Insurers Fleeing California Market Want Rate-Hike Flexibility

Bloomberg Law

California's size makes it "hard for insurers to walk away"
State has an unhealthy property insurance market, industry says
As property insurers flee California, a state riven by billion-dollar wildfires, mudslides, and the ever-present threat of a catastrophic earthquake, state lawmakers on Wednesday will take up the complex but necessary issue of how to convince the carriers to stay.

The joint hearing of the California Assembly's Insurance and Emergency Management committees will concentrate on insurance and catastrophe modeling.

The session comes as the state's geographical, environmental, and political realities combine to create an inflection point compelling carriers, shareholders, regulators, and consumer groups to shore up California's crumbling market. State Farm General Insurance Co. is the latest insurer to cut coverage in the nation's disaster-prone most populous state, following Allstate Corp., American International Group Inc., and Chubb Ltd.

The insurance industry is pushing regulators to allow rate increases that they say would allow them to remain in the property insurance market.

"The pullout from new homeowners' coverage for consumers living in California poses an existential dilemma for California insurance regulators, California homeowners, and the government of the State of California," Boston College Law Professor Patricia McCoy said.

"Should the State attempt to coerce insurers to continue to provide new coverage? If the state is too heavy-handed, insurers could flee the California market altogether," McCoy said in an email. "On the other hand, doing nothing could lead to more attrition in the form of pullouts like State Farm's, causing the private market for homeowners' insurance in California to eventually collapse."

State Farm announced May 26 that it would stop writing new property policies in California, effective the next day. The Bloomington, Ill.-based company is the largest underwriter of property and casualty insurance in California, where last year it had more than 21% of the market and incurred $5.9 billion in losses, according to California Department of Insurance figures.

The insurance giant, one of the catalysts for today's hearing, failed to respond to multiple email and phone requests for comment on whether it would participate, or defend its exit decision, at the hearing.

The departures are "definitely putting a lot of pressure on the Department of Insurance and on the California Legislature," said Mark Robinson, an insurance regulatory partner at Michelman & Robinson LLP. The regulators need to allow reasonable rate increases to maintain a healthy property insurance market, he said.

Prop 103 Process
California voters in 1988 passed Proposition 103 that requires insurers to seek approval for rates from the elected insurance commissioner. The state requires insurers to use 20 years of historic risk modeling to price current risks, a pain point for insurers as they ask for rate increases.

"Prop 103 is a disincentive to insurers to issue policies in the high-risk areas. Because homes didn't exist there before, there were no wildfire losses," said Karen Collins, vice president of property & environment at the American Property Casualty Insurance Association.

The rule also allows consumer protection groups to intervene and object to any premium increase higher than 6.9%, and it can be a lengthy process with a lot of legal costs to insurers, Collins said.

Harvey Rosenfield, author of Prop 103 and founder of Consumer Watchdog, last month accused State Farm of pulling the plug on new policies to push through increased rates. The insurer filed an application to increase its homeowners' insurance premiums by an average 28.1%, and its residential rental property insurance by an average of 20%.

"Under Proposition 103, insurance companies can't just stop selling insurance to consumers in order to make more money for themselves – they have to open their books and get the Insurance Commissioner's approval," Rosenfield said in a May 30 blog post.

To that end, US Rep. Maxine Waters (D-Calif.), ranking member on the House Financial Services Committee, in a June 6 letter to the Treasury Department's Federal Insurance Office said some consumer advocates are raising concerns that the exodus of private insurers "may represent efforts to force insurance regulators to approve substantial rate increases that were previously denied, and may also raise anti-trust concerns."

Reinsurance Reality
Some insurers are asking California regulators to expedite rate increase requests and allow carriers to match their pricing with rising reinsurance costs, Robinson said. Reinsurers take on risks already on insurers' books, freeing them up to write more policies.

"California is really the only state that doesn't recognize reinsurance costs incurred by insurers in determining rate increases," Robinson said.

"Reinsurance rates for North American catastrophic losses have increased by 40% to 60% this year," following a series of significant natural disaster losses in the US, said Pete Walther, president of Marsh McLennan Agency's private client services.

Insurers also want California regulators to allow them to use contemporary catastrophe models instead of 20 years of historical loss data to price more frequent and severe climate change risks.

Catastrophic modeling—or "CAT modeling"—isn't a panacea, counters Amy Bach, co-founder and executive director of the pro-consumer United Policyholders.

California disallows using catastrophic modeling for ratemaking. Computer models put a number to financial impacts from disasters and depart from traditional fact-based empirical ratings, are developed by for-profit modelers for sale to for-profit insurers, "and have historically resulted in significant rate increases ," Bach said.

But given the state of the California insurance market in areas where urban developments are increasingly spreading into wildlands, "and the fact that insurers are on an all hands-on-deck campaign to break down the DOI's resistance," the nonprofit consumer advocate group is prepared for the rule to change “and allow CAT models to be used in ratemaking,” Bach said.

States’ Inspiration
California ultimately could adopt a rule similar to what other states such as New York have that limits the number of company-determined nonrewals in one year, Bach said.

And California can look to North Carolina, Boston College’s McCoy said.

Hurricane-prone North Carolina in 1969 created a nonprofit insurer of last resort for coastal homeowners’ coverage, with private insurers providing the funding. The state after rounds of devastating storms conditioned carriers’ ability to offer coverage anywhere in the state upon their participation in the so-called wind fund. There too, insurers threatened to leave, prompting the state to revise the funding structure to firm up its footing and cap insurers’ liability, she said.

The big question is whether insurers would balk at a similar proposal in the Golden State. “California is such an enormous market—practically a country unto itself—that it may be very hard for insurers to walk away,” McCoy said.

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