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

NOTICE OF PROPOSED ACTION AND NOTICE OF PUBLIC HEARING

MITIGATION IN RATING PLANS AND WILDFIRE RISK MODELS

February 25, 2022 **REG-2020-00015**

SUBJECT OF PROPOSED RULEMAKING

Notice is given that California Insurance Commissioner Ricardo Lara will hold a public hearing to consider amending, and the contemplated addition of, California Code of Regulations, Title 10, Chapter 5, Subchapter 4.8, Article 4, section 2644.9.

PUBLIC HEARING

Public Hearing Date and Location

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

Date: **April 13, 2022**

Time: **1:00 p.m.** The public hearing shall continue until all in attendance wishing to provide comments have commented, or 5:00 p.m.

Location: **California Department of Insurance**
1901 Harrison Street, 3rd Floor - Room #30000
Oakland, California

Link to Register for the Web-based Virtual Format:
https://us06web.zoom.us/webinar/register/WN_MoTcvOKCRdKSe9GAmZE5Hw

ACCESS TO PUBLIC HEARING

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

To increase public participation and improve the quality of regulations, interested parties are invited to attend virtually or in-person, and offer comment, if they so choose. Please be advised that in-person attendance at the hearing may be limited or curtailed, depending upon any state or local restrictions on public gatherings that may be in effect at the time of the hearing, or due to Covid-19 transmission control precautions implemented by the Department.

The moderated call-in line to be used for the public hearing is accessible to persons with mobility impairment. Persons with sight or hearing impairments are requested to notify the contact person for these hearings (listed below) in order to review available accommodations, if necessary.

Please direct all inquiries regarding these workshops to the contact persons named below.

PRESENTATION OF WRITTEN COMMENTS; CONTACT PERSONS

All persons are invited to submit written comments on the proposed regulations during the public comment period. The public comment period will end on April 13, 2022**.** Please direct all written comments to the following contact person:

Daniel Wade, Senior Staff Counsel
Rate Enforcement Bureau
1901 Harrison Street, 6th Floor
Oakland, CA 94612
Phone: (415) 538-4158
Email: daniel.wade@insurance.ca.gov

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

Lisbeth Landsman-Smith, Senior Staff Counsel
Rate Enforcement Bureau
300 Capitol Mall, Suite 1700
Sacramento, CA 95814
Tel: 916-492-3561
Email: Lisbeth.Landsman@insurance.ca.gov

Please note that under the California Public Records Act (Government Code Section 6250, et seq.), your written and oral comments, and associated contact information (e.g., your address, phone number, e-mail, etc.) become part of the public record and can be released to the public upon request.

DEADLINE FOR WRITTEN COMMENTS

All written materials must be received by the Insurance Commissioner, addressed to the contact person at the address listed above, by the end of April 13, 2022**.** Any written materials received after that time may not be considered.

COMMENTS TRANSMITTED BY E-MAIL

The Commissioner will accept written comments transmitted by e-mail provided they are sent to the following e-mail address: daniel.wade@insurance.ca.gov.

Comments sent to e-mail addresses other than those designated in this notice will not be accepted. Comments sent by e-mail are subject to the deadline set forth above for written comments.

AUTHORITY AND REFERENCE

The proposed regulations will interpret and make specific the provisions of Insurance Code sections 1858, 1859, 1861.01, 1861.05, and 1861.07, which also provide the rulemaking authority for this action. The Commissioner is authorized to promulgate regulations to implement Proposition 103. *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216.

INFORMATIVE DIGEST/ POLICY STATEMENT OVERVIEW

Summary of Existing Law

With the passage of Proposition 103 in 1988, California voters enacted numerous new laws related to the regulation of insurance rates in California, including Insurance Code sections 1861.05(a) and (b). California Insurance Code section 1861.05(a) makes it unlawful for a rate to be approved or remain in effect which is excessive, inadequate, or unfairly discriminatory. California Insurance Code section 1861.05(b) requires an insurer which desires to change any rate to file a complete rate application containing specified information "and such other information as the commissioner may require." California Code of Regulations Title 10, Chapter 5, Subchapter 4.8, Article 4, sections 2644.1 et seq. provide the rules that insurers must follow to obtain approval of their rate applications.

Proposition 103 sets forth the following findings: (a) "Enormous increases in the cost of insurance have made it both unaffordable and unavailable to millions of Californians."; (b) "The existing laws inadequately protect consumers and allow insurance companies to charge excessive, unjustified and arbitrary rates." (Prop. 103, § 1.) The stated purpose of Proposition 103 is "to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians." (Prop. 103, § 2.)

Proposition 103 provides the Commissioner substantial authority and flexibility in establishing rules and procedures for assessing insurers proposed rates, which necessarily include rating plans. (*20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216, 280; *Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal. 3d 805, 824.)

Also, a part of Proposition 103, California Insurance Code section 1861.10 promotes consumer participation by allowing consumers to participate in the ratemaking process and enforce the rating laws. It requires the Commissioner to notify the public after an insurer files a rate application, subject to certain conditions. California Insurance Code section 1861.07 requires all information provided to the Commissioner in the rate application process to be publicly available. Furthermore, California Insurance Code section 1858 permits any person aggrieved by any rate charged, rating plan, rating system or underwriting rule to also challenge the insurer's action directly before the commissioner.

In addition, advisory organizations that provide rate manuals to insurers must have such manuals approved by the Commissioner prior to their use. (California Insurance Code section 1855.5.)

Insurance ratemaking requires an assessment of the risks to be insured. In California, property insurers are permitted to classify (segment) wildfire risks depending on how high or low the assessed wildfire risk is in different areas and localities. Different wildfire risks are assigned different wildfire risk scores, which affect the premium policyholders pay. California Insurance Code sections 929 et seq. requires the Commissioner to collect from insurers data regarding wildfire incurred losses for each insured property, wildfire risk scores assigned to those properties by the insurers and the source of those scores.

Irrespective of scores assigned by insurers, some policyholders take proactive measures to reduce — or "mitigate" — the risk of wildfire on their property and in their neighborhood. For example, someone may clear vegetation near their house, or install fire-resistant building materials. Such measures reduce the wildfire risk at their insured property. Likewise, communities may employ mitigation measures such as firebreaks which can reduce the risk of conflagration.

Numerous laws and national standards provide effective methods for mitigation of wildfire risk. For example, Chapter 7A of the 2019 California Building Code (24 CCR 701A) addresses building standards for wildfire areas, including fire resistant vents (24 CCR 706A.2). ASTM E108 and UL 790 are standards set by private entities that all manufacturers follow to create a Class-A fire rated roof. California Public Resources Code 4290.1 identifies criteria for a community to be recognized as a Fire Risk Reduction Community. Those criteria include participation in Firewise USA, a nationally recognized program developed by the National Fire Protection Association, a Massachusetts 501(c)(3) corporation. This program is co-sponsored by the United States Department of Agriculture's Forest Service and the National Association of State Foresters. And, California Public Resources Code section 4291 sets forth requirements for maintaining defensible space in areas at risk for wildfire.

Current law, however, is silent with respect to the manner in which these mitigation measures must be considered by an insurer and reflected in their rating plan. Thus, a reduction in risk resulting from these mitigation measures may not be considered by insurers and the rates and premium may not reflect the mitigation work accomplished.

Similarly, current law does not provide clear direction to insurance companies to disclose to insurance applicants or policyholders the criteria the insurance company relied upon when calculating a particular insurance premium for a particular consumer. Stated another way, existing law does not specify the level of transparency that an insurance company must maintain with the consumer so that both the consumer and the insurance company can validate the accuracy of the rating plan when applied to that consumer's property.

Effect of Proposed Action

The proposed regulations will require insurers, for the purposes of segmenting rates, creating a risk differential, or surcharging the premium due to wildfire risk, to reflect and take into account specified mitigation factors in their rating plans. The proposed regulations will at the same time provide flexibility to insurers to incorporate additional factors into their rating plans for the purposes of segmenting rates, creating a risk differential, or surcharging the premium due to wildfire risk, provided such factors are substantially related to the risk of wildfire and will not result in rates which are excessive, inadequate, or unfairly discriminatory. The proposed regulations will help to ensure that rates and premiums corresponding to wildfire risk are not excessive, inadequate, or unfairly discriminatory by ensuring the insurer has accurate information upon which the rate or premium is based. For example, the proposed additions will also require insurers to provide certain mitigation and wildfire risk information to applicants and policyholders, and to provide a process by which applicants and policyholders may appeal a wildfire risk score or classification assigned by the insurer.

Policy Statement Overview

Broad Objectives

The regulations are intended to promote careful and systematic consideration of wildfire risk by insurers, and to enhance communications by insurers about their rating of properties with respect to wildfire risk, in order to ensure that rates attributable to wildfire risk are not excessive, inadequate or unfairly discriminatory.

For instance, the proposed regulation requires insurers, in assigning wildfire risk scores or otherwise classifying wildfire risks, to conduct a more granular, and thus more accurate risk assessment. By requiring insurers to include wildfire mitigation measures — and the reduction in risk therefrom in their risk assessment — the proposed regulations make insurers' rates and premiums less likely to be excessive, inadequate, or unfairly discriminatory due to failure to consider mitigation measures. Ensuring that rates and premiums are not excessive, inadequate, or unfairly discriminatory is a central statutory command of Proposition 103.

Benefits Anticipated

The proposed additions are expected to: incentivize individual and community mitigation efforts by requiring consideration of property and community-level mitigation against wildfire risk; reduce the risk of loss posed by wildfires; improve accuracy in the classification of wildfire risk and the resulting rates and premiums; increase transparency in, and consumer awareness of, insurers' rating and/or scoring of wildfire risk; enhance consumer protection by establishing a consumer appeals process; reduce unfair discrimination by enhancing consistency in insurers' wildfire rating practices and/or risk scoring practices; and potentially improve availability and affordability of property-casualty insurance for communities and properties where wildfire mitigation measures have been implemented.

Compliance with the regulation does not change the job responsibilities of employees in the affected industries in a way that would impact their safety. Thus, the regulation will neither increase nor decrease worker safety.

The Department believes that long-term the regulation will have a beneficial impact on the state's environment, as increased wildfire risk mitigation may help to slow or stop the spread of some wildfire events. Better watershed health and wildlife protection may result as toxic debris cleanup after fires is reduced, and fewer wells become contaminated.

The regulation is expected to result in a benefit to the welfare of California insurance consumers by ensuring approved property insurance rates are more closely related to the property's actual risk of loss. Additionally, if the regulation prevents some future wildfire losses, it could lead to better health outcomes for individuals negatively impacted by the poor air quality caused by California's recent wildfires.

Consistency or Compatibility with Existing State Regulations

After conducting an evaluation of applicable law, the Department has found that the proposed regulations are not inconsistent or incompatible with any other existing regulations.

NOT MANDATED BY FEDERAL LAW OR REGULATIONS

These regulations are not mandated by federal law. There are no existing federal regulations or statutes comparable to these proposed regulations as no federal statutes or regulations address wildfire mitigation measures or rating factors.

OTHER STATUTORY REQUIREMENTS

The Department evaluated whether there were other requirements prescribed by statute applicable to these regulations by reviewing statutes and regulations relating to this issue, and determined that there were no such specific requirements.

LOCAL MANDATE

The proposed regulations do not impose any mandate on local agencies or school districts.

FISCAL IMPACT

Fiscal Impact on Other State and Local Government Agencies

There are no costs or savings to any other State agencies; however, the Department is expected to incur a fiscal impact, as discussed immediately below under "Fiscal Impact on the Department." There is no cost to any local agency or school district for which Part 7 (commencing with Section 17500) of Division 4 of the Government Code would require reimbursement. There are no other nondiscretionary costs or savings to local agencies, nor do the regulations impose a cost or savings in federal funding to the state.

Fiscal Impact on the Department

The proposed regulation is anticipated to have a fiscal impact on the Department. The Department will incur costs in the administration, review and analysis of all models and rating plans that insurers are required to submit to comply with the proposed regulation. Rate Analysts and Casualty Actuaries are likely to be the primary reviewers of models and rating plans that are likely to be detailed and complex. The Department's review and approval of rate filings is expected to span multiple state fiscal years at a total cost of $1,047,000.

The proposed regulation is expected to be effective July 2022 and allows 180 days for insurers to file their new rating plan. Therefore, the review of rating plans by the Department is expected to begin in January 2023, or the midpoint of the 2022-23 fiscal year (FY). In a review of rate filings that were completed between January 1, 2019 and September 23, 2020 the Department found the average time to approve a rate filing was 167 days. Given that the average review and approval time is nearly six months and complex filings or initial filings that need modification often take longer to get approved, the Department assumes that 50 percent of the review work will be completed in the first FY (6 months from Jan 2023-June 2023), and the remaining 50 percent will be completed in the second FY (23-24). As a result, the Department expects a fiscal impact of $523,500 in the first year and $523,500 in the second year to review and approve rate filings.

The Department will also likely require support from outside actuaries to verify some of the more complex wildfire models included in insurer submissions. The Department estimates that 6 rate filings will need to be referred to consulting actuaries at an average cost of $15,000 per filing. The outside actuarial reviews are assumed to occur in the first FY, increasing the estimated first-year fiscal impact to $613,500. As a result, the total anticipated fiscal impact on the Department is $1,137,000.

HOUSING COSTS

The proposed regulation is not anticipated to impact housing costs.

SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS, INCLUDING THE ABILITY OF CALIFORNIA BUSINESSES TO COMPETE

The types of businesses that will be affected are insurers and insurance producers.

In order to comply with the proposed regulations, insurers will need to file rate applications that include compliant rating plans within the timeframe set forth in the proposed regulation. Rate applications are currently required any time an insurer desires a rate change; the proposed regulation builds upon existing required record keeping and administrative process required by current rate regulations. The proposed regulation, however, would require additional actuarial support and analysis to be included in the rate application because compliant rate applications must include rating factors not currently required by existing regulations. As such, additional costs may be acquired by insurers to update existing rating plans with new documentation to be compliant with the portions of the proposed regulation which require the inclusion of the specified mitigation factors.

The portion of the proposed regulation that requires the insurer to provide information to a consumer related to their wildfire risk score or classification is a wholly new requirement that would necessitate insurers to create and maintain records they currently do not, and likewise creates a new administrative process for (1) providing information related to the consumer's wildfire risk score or classification and (2) providing a process for appealing the wildfire risk score or classification; neither of these processes are currently required under existing rate regulations. This portion of the proposed regulation would also impact insurance producers because the regulation permits a consumer to procure a producer's assistance in filing the appeal of the consumer's wildfire risk score or classification.

There will likely be an adverse impact on insurance agents and brokers, who will have to document and forward consumer wildfire risk score appeals. To help insurers validate information, some agents and brokers may also incur costs when conducting in-person inspections of residential or commercial properties. Producers who are independent or captive with their own offices or business locations would likely need to implement their own processes separate from an insurers processes (this would not apply to producers who work for an insurer directly or sell on a direct-basis) for assisting a consumer with the wildfire score/classification appeal process. This would include additional costs, recordkeeping, and staff time.

The Department has made an initial determination that the adoption of the proposed regulations may have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to complete with businesses in other states. The Department has considered proposed alternatives that would lessen any adverse economic impact on business and invites you to submit proposals. Submissions may include the following considerations:

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

STATEMENT OF RESULTS OF THE ECONOMIC IMPACT ASSESSMENT

The Department is required to assess any impact the proposed adoption may have on the following: the creation or elimination of jobs within the State of California (Government Code § 11346.3(b)(1)(A)); the creation of new businesses or the elimination of existing businesses within the State of California (Government Code § 11346.3(b)(1)(B)); and the expansion of businesses currently doing business within the State of California (Government Code § 11346.3(b)(1)(C)).

Below is a summary of the results of the Economic Impact Assessment pursuant to Government Code sections 11346.3(b)(1)(A) through (D).

A. The proposed regulation is estimated to result in the creation of 40 jobs within the State of California. Overall, the impact of jobs created by the proposed regulation is less than one-thousandth of a percent of the total projected civilian employment in California (40 / 19,238,071= 0.0002%).

B. The proposed regulation is estimated to result in the elimination of 131.1 jobs within the State of California. Overall, the impact of jobs lost resulting from the proposed regulation is less than one-thousandth of a percent of the total projected civilian employment in California (131.1 / 19,238,071= 0.0007%)

C. Given that the average direct benefit to an impacted insurer is estimated to be $2,900 ($391,400 / 136 firms), it is not anticipated that the proposed regulation will have a significant impact on the creation of new businesses in California.

D. Given that the initial average direct cost to an impacted insurer is estimated to be $112,500 ($15.3 million / 136 firms), it is not anticipated that the proposed regulation will result in the elimination of existing businesses in California. It is also not expected that the initial average estimated cost of $300 ($562,000 / 1,847) to insurance agents or brokers will result in the elimination of existing businesses in California.

E. It is not anticipated that the proposed regulation will have an impact on the ability of businesses located in California to expand, as most of the costs resulting from the proposed regulation will be incurred by multimillion-dollar businesses. The estimated initial net loss to total output of $32 million suggests that the proposed regulation will have a minimal impact on the multitrillion-dollar California economy as a whole.

F. The proposed regulation is expected to result in a benefit to the health and welfare of California residents, specifically insurance consumers, by ensuring approved property insurance rates are more closely related to the property's actual risk of loss. Additionally, if the Department's expectation that the regulation prevents some future wildfire losses is realized, it could benefit the state's environment and lead to better health outcomes for individuals negatively impacted by the poor air quality caused by California's wildfires. The proposed regulation is not expected to affect worker safety.

POTENTIAL COST IMPACTS ON REPRESENTATIVE PERSON OR BUSINESSES

The initial average direct cost to an impacted insurer is estimated to be $112,500 ($15.3 million / 136 firms). The initial average estimated cost to insurance agents or brokers is $300 ($562,000 / 1,847). There are no other cost impacts known to the Department that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

BUSINESS REPORT

The Department finds that it is necessary for the health, safety or welfare of the people of the state that the regulation apply to businesses.

IMPACT ON SMALL BUSINESSES

The proposed regulation is projected to have a direct adverse impact on insurers, however by law insurance companies are not considered small businesses (Government Code § 11342.610(b)(2)).

However, there will also likely be an impact on insurance agents and brokers, who will have to document and forward consumer wildfire risk score appeals. To help insurers validate information, some agents and brokers may conduct in-person inspections of residential or commercial properties. The Department assumes that the vast majority of agents and brokers operating in communities that are more likely to experience the effects of wildfire are small businesses. As such, the Department expects that there will be a total adverse impact on small business of $562,000.

In 2020, there were 16,063 business establishments classified as insurance agents and brokers in California. The Department assumes that only the agents and brokers operating in moderate to very high wildfire risk areas are likely to be impacted, because this is where the properties most likely to appeal their wildfire score are located. In the Establishing a Baseline section, the Department calculated that 11.5 percent of all homes in California are in a moderate to very high wildfire risk area. That percentage was also applied to calculate the number of commercial properties in moderate to very high wildfire risk areas, and is used here to estimate that approximately 1,800 (16,063 x 11.5%) insurance agents and brokers operate in moderate to very high wildfire risk areas. As a result, the Department estimates that the initial average adverse impact on an insurance agent or broker operating as a small business in an impacted moderate to very high wildfire risk area is approximately $300 ($562,400 / 1,847). However, the average cost to small businesses is expected to increase to $610 in year 2, and then decline to $400 per business after 6 years.

ALTERNATIVES INFORMATION

The Department must determine that no reasonable alternative considered by the Department, or that has otherwise been identified and brought to the attention of the Department, would be more effective in carrying out the purpose for which this action is proposed; would be as effective and less burdensome to affected private persons than the proposed action; or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy underlying Insurance Code section 11736.5.

AVAILABILITY STATEMENTS

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

The file for this proceeding, which includes a copy of the express terms of the proposed action, the Initial Statement of Reasons, the Economic Impact Assessment, and all the information upon which the proposed action is based, and any supplemental information, including any reports, documentation and other materials related to the proposed action that are contained in the rulemaking file, is available by appointment for inspection and copying at 300 Capitol Mall, 16th Floor, Sacramento, California, 95814 between the hours of 9:00 a.m. and 4:30 p.m., Monday through Friday.

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

AUTOMATIC MAILING

A copy of this Notice (including the Informative Digest, which contains the general substance of the proposed adoption) will be sent to all persons who have previously filed a request with the Department to receive notice of proposed rulemakings.

FINAL STATEMENT OF REASONS

Upon request, the Final Statement of Reasons will be made available for inspection and copying once it has been prepared pursuant to Government Code section 11346.9(a). Requests for the Final Statement of Reasons should be directed to the contact person listed above.

INTERNET ACCESS

Documents concerning proposed regulations are available on the Department's website at the following link: https://legaldocs.insurance.ca.gov/publicdocs/RegulationList.