.25.

The purpose of (B) is to make clear that reinsurance agreements used in an insurer's proposed NCOR provision calculation are subject to the same limitations as CCR 2644.25(d).

(C) There will be no allowance for reinsurance between affiliated entities as set forth in Schedule Y of the Annual Statement.

The purpose of (C) is to prohibit an allowance for affiliated reinsurance, as in CCR 2644.25(e).