CLIENT ALERT

California's Proposed Regulations to Enable Catastrophe Modeling and Expand Wildfire Protection in High-Risk Areas

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The California Department of Insurance ("CDI") has issued a notice of proposed action with respect to an exempt rulemaking for Catastrophe Modeling and Ratemaking. The action would amend existing regulations and add new provisions to existing ratemaking regulations (the "Proposed Regulations")[1] to allow insurers to use catastrophe modeling in ratemaking under certain specified circumstances. The Proposed Regulations are linked in the CDI's press release.

The CDI formulated the Proposed Regulations as part of its overall efforts to ensure a competitive and sustainable insurance market for property insurance while protecting consumers in response to the increased severity of wildfires and their subsequent impact on homeowners insurers' decisions, which has led to decreased availability and affordability of homeowners insurance across California and in wildfire-prone areas in particular. If adopted, the Proposed Regulations would enable insurers who write increased amounts of homeowners policies in high-risk areas to use catastrophe modeling in calculating property and casualty insurance rates, bridging the CDI's desire to increase available homeowners policies in high-risk areas, and insurers' wishes to use catastrophe modeling to more accurately manage and price risk than is possible using only historical data.

[1] REG-2023-00010, which amends Ca. Code Regs. tit. 10, §§ 2644.4, 2644.5, 2644.4.8 and 2644.27, and adopts §§ 2644.4.5, 2644.4.8 and 2648.5.

The CDI will hold a public hearing on the Proposed Regulations via Zoom from 10 AM – 1 PM PT on September 17, 2024, with a written comment period to open through the end of that day. Comments will be received both orally at the hearing or via email to Sarah Ahn, Staff Counsel.

Summary of the Proposed Regulations

The Proposed Regulations consist of three larger parts that: 1) allow insurers to use catastrophe modeling to calculate the catastrophe adjustment for wildfire exposure and describe calculation of the catastrophe adjustment; 2) set standards for insurer commitments to increase the writing of insurance; and 3) specify the process for the Pre-Application Required Information Determination ("PRID") required for use of catastrophe models in ratemaking.

Use of Catastrophe Modeling for Catastrophe Adjustment

The first part of the Proposed Regulations sets forth the permitted usage of catastrophe models as the basis for calculating catastrophe adjustments for wildfire and other catastrophe exposures.[2] Actual catastrophic losses in a given year would be measured by either an adjustment based on the average annual loss generated from one or more catastrophe models, an adjustment based on a multi-year, long-term average of catastrophe losses net of actual and anticipated salvage and subrogation recoveries, or by a combination of these methods unless otherwise prohibited by the regulation. For both residential and commercial property insurance lines, the average would be taken over 20 years. Regardless of the method used for catastrophe adjustment, the insurer would be required to submit their history of various metrics over a recorded period, including California catastrophe losses and California non-catastrophe losses, based on the data aggregation method used for the recorded period.

The proposed regulation would also allow use of catastrophe models to protect annual aggregate losses for wildfire exposures of non-earthquake and non-flood insurance where limited historic data is available.

Increased Policy Writing Requirements

The second part of the Proposed Regulations[3] would authorize insurers who meet threshold commitments to increase their writing of policies in certain wildfire-risk areas to use catastrophe modeling. The proposed regulation would incentivize insurers to provide residential or commercial property insurance in defined "distressed areas." These areas include defined "Undermarketed ZIP Codes," which are ZIP codes designated by the Commissioner that at least partially overlap with a high or very high fire hazard safety zone, as qualified by the Department of Forestry and Fire Protection ("Cal Fire"), and in which either: (1) 15% of insured residential properties are insured by the California Fair Access to Insurance Requirements (the "FAIR Plan") or (2) the average premium per $1,000 of Coverage A is at least $4.00 and the per-capita income is no

[2] §§ 2644.4.5(b) and 2644.5.
[3] § 2644.4.4.

higher than the 50th percentile. Distressed areas also include "distressed counties," which are areas where "the percentage of structures situated in that county that are at high or very high risk wildfire risk is no lower than the 50th percentile of counties in this state as determined by the Commissioner." Insurers could also fulfill their commitment by insuring properties that were covered by the FAIR Plan and subject to medium to very high fire risk.

The Proposed Regulations would provide different thresholds for residential and commercial property insurers. A residential property insurer could use catastrophe modeling if it commits to write a number of policies in the distressed areas that is no less than the product of (i) 85% of its statewide market share and (ii) the total number of statewide distressed areas earned exposures (as defined in the Proposed Regulations) two years after its rate filing approval. A residential property insurer that already meets this threshold at the time of rate application would be allowed to use catastrophe modeling if it maintains at least the same amount of earned exposures in the distressed areas three years after its rate filing approval. Alternatively, a residential property insurer could commit to increasing its writing of policies for distressed areas by 5% of its earned exposures in the distressed areas of the state within the most recent 12-month period used for the insurer's rate application. The additional policies described for qualifying residential property insurance would only include properties in distressed areas and/or properties in areas that the insurer classifies as moderate to very high fire risk that had been covered under the FAIR Plan immediately prior to the insurer's insuring of these properties. A commercial property insurer would need to commit to writing an additional 5% of its total insurable value within ZIP codes that at least partially contain high to very high fire hazard risk as shown on the most recent map published by Cal Fire within two years of their rate approval filing. The regulation would also require that fire hazard risk levels and the thresholds be reassessed regularly.

The Proposed Regulations would provide an exemption for insurers writing less than $10 million of annual premiums in California. An insurer would also be allowed to use catastrophe modeling if it makes an alternative commitment based on either its size, scope of coverages or frequency or severity of recent events impacting the insurer, when, in good faith, the insurer cannot meet the thresholds noted above.

Pre-Application Required Information Determination Requirement

Finally, the new Section 2648.5 of the Proposed Regulations would require an insurer who wishes to rely upon modeled information for purposes of determining appropriate rates for a property and casualty line of business to make a filing prior to submission of its rate filing, seeking a PRID, which is a non-adjudicative determination by the CDI of what information and data regarding the utilization of models are required to be provided to the Commissioner as part of a complete rate application.

The required model information would include all information specified as part of the rate application process, as well as information demonstrating that the model uses established concepts, data and principles and the best available scientific data, insurance claims expertise and other assumptions appropriate for the risk or peril being modeled. The PRID procedure would be overseen by a Model Advisor delegated authority by the Commissioner. The model information specified in the

PRID is confidential and cannot be submitted to the Commissioner nor become public until the insurer submits the information as part of a complete rate application.

Any person would be able to petition to initiate or participate in a PRID procedure. The CDI would be authorized to initiate a PRID procedure by submitting a Notice of PRID Procedure to the Model Advisor. The Model Advisor would then grant a petition to initiate only if the petitioner has indicated that it is more likely than not that the Commissioner would benefit from a PRID and either of the following conditions are met: there is no currently valid PRID, or the model has not been previously subject to public review in any other forum in California within the past four (4) years. The Proposed Regulations require the Model Advisor to rule on a petition within ten (10) business days and to publicly notice a PRID procedure within three (3) business days of petition or Notice of PRID Procedure. The PRID procedure would need to be initiated five (5) business days after the Model Advisor has issued a ruling granting any petition to participate in the PRID procedure. The owner or vendor of a model would have the option to decline to participate in the PRID but would need to provide witness testimony, documents and other information in response to a subpoena, as the parties to the PRID procedure may propound discovery in this manner. The Proposed Regulations allow anyone to rely on a PRID to ascertain the model information required, and the PRID can be relied upon in multiple complete rate applications by unaffiliated insurers. A PRID would remain valid until four(4) years from the date of the complete rate application submission that relied upon the PRID.

Conclusion

The Proposed Regulations would significantly change the ratemaking process for property insurers by allowing them to use catastrophe modeling when filing rates for wildfire exposures of qualified residential and commercial properties. Should you be interested in commenting on the proposed regulation, please reach out to one of the following Willkie attorneys for further assistance.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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