
SENATE COMMITTEE ON INSURANCE

Senator Susan Rubio, Chair

2019 - 2020 Regular

Bill No: SB 872 **Hearing Date:** May 14, 2020
Author: Dodd
Version: January 21, 2020 Introduced
Urgency: No **Fiscal:** No
Consultant: Hugh Slayden

SUBJECT: Residential property insurance: state of emergency

DIGEST: This bill provides extensions to the time limits to collect on policies covering commercial properties after a declared emergency; prohibits an insurer from deducting the land value from the replacement cost when a residential or commercial insured rebuilds or purchases an existing structure on another property; streamlines the claims process for residential property insurance and adds consumer protections to the process for settling claims for lost personal contents and additional living expenses (ALE); and requires insurers to provide a 60-day grace period for nonpayment in an area impacted by a declared state of emergency.

ANALYSIS:

Existing law:

- 1) Establishes the minimum benefits for an “open” policy of property insurance (that is, one where the value of the benefits is determined after the loss or damage) and establishes procedural standards for the settlement of the claim.
- 2) Extension of Time to Collect Replacement Cost. Requires property insurance to pay the actual cash value of the damaged property until it has been repaired, rebuilt, or replaced, and establishes minimum periods to collect the full replacement cost of a structure once the insurer has made a first payment.
 - a) Grants the insured at least 12 months to collect the full replacement cost of a damaged structure.
 - b) If the loss is due to an event that was declared a “state of emergency,” grants an insured *homeowner* at least 36 months, as well as one or more six-month extensions if the insured acting in good faith encounters delays in the reconstruction process.
- 3) Additional Living Expense. Requires homeowners insurance to cover additional living expenses (ALE) for at least 24 months if the loss resulted from an event declared to be a state of emergency and requires extensions of up to 12 additional months, for a total of 36 months, if the insured acting in good faith encounters delays in the reconstruction process.
- 4) Relocation after Loss. Prohibits homeowners insurance, in the event of a total loss of a home, from limiting or denying payment of building code upgrade cost or the replacement cost on the basis that the insured has decided to rebuild at a new location or to purchase an existing home at a new location.

This bill:

- 1) Extension of Time to Settle Claim. Grants the insured of a commercial property policy the same time limits to collect full replacement value as residential properties.
- 2) ALE Benefit for Residential Properties. Revises or clarifies the rules governing ALE benefits for insureds who have lost their homes or cannot live in their homes.
 - a) Requires ALE to cover all reasonable expenses incurred by the insured to maintain a comparable standard of living, including housing, furniture rental, food, transportation, storage, and boarding of pets and noncommercial livestock.
 - b) Authorizes an insured to collect the fair rental value of the dwelling in lieu of itemized expenses.
 - c) If the loss resulted from an event declared to be a state of emergency, requires ALE to provide the following:
 - i) Expenses accrued after the direct physical loss has been remediated if the premises remains uninhabitable because of direct damage to neighboring premises or public infrastructure that was covered by an insured peril.
 - ii) An advance payment of at least four months if the home was a total loss.
- 3) Contents. If the loss resulted from an event declared to be a state of emergency and the insured files a claim for lost or damaged contents of a home (appliances, furniture, clothing, etc.), requires the insurer to do the following:
 - a) Provide an advance payment of no less than 25% of the policy limit for contents without an inventory of lost items but allows the insurer to require proof for additional payments;
 - b) Accept an inventory in a reasonable form that provides substantially the same information as the insurer's form but allows the insurer to request additional information if reasonable; and
 - c) Accept an inventory of contents that includes groupings of personal property, including clothing, books, food items, etc.
- 4) Relocation after Loss. Revises rules applicable to claims where the insured chooses to build a new home or purchase an existing home on a different piece of property.
 - a) Prohibits the insurer from deducting the value of the new land from the replacement cost.
 - b) Applies these rules to commercial properties.
- 5) Grace Period for Nonpayment of Premium. Requires an insurer to offer a 60-day grace period for premium payments for policies on property located in areas covered by a declared state of emergency.
- 6) Severability. Declares that the provisions of this bill are severable.

Background

According to the author:

According to the California Department of Forestry and Fire Protection (CAL FIRE), the State of California experienced 7,860 wildfires in 2019. By the end of October 2019, California's wildfires caused an estimated \$25.4 billion in economic damages, and those who suffered residential property damage find themselves struggling to navigate the arduous process of obtaining insurance payouts.

SB 872 aims to remedy this problem by cutting through red tape and unfair delays. The bill requires insurers to make an advance payment of at least four months for living expenses, such as temporary housing. Insurers are also required to make an advance payment of at least 25 percent of a policy limit for lost contents. These steps will allow families who lost everything to be able to afford shelter and other necessities following a disaster by speeding funding they are already entitled to receive.

In 2017 and 2018, California experienced the largest and most destructive wildfires in its history. Following those fires, CDI issued notices requesting that insurers follow voluntary procedures designed to expedite claims. Some of those procedures included providing an advance payment of at least 4 months of ALE and 25% of the personal contents coverage; accepting alternative forms of inventories as opposed to requiring the insured use the insurer's forms; allowing insureds to group items in the inventory; and providing a 30-day grace period make premium payments. This bill primarily addresses claims issues experienced by victims of the 2017 and 2018 wildfires and codifies some of the expedited procedures.

Replacement Cost Value and the Time to Collect Replacement Cost. Most homeowners insurance policies are "open" policies intended to cover the cost to repair, rebuild, or replace the home, i.e. the "replacement cost" of the home or structure. These policies are the most common form, but only pay up to a limit set in the policy. The insured only has a right to the limit if the actual cost to repair, rebuild, or replace the home reaches or exceeds the limit.

Insurers may set a time limit for establishing and negotiating the full replacement cost value. Existing law gives the insured at least 12 months to collect the full value of the policy with six month extensions for good cause.

Existing law also provides a homeowner a minimum of 24 months following a declared state of emergency to collect the full replacement cost value. This bill would apply that extension to commercial properties as well. CDI argues that, prior to legislation enacted in 2018, the 24-month limit was not limited residential properties (former Ins. Code § 2051.5(b)(1)) and suggests that the bill, in this regard, is only correcting a drafting error. CDI argues that legislation in 2018 unintentionally limited provisions to residences when they were originally intended to cover both residential and commercial properties. Some insurance trade representatives disagree.

There is evidence on both sides. AB 2199 (Kehoe), Chapter 311, Statutes of 2004, the bill that established that Insurance Code provision used the generic term "structure" in

that section (the urgency language refers to “consumers of insurance who suffer the loss of their homes or other structures”). Legislation in 2018, struck the reference to a structure and replaced it with a reference to a home. (See AB 1800 (2018), AB 1772 (2018), and AB 894 (2018).)

On the other hand, the May 5, 2004 analysis by the Assembly Insurance Committee states, in part, that the purpose of the bill, according to the author, is to “provide homeowners” with adequate time to repair or replace “their property”.

SB 872 would replace that reference to “home” with the word “structure” with the intent to apply that provision to commercial as well as residential, properties.

Additional Living Expenses (ALE). ALE provides homeowners assistance with paying for the additional costs of living outside the home while the wait to rebuild, repair, or replace their home. Most policies provide ALE when the home is lost or direct damage to the home renders it uninhabitable. Existing law requires policies to cover up to 12 months of ALE while the home is being repaired or rebuilt. Following a state of emergency, policies must provide at least 24 months which gives the homeowner more time to deal with the additional challenges that follow large scale disasters such as extensive community debris removal, to obtaining permits, finding an available contractor and necessary materials, etc.

This bill provides streamlined ALE options and more explicitly define what is covered.

- *Clarifies that the minimum coverage period for ALE applies to “loss of use”.* Technically, policies often refer to “loss of use, not “ALE”. According to CDI, that change is not intended to expand the provision to apply to commercial policies.
- *Provide insureds the option to collect the fair rental value of the lost property rather than seek reimbursement.* Insurers may provide ALE in the form of reimbursement so that the insured must incur the expenses first and provide receipts to collect the benefit. Some insurers offer the option to collect the fair rental value of the home on a monthly basis. For example, if the insured’s home could rent in a furnished condition for \$3,000 per month at the time of the claim, the insured could collect this amount without having to show receipts.
- *Requires ALE to cover “all reasonable additional expenses incurred by the insured to maintain a comparable standard of living”.* The bill’s proponents suggest that insurers may refuse to cover some types of expenses that should be covered. For example, after a major event, there may be a lack of hotels and other traditional housing. They argue that insurers should cover the expenses for Airbnb, short-term rentals, renting an RV, or even purchasing a temporary home or RV while the primary insured home is being rebuilt. The author also notes that oftentimes, insureds with pets, livestock, etc. have problems “housing” these animals in hotels or rental properties (which would not take them).
- *Expands ALE to cover uninhabitable properties where the damaged has been repaired.* Property insurance covers costs, including ALE, related to damage to the property. This approach leaves gaps in coverage where the property has been repaired but remains unusable for some other reason. In supporting this

bill, Insurance Commissioner Ricardo Lara cites examples of homeowners in Paradise that, due to the 2018 Camp Fire, were unable to live in their homes for lack of electricity, water, and other essential services. This bill would allow homeowners who suffered covered damage to continue to receive ALE if the home is fixed, but remains uninhabitable for specified reasons.

Contents Coverage: Replacing Clothing, Appliances, Furniture, Etc. Most homeowners insurance policies cover lost or damaged contents of the home, but the insured may have to submit an inventory and documentation of the loss. Generally speaking, contents limits are set as a percentage of the primary dwelling coverage and do not necessarily reflect the actual value of the contents of the home. Insurers use different formulas for setting contents coverage. One may use 50% of the replacement cost of the primary dwelling, while another might use 75%.

Insurers usually require the claimant to furnish a complete inventory of the destroyed and damaged contents, often on the insurer's own form, showing in detail quantities, costs, actual cash value and amount of loss claimed. After destructive wildfires, however, policyholders often find that documentation required by the insurance company is missing or was destroyed in the fire, such as home inventories, receipts, bills of sale, and vehicle ownership papers. In 2018, the committee heard extensive testimony on the how difficult and distressing the process may be for wildfire victims. Nevertheless, it is an urgent task. In their letter of support, UnitedPolicyholders explains that one of the next steps after losing a home is to replace necessary personal property, including medications, cooking supplies, and clothes, etc., as soon as possible.

SB 872 requires the insurer, for losses related to a declared state of emergency and for which an insured makes a claim on or after January 1, 2021, to make a minimum payment for contents without an inventory, and to accept an inventory of contents in any reasonable form that contains substantially the same information as the insurer's form. The bill does not prohibit the insurer from asking for follow-up information or documentation). The bill also permits claimants to list property in groups, such as "100 DVDs" instead of individually listing each DVD title and assign a price.

Relocation. After a total loss, the insured may rebuild the existing home or purchase another home at a different location. Some insurers have been deducting the value of the new land from the "replacement cost" when homeowners purchase elsewhere.

This practice is anchored in the principle of indemnity which attempts to put the insured in the same financial position they were in prior to the event. Insurance is not intended to allow an insured to profit from the event. For example, when an automobile is "totaled," the insurer pays the fair market value of the car but keeps the car (some insurers "sell" the car back at a discounted value). If the insurer does not deduct the value of the new land, the insured may come away with a dwelling, the original land, and a new piece of land—more than they had before the loss.

However, the practical effect of deducting the land value is going to depend on the individual circumstances and may leave the insured in a position where they may have to purchase a lesser value dwelling, borrow money, or come up with cash out of their own pockets. According to UnitedPolicyholders, the land deduction is often not discovered until the insured has already found a home and needs to close escrow.

This bill prohibits an insurer from deducting the value of land at the new location if the insured, both residential and commercial, purchases a pre-existing home or building elsewhere. Although it could increase the chance that an insured might be “overcompensated,” there is a public policy argument to encourage the purchase of an existing structure rather than rebuilding in a high fire-risk area. It also extends the existing rules against limiting or denying payment of the building code upgrade cost or the replacement cost that to residential property coverage to commercial policies.

Grace Period for Nonpayment of Premium. After a fire, many consumers, particularly homeowners who have lost their home, will have trouble receiving mail. A consumer may fail to pay the premium if an important billing reminder or statement is not received. According to the author, this can result in survivors losing their insurance coverage for nonpayment. The author also points out that many insurers already voluntarily grant payment leniency for wildfire victims. SB 872 would require residential property insurers to grant billing leniency for at least 60 days for customers in designated wildfire disaster areas.

Consumers who prepay their policy, make automatic payments, or pay through an escrow account may not need grace period. Some insured finance their payment through another type of company. Insurers raise a concern that the grace period does not apply to premium finance companies that lend money to cover the cost of insurance premiums for a full year of coverage; these companies receive payments from the homeowner on a monthly basis and that payment would not be affected by this bill.

Potential Impact on Rates. Since 2018, the Legislature has enacted several proposals that expand benefits or protections to wildfire victims that could increase insurance rates, particularly in high-fire risk areas. However, there is little reliable information offered to project their potential impact on rates and no system in place to provide objective impact information to the committee.

Legislation is often scrutinized for its potential financial impacts. Bills proposing to mandate benefits or services in health insurance are reviewed by the California Health Benefits Review Program before they are heard in policy committee. (Health & Safety Code § 127660.) Similarly, bills with a fiscal impact are scrutinized by the Department of Finance and legislative fiscal committees. That process provides an independent impact analysis and allows the Legislature to prioritize among competing proposals.

CDI, the sponsor of this bill, did provide a basic assessment of the potential impact this bill may have on rates. According to CDI, many of the expedited claims provisions and time limit extensions should not impact rates significantly because they only provide what the insured would have received anyway. Other instances covered by the bill, except for one category, are likely to be so infrequent that they will not have much of an overall impact; for example, most homeowners rebuild rather than purchasing another home elsewhere, so rules expanding a homeowners right to purchase elsewhere may have a limited impact. Moreover, savings from expedited claims settlement and lower ALE costs related to the claim may offset any additional losses caused by that expansion.

For other aspects of the proposal, the potential impact is less clear because of the lack of underlying data. For example, there is no reliable estimate on the number of homeowners who were unable to live in their homes once they are repaired. There is probably even less data on commercial properties. However, this bill includes clarifications that should help to moderate pricing impact: (1) it only applies to properties that have been damaged and rendered uninhabitable, and (2) the triggering damage to the neighboring property is limited to insured perils. Those provisions narrow the added costs and the potential impact on rates.

Still, projecting the potential impact of insurance bills on rates requires a very sophisticated and complex analysis probably better suited for sophisticated computer-driven loss models, especially when estimating the impacts in catastrophic scenarios or applying “what if” scenarios (like “what if” we increased a certain limit). Loss models calculate potential losses based on event parameters, exposed structures, insurance coverage, etc. Neither the Legislature, nor CDI, has consistent access to the information that a wildfire loss model can provide and most projections are, at best, educated guesses.

Related/Prior Legislation

AB 1852 (Daly, 2020), pending in the Assembly Insurance Committee, and AB 3012 (Wood, 2020), pending on Assembly Floor, would (1) prohibit insurers from deducting the land value after a total loss and the insured chooses to rebuild in another location; (2) requires insurers to cover ALE when the property is rendered uninhabitable or otherwise unusable due to orders from appropriate authorities or conditions affecting habitability; (3) requires insurers to provide a minimum of 30% of dwelling coverage for personal contents without requiring an inventory; and (4) makes changes relative to the California FAIR Plan.

SB 894 (Dodd), Chapter 618, Statutes of 2018, after a total loss of a home in a declared disaster area (1) requires an insurer to renew a residential insurance policy for at least two annual renewal periods or 24 months, whichever is greater, as specified; (2) requires an insurer to grant an additional 12-month extension for a total of 36 months for additional living expense (ALE) if an insured acting in good faith and with reasonable due diligence encounters a delay in the reconstruction process, subject to policy limits; (3) allows an insured to combine payments for actual losses up to the policy limits for the primary dwelling and other structures, limited to the amount necessary to rebuild or replace the home if the policy limits for the dwelling are insufficient; and (4) specifies that the payments for losses under this provision shall be full replacement value without requiring the replacement of the other structures.

SB 897 (McGuire, 2018) would have (1) required ALE to include all reasonable expenses incurred by the insured to maintain a comparable standard of living following a covered loss; (2) required, in the case of a total loss that is a result of a state of emergency, an insurer to provide an advance payment of no less than four months of ALE or fair rental value, to make an initial advance payment of no less than 25% of the policy limit for a claim for contents related to a total loss of a primary residence without completion of an inventory, to offer no less than 80% of the policy limits for contents without requiring the insured to file an itemized claim, and prohibited an insurer in the case of a claim for contents from requiring the use of a company-specific inventory

form, as specified; (3) required insurers, in the event of a state of emergency, to grant a 30-day grace period for payment of premiums for all homeowners' policies covering properties within the affected area; and (4) made specified provisions retroactive for any claim filed after July 1, 2017 but not submitted by January 1, 2019. Died on the Senate Inactive File.

AB 1772 (Aguiar-Curry), Chapter 627, Statutes of 2018, extended the minimum time to rebuild or replace after a declared disaster from 24 to 36 months and requires an insurer to provide additional extensions of 6 months if the insured, acting in good faith and with due diligence, encounters a delay or delays in approvals or reconstruction of the home; and requires all policy forms issued or renewed by an insurer to be in compliance with these changes on or after July 1, 2019.

AB 1800 (Levine), Chapter 628, Statutes of 2018, prohibits, in the event of a total loss, a residential property insurance policy from containing a provision that limits or denies payment of building code upgrade cost or replacement cost, including extended replacement cost, to the extent those costs are otherwise covered under the policy, based on the fact the insured has chosen to rebuild or purchase a home at a new location. As an urgency measure, went into effect on September 21, 2018.

SB 2 (Speier), Chapter 447, Statutes of 2005, requires insurers to provide ALE coverage (not including loss of use for commercial properties) for at least a period of 24 months, subject to other policy provisions.

AB 2199 (Kehoe), Chapter 311, Statutes of 2004, under an open policy, revised the measure of an open fire insurance policy from the cost of replacing the thing lost or injured in its condition at the time of the injury to the expense being to be the amount that it would cost the insured to repair, rebuild, or replace the thing lost or injured; (2) requires an insurer to grant a time extension of at least 24 month to rebuild, repair, or replace the insured property; and (3) requires the insurer to allow the insured to rebuild, repair, or replace the property at a location other than the original insured premises.

ARGUMENTS IN SUPPORT: Rural County Representatives of California (RCRC) writes in support that residents in RCRC member counties have been experiencing these difficulties for years in relation to high severity wildfires such as the Butte, Rim, and Valley Fires, and more recently in disastrous fires such as the Tubbs Fire, Camp Fire and Kincade Fire. These recent fires have only underscored the need for relief to property owners suffering losses who are trying to move on and recover some sense of normalcy after such a devastating event.

ARGUMENTS IN OPPOSITION: Several insurance trade associations point out that under existing CDI rules, insurance premiums are largely determined by past losses and loss related expenses. The 2017 and 2018 wildfires resulted in over \$26 billion of losses for California home insurers driving California homeowners insurance loss ratios to the highest in the nation in 2017-18." They argue that this measure will drive up insurance costs for Californians by significantly expanding the kinds of expenses that must be reimbursed and the circumstances under which extended ALE payments will be required, while simultaneously reducing the level of scrutiny for contents claims.

These associations further explain that historic financial losses place tremendous upward pressure on the price of homeowners insurance, and have forced many insurers

to safeguard their solvency (and their ability to pay claims in the event of another disaster) by limiting the amount of insurance they sell in high fire-risk areas of the state. Ultimately, they assert that, absent clear direction to the CDI to approve adequate rates that reflect the new costs imposed by this bill, this bill may exacerbate the homeowners insurance availability challenges in high fire-risk areas of the state.

SUPPORT:

California Department of Insurance (source)
Rural County Representatives of California
United Policyholders

OPPOSITION:

Pacific Association of Domestic Insurance Companies
Personal Insurance Federation of California
National Association of Mutual Insurance Companies
American Property Casualty Insurance Association

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