WILLKIE FARR & GALLAGHER LLP

CLIENT ALERT

California Department of Insurance to Host Workshop on Contemplated Regulation to Standardize the Net Cost of Reinsurance and Increase Reinsurance Coverage in High Wildfire Risk Areas

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The California Department of Insurance ("CDI") has issued a public notice inviting interested parties to a workshop titled "Net Cost of Reinsurance and Ratemaking," which will occur on December 5, 2024 at 10:00 a.m. PST. The public notice is linked in the CDI's press release. The CDI has scheduled the workshop to seek input on its contemplated proposal to standardize treatment of reinsurance costs in property insurance ratemaking, and will receive both written comments prior to the workshop and oral comments during the session. The workshop is part of Commissioner Ricardo Lara's Sustainable Insurance Strategy, which is aimed at stabilizing California's property insurance market and expanding coverage options for homeowners, businesses and other consumers.

Increased wildfire risk has depressed the affordability and availability of homeowners and commercial property insurance across California. The CDI has introduced several measures targeting this issue, including its proposed regulation to enable insurers who write increased amounts of homeowners policies in high-risk areas to use catastrophe modeling in calculating their property and casualty insurance rates, which we have previously reported on here.[1] This workshop will focus on providing a standardized method for addressing the costs of reinsurance in ratemaking.

In order to increase property insurance coverage, the CDI's proposal seeks to include a standardized net cost of reinsurance factor ("Standard NCOR") developed by the CDI based on market reinsurance data and related markets such as catastrophe bonds[2] in property insurance ratemaking. Insurers seeking to use Standard NCOR in their rates would have to commit to increased writing of policies in higher risk areas. Use of Standard NCOR is expected to simplify property rate filings, as insurers that use Standard NCOR would not be required to provide company-specific information regarding reinsurance structure or costs in their rate filings.

The workshop will not focus on specific regulatory text, but will focus on the following questions addressing the contemplated regulation:

- Does incorporating Standard NCOR promote insurer solvency and address market stability?
- What information about reinsurance programs is most important to be provided to the public?
- How could a regulation on NCOR and corresponding insurer commitments most effectively align with the diversity of insurance companies writing in California?
- What are the most important components for establishing and conducting an efficient variance process?
- Is there any aspect of the process that is not addressed in this proposal?

Should you be interested in commenting on the proposal, please reach out to one of the following Willkie attorneys for further assistance.

1 The CDI has since proposed a finalized text pending the California Office of Administrative Law's approval, after which the regulation will take effect at year-end.

2 The CDI would derive market-expected returns for property catastrophe risk by loss probability by analyzing data on reinsurance placements and various insurance-linked security market prices, such as catastrophe bonds. CDI could calculate permitted return multiples for specific loss probability layers and promulgate them as the Standard NCOR in relation to the expected losses in those layers. Insurers could then apply the approved Standard NCOR multiples to California-only modeled wildfire or flood losses within their property rate filings to yield their permitted NCOR provision. Insurers would not need to provide information on their individual reinsurance structure or costs in rate filings since calculations would be based on industry risk transfer benchmarks.

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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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