



October 17, 2024

Sara Ahn
Staff Counsel
California Department of Insurance
c/o Office of the Special Counsel
300 Capitol Mall, 16th Floor
Sacramento, CA 95814

Re: Catastrophe Modeling and Ratemaking, REG-2023-00010

Dear Ms. Ahn,

On behalf of the Casualty Practice Council (CPC) of the American Academy of Actuaries,¹ I appreciate the opportunity to provide comments on the California Department of Insurance's (Department) Notice of Proposed Rulemaking on Catastrophe Modeling and Ratemaking. As [noted previously](#), the CPC appreciates and supports the Department's continued efforts to listen to and engage with stakeholders on improving risk management, with a shared goal of affordable and reliable residential and commercial insurance.

The amended text of the regulation on Catastrophe Modeling and Ratemaking (REG-2023-00010) includes the phrase "most actuarially sound," which has been used in California rate regulation statutes for several years. The Department may wish to consider additional regulatory guidance within REG-2023-00010, as this phrase may not be a term *de art* that is universally understood.

The attribute of "most" in the phrase "most actuarially sound" is not required in actuarial standards, nor in other sources of actuarial guidance or in other actuarial literature to the best of our knowledge. Actuarial estimates are frequently expressed in terms of a range of reasonable estimates. It is widely recognized within the actuarial profession that such ranges will typically reflect an actuarial assessment of uncertainties and various necessary assumptions underlying the estimates. However, the actuarial standards, principles, and other forms of actuarial guidance do not address professional considerations in assessing the level of actuarial soundness.

We believe that it is appropriate that the proposed regulation refer to the actuarial standards of practice (ASOPs) as set by the Actuarial Standards Board. The proposed regulation clearly establishes that the applicant has the burden to demonstrate, in part, that "the applicant's use of its selected model(s) produces the ***most actuarially sound*** (emphasis added) estimate of projected catastrophe losses." There is no generally accepted actuarial guidance that addresses an assessment of relative actuarial soundness. Consequently, the actuaries who are relied upon by the applicants, and the actuaries who may be reviewing such estimates for the Department and

¹ The American Academy of Actuaries is a 20,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.



the commissioner, do not have actuarial guidance upon which they may rely, which would seem to be at odds with the implied belief that such standards are and have been in place for some time.

We understand that the Department received comments regarding the use of “most actuarially sound” several years ago. At the time, the Department had responded:

The commentor is referring to language which provides that rates for specialty insurance shall be approved or disapproved using the most sound actuarial method, consistent with California law, in accordance with the Actuarial Standards of Practice, and relevant and accepted actuarial principles, guidelines, and literature. The amendments proposed in the October 5, 2006, version of these regulations allow insurers significantly more flexibility in developing rates for specialty lines. Nevertheless, the Department must review and approve each specialty line rate application and ensure that the proposed rates are neither excessive, inadequate, unfairly discriminatory, or otherwise in violation of law.

The Department believes that it can best ensure that the proposed rates are appropriate if it reviews a rate application using the most sound actuarial method applicable for that application. The commentor references actuarial principles which indicate that an insurer need only demonstrate that it is using a sound and reasonable actuarial methodology, not the most sound. However, actuarial principles must yield to applicable legal requirements. California Insurance Code Section 1861.05(b) provides that the applicant shall have the burden of proving that the requested rate change is justified. The Commissioner has therefore determined that, in some limited circumstances, including for specialty lines, the Commissioner shall review a rate using the most sound actuarial method. The language is intended to give the Commissioner the ability to prefer a more sound approach to a less sound one. Without this language, the Commissioner would be forced to accept a less sound method so long as it met a minimum threshold of soundness. It allows the Commissioner to select between two minimally sound methods where one is clearly preferable.

As the actuarial concern with the phrase will most likely continue to be raised, it may be prudent to include similar clarifying language in this proposed rule, as well as in future proposals. As an example, the Department may consider including the following suggested language:

California Insurance Code Section 1861.05(b) provides that the applicant shall have the burden of proving that the requested rates are justified. For the purpose of this regulation, the Commissioner shall review rates using the most sound actuarial method. The regulation is intended to give the Commissioner the ability to prefer a more sound approach to a less sound one. The applicant has the burden to justify that the proposed rates relied on an approach that was preferable on the basis of actuarial soundness when compared to other recognized approaches which would meet the minimum actuarial standards associated with actuarial soundness.

There are several ASOPs and an American Academy of Actuaries [public policy special report on actuarial soundness](#)¹ that we believe you will find helpful in this matter:



- [ASOP No. 1](#), *Introductory Actuarial Standard of Practice*
- [ASOP No. 39](#), *Treatment of Catastrophe Losses in Property/Casualty Insurance Ratemaking*
- [ASOP No. 41](#), *Actuarial Communications*
- [ASOP No. 53](#), *Estimating Future Costs for Prospective Property/Casualty Risk Transfer and Risk Retention*

Please note that ASOP No. 1, section 2.3 defines the term “actuarial soundness” as follows:

The phrase “actuarial soundness” has different meanings in different contexts and might be dictated or imposed by an outside entity. In rendering actuarial services, if the actuary identifies the process or result as “actuarially sound,” the actuary should define the meaning of “actuarially sound” in that context.

The CPC appreciates the opportunity to share this feedback and offer our recommendations to help provide additional clarification around the term “most actuarially sound.” We hope these observations are helpful, and we welcome further discussion. If you have any questions about our comments, please contact Rob Fischer, the Academy’s casualty policy analyst, at fischer@actuary.org.

Sincerely,

Amy Angell, MAAA, FCAS
Vice President, Casualty Practice Council
American Academy of Actuaries

ⁱ https://www.actuary.org/sites/default/files/files/Actuarial_Soundness_Special_Report_5.10.12.pdf