California’s New Home, Auto Insurance Strategy Is Controversial. Here’s Why

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It happened like clockwork.

On Thursday, Gov. Gavin Newsom issued an executive order calling for swift action to expand insurance coverage options for consumers. Hours later, California Insurance Commissioner Ricardo Lara outlined what he termed “the largest insurance reform” in decades.

The regulation, to be drafted by the end of 2024, would allow insurance companies to use controversial forward-looking modeling in setting rates in return for covering more Californians living in areas with the most wildfire risk.

The strategy took direct aim at a rapidly growing problem in the state and a serious liability for political leaders: dwindling access to homeowners insurance.

Seven of the 12 largest writers of homeowners insurance—including State Farm, Allstate, Farmers, USAA and others—have limited business in California or pulled out of the state entirely, shrinking home insurance availability.

“Can consumers get the insurance they need? Can they get it today?” Lara asked on Thursday. “And the answer, in all honesty, is no.”

But Lara’s reform—which is currently more of an outline or plan—won’t thrill all policyholders: Insurance rates are expected to increase as a result.

That isn’t the only controversy.

Newsom took executive action after an 11th-hour bill to alleviate the state’s insurance woes died in the legislature earlier this month.

But the new strategy unveiled by Lara cannot legally alter California's regulatory framework: Proposition 103, a powerful law passed by voters in 1988 that has governed insurance for over three decades. But it may undermine it.

Insurance companies say that Prop. 103 has made it too difficult to increase rates and factor the effects of climate change into them.

The law's supporters say it has kept rates affordable and has given California likely the strongest protections for insurance consumers in the country.

But even some of them are starting to have their doubts.

From Consumer Struggle to Law
Prop. 103 emerged from a period in the late 1980s that looked a lot like today: Insurance coverage was hard to find, premiums were out of control and consumers were frustrated.

California required drivers to have auto insurance, but people of color struggled to obtain it due to discrimination, according to Harvey Rosenfield, the founder of Consumer Watchdog.

"It was a full-fledged crisis, just like today," he said.

That drove Rosenfield, then a young lawyer and protegé of consumer advocate and later presidential candidate Ralph Nader, to write the bill and lead a campaign for its passage.

Despite intense opposition from the insurance industry, the proposition passed in November 1988 with support from 51% of voters.

The law had several key features: It required insurance companies to roll back rates by 20%, made the insurance commissioner an elected official and obligated auto insurers to offer consumers a "good driver" discount.

It also required insurance companies to get prior approval from the California Department of Insurance before raising rates and mandated a public hearing for rate requests above a certain level.

That wasn't even the most contentious part of the law.

"I knew when I wrote [Prop.] 103 that it doesn't make a difference how good a law is," Rosenfield said. "If it can't be enforced or isn't enforced, it's useless."

So Rosenfield wrote in a provision unique to California.

That provision allows consumers or their representatives—termed "interveners"—to participate in rate hearings, independently scrutinize and challenge unjustified rates, and go to court to sue insurance companies. It also allows the interveners to get the costs of their participation paid by the insurance companies.

Out-of-Date?

To say that Prop. 103 is unpopular with insurance companies would be an understatement. But the latest moves by Newsom and Lara suggest they, too, believe the regulatory system is out-of-date.

Insurance companies argue that climate change contributed to more extreme wildfires, yet the law requires them to calculate risk based upon the past 20 years, not future projections. The cost of home and auto repairs has skyrocketed, increasing their costs.

And high inflation since 2021 has meant that, once an insurance company gets a rate increase approved, they often already need another one, according to Rex Frazier, president of the Personal Insurance Federation of California, an industry lobbying group.

"The pricing system we have can function in a low-inflation environment, but the deficiencies of strict price controls become very evident when there's significant inflation," Frazier told The Standard in July.

The rate hearings also can force insurers to reveal proprietary information to the public and their competitors, said Karl Susman, president of the Susman Insurance Agency in Los Angeles and a commentator on insurance issues.

"That would be like telling McDonald's and Burger King: You've got to sit down at the table and show us your secret sauces," he told The Standard.

But these assessments of the problem are not universal.

Rosenfield said he attributes the delays in rate approval not to the review process but to understaffing at the Department of Insurance and actions of insurance companies. He isn't sympathetic to concerns about insurers having to share their "secret sauce."

"I say, 'too bad,'" he said. "That's what the voters decided."

There is one other complaint about Prop. 103 that both insurance professionals and Lara himself have vocalized.

In recent years, Consumer Watchdog has become the main intervener during rate hearings. That means the nonprofit has been able to receive millions of dollars in compensation, usually from the insurer, for its in-house expenses and the costs of bringing in outside witnesses.

Although he did not name Consumer Watchdog directly, Lara said on Thursday that the organization was "materially benefiting from a process that is meant for a broader public participation."

Rosenfield called that "demonstrably false" and said efforts by a previous insurance commissioner to not pay interveners led to many others having to pull out of the process.

He said Consumer Watchdog's participation has led to $3.5 billion in savings for consumers since 2003.

"That's money that we've kept in consumers' pockets that would be in the industry's pocket," Rosenfield said. "The industry hates that."

Change Needed?
Despite Rosenfield's full-throated defense of Prop. 103, both industry representatives and, increasingly, politicians seem to believe something needs to change.

Prior to Newsom and Lara's announcements, insurance agent Susman said climate change had fundamentally altered insurance and that reform was needed. To respond to the changing reality, there needs to be more trust between consumer advocates and the industry, he told The Standard.

"We need to be at a place where, if an insurance company can show in math that a model makes sense, it’s nondiscriminatory, it can be justified by math and big numbers, it should be approved,” he said.

Lara’s reform appears to push the situation in that direction.

Last week, Newsom emphasized the gravity of California’s insurance crisis in a conversation with Politico.

“This is not a yellow-flag issue,” he said during an event organized by the publication. “This is a waving red-flag issue.”

But Amy Bach, who leads the San Francisco-based nonprofit United Policyholders, said Prop. 103 has largely benefited consumers but there is no doubt that California faces big problems.

“From [Lara’s] perspective, he’s just trying to save the market here,” Bach said days before the announcement. “Competition is so weak right now. We have a very complicated problem on our hands.”

As for Rosenfield, he is waiting to see Lara and Newsom’s new strategy in writing to find out whether they will try to alter Prop. 103.

“If they try,” he said, “we will sue them, and we will win.”

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