Little Hoover Commission

Hearing on California's Homeowners' Insurance Market, March 28, 2024

<u>Where we are</u>

California's home insurance marketplace has undergone unprecedented, dramatic changes in recent years. Premiums are at an all-time high for large numbers of residents across the state. In Wildland Urban Interface (WUI) zones, rural and suburban areas throughout California, "admitted" insurers have been non-renewing *many* of their customers, drastically reducing the number, location and types of homes they'll insure, and in some cases, announcing they're no longer selling new policies in the state at all. As this Commission recognizes, we are in the grip of a property insurance crisis in California.

As detailed below, we saw a pattern of non-renewals impacting residents of Sierra Nevada foothills communities as early as 2017. After a series of record-breaking wildfires led to non-renewals in impacted and contiguous regions, the CA legislature empowered Insurance Commissioner Lara to impose non-renewal moratoriums in disaster-impacted zip codes. The non-renewal moratoriums were extremely helpful to residents in those regions, but in recent years, they largely expired, leaving many households no choice but the state's insurer of last resort, the California Fair Plan.

Then in May 2023, State Farm (the insurer with the largest market share) made a public announcement by that they would not be issuing any new policies in the state. The announcement made headlines all across the country. Soon thereafter, several of their competitors made similar announcements, "closing" zip code after zip code to new business, imposing strict sales quotas on their agents, and non-renewing older homes and homes in brush areas at a rapid rate.

Today, home insurance options for property owners in many regions have shrunk precipitously, and the Fair Plan is now receiving 900 applications per day. To keep pace with the increased volume, the Fair Plan transitioned to a new technology platform for binding and issuing new policies. Applicants and agents are experiencing extensive delays and frustration.

To keep things in perspective, the Fair Plan currently insures fewer than 450,000 people, in contrast to Florida's version (Citizens), whose current policy count 1.6 million. Some experts fear we're heading in that direction. Others predict the Commissioner's

Sustainable Insurance Strategy[1], combined with a softening reinsurance market and insurers natural thirst for premium income will bring insurers back into the California marketplace. Many stakeholders, including United Policyholders, are worried that premiums for home insurance are going to become unaffordable for a significant number of California households if we continue relying solely on the private market for financial safety nets.

Why this is happening

The advent of risk modeling and risk scoring have combined with inflation, a drought, a “hard” reinsurance market, a series of record-breaking wildfires and insurers’ concerns about climate change to create a perfect storm for property owners and public officials.

Premiums are spiking and competition among private insurers is at a virtual standstill in regions throughout the state. Many households are having to insure their homes through lightly regulated “non-admitted“ (also called surplus/excess insurers) that do not pay into/participate in our state’s insolvency/guarantee fund. Our insurer of last resort is inundated and overwhelmed. Their products are expensive and bare bones, and they are continuing to appeal a court ruling that upheld a CDI order requiring them to sell more comprehensive coverage.

Households, agents, realtors and developers are scrambling for options. Property owners are panicking, desperate and despondent. For those with paid-off homes, the choice of putting food on the table versus keeping insurance in place has led a substantial number opting to “go bare” (be uninsured).

California is not alone – Florida, Louisiana, Colorado, Idaho and many other states are experiencing similar home insurance affordability and availability problems. State and Federal actions are imperative.

Here in California, we need more funding for wildfire risk reduction and prevention. We need insurers to incentivize and reward investments in risk reduction through discounts and renewals. To bring home insurance prices back down to earth, we need an independent, public catastrophe model against which to measure the accuracy of private models. To reduce the absolute power that reinsurers have to impact pricing and limit underwriting, we need a public facility that will provide *some* of the reinsurance that insurers must buy for their catastrophic risk exposure.

We need more consumer protections in place in regard to surplus lines policies. We don’t need deregulation. We need improved, more efficient regulation. We need admitted insurers to come back into our market, but simultaneously, we need to be building alternative risk pooling solutions in recognition of the reality that publicly-traded, for-profit, privately-run insurance companies and their investors are unlikely to regain

[1] https://www.insurance.ca.gov/01-consumers/180-climate-change/SustainableInsuranceStrategy.cfm

their previous appetite for insuring real properties in brush, coastal and flood-prone regions.

Where we've been

United Policyholders had seen patterns of non-renewals in wildfire areas in the past, but they were temporary. Competition had always restored access to home insurance for impacted residents. But after it became widely known that millions of trees were dead and dying along the spine of the Sierra Nevada mountains, we began seeing patterns of non-renewals in nearby foothills communities. Competition among insurers was not curing the problem.

A Governor's Tree Mortality Task Force spawned an Insurance Subgroup. United Policyholders participated in the Subgroup's meetings, along with representatives of CalFire, insurance companies, the CA Department of Insurance, Fire Chiefs from rural areas and other stakeholders.

At the subgroup meetings, we learned that rural fire departments were organically helping residents who'd gotten non-renewal notices from their home insurance companies. They were sending personnel out to inspect, giving homeowners a prescription for improving conditions/reducing wildfire risk, helping them clear defensible space, limb trees, etc. These rural fire departments were also giving homeowners letters to send their insurers confirming the risk reduction steps they'd taken, and in many situations, the letters were succeeding at getting insurers to reverse their decision and agree to renew coverage. We saw the germ of a solution to insurers' shrinking appetite for insuring homes in WUI and suburban regions…increase risk reduction as much and as fast as feasible.

We also learned during the Insurance Subgroup meetings that insurance companies are now using a risk scoring tool branded as "Fire Line" that seemed to be triggering non-renewals. Today, Verisk, Core Logic and Zesty A.I. offer similar products that insurers are using to assign every home a numerical risk score. Insurers are now using that score to decide which homes they'll insure and which they'll reject. The scoring systems are helping insurers segment, (the opposite of pool), risks. But they are only one of the drivers of the current crisis.

When the Insurance Subgroup lost its public entity employee chair, Mariposa County Supervisor Rosemarie Smallcombe asked United Policyholders to keep the work going, so we launched an initiative called WRAP[2] – which stands for Wildfire Risk Reduction and Asset Protection, and a working group to support the initiative. Our WRAP group has been meeting every month for well over two years to share information, innovation, and advance the "inspect, rectify/mitigate, document for insurer, secure a renewal" concept those rural fire departments had developed organically.

[2] https://uphelp.org/preparedness/wrap-resource-center/

Despite significant progress in risk reduction, insurers are taking a very conservative view of the value of mitigation and are instead focused on getting regulatory relief

In part due to our WRAP group's work, we now have clear standards in place for what constitutes effective wildfire risk reduction, regulations that require insurers' rating plans to reward individual and community-wise risk reduction, and a growing network of experts across the state helping create defensible space, shaded fuel breaks, hardened homes, and Fire Safe and Firewise communities. Now we need insurers to support our efforts. Insurers need to recognize the value of all the hard work that's going on across California to reduce risk, accept that Prop 103 means California is not and will not be a "file and use" state and cooperate with the CDI's efforts to bring more efficiency to the rate review process that doesn't weaken appropriate oversight of rates.

United Policyholders' ongoing efforts

United Policyholders, ("UP"), through our Roadmap to Preparedness program, uses lessons learned after past disasters to educate consumers and help households be adequately insured and prepared to be resilient to disasters and adversity. Traditionally, our home insurance guidance has focused on helping people adequately insure their homes, shop and compare coverage options and not just aim for the cheapest policy, inventory their assets and take basic steps to be disaster-prepared.

As home insurance non-renewals climbed, we began getting more and more requests for help from households that had been dropped and couldn't find replacement coverage. UP began developing guidance and programming to help those households shop in a marketplace where competition and options were rapidly disappearing. That effort continues to this day.

Through surveys, consumer complaints, input from stakeholders and a combination of online and in person information that UP staff are disseminating across the state, we are continuing to keep our finger on the pulse of the home insurance marketplace and give consumers and public officials guidance and ideas for short and long term solutions.

By working closely with the California Department of Insurance, consumer-oriented insurance agents and brokers, fire science and risk reduction experts, United Policyholders is working hard to help California property owners stay insured and financially protected despite unprecedented availability and affordability challenges in the current marketplace.

Proposed solutions

There is no shortage of opinions on how to repair California's home insurance marketplace, but United Policyholders would like to see some new ideas considered:

Insure tech has made it way too easy for insurers to segment risks and reject all but the lowest ones. Similar to how we attacked lender redlining in the past, we need to take bold action to reverse excessive risk segmentation. It may be too late to ban risk scoring systems and underwriting decisions based on aerial imagery, but we can limit their use, require transparency, provide avenues for consumer appeals, and expand the requirement that insurers participate in the Fair Plan to *all* insurers doing business in the state – including surplus lines insurers. To be fair, we should start requiring surplus lines insurers to participate in the Fair Plan and the California Insurance Guarantee Association, (CIGA). Surplus lines insurers are very lightly regulated but are now covering an increasing number of homes in California (and all the states that are experiencing availability problems) and they are getting a free pass on participating in both the Fair Plan and CIGA.

Admitted insurers say they lost their appetite in California because they "lost hope" of being allowed to charge rates commensurate with the higher risks they face due to climate change and inflation. They say they need faster and fairer rate approvals. They say they need to be allowed to use catastrophe models for setting their rates, and be able to include their reinsurance costs in the rates they charge. They've been making these points for years and clearly they are top priorities, and the Commissioner has determined both changes are warranted, with conditions.

Insurers are also advocating to change the current Fair Plan Association formula for assessing member companies in the event the entity does not have sufficient funds to meet claim-paying obligations. Beyond requiring surplus lines insurers to participate in the Fair Plan, we do not support changing the current formula.

On the topic of allowing Catastrophe ("CAT") models to be used for ratemaking, every other state allows insurers to use them, and we are deferring to the expertise of the California Department of Insurance's Rate Regulation Bureau which recently issued regulations that will allow them following pre-approval peer review of the models. CDI assures us they will still be able to review and parse rate filing applications, just as they do now, even if the applications are based on CAT models. CAT modeling proponents insist they'll make it easier for insurers to give mitigation discounts. We strongly support development of a non-commercial, public model as a measuring stick against private models.

On the topic of a reinsurance pass-through, allowing that change will adversely impact consumers through higher premiums. We appreciate the CDI's commitment to limit the reinsurance pass-through to California-only reinsurance costs and tie the allowance to a firm commitment from insurers to take customers out of the Fair Plan and write more policies in WUI areas, but we sincerely hope the market opens back up before that change can be implemented.

United Policyholders has long been exploring concepts to use the financial strength of the federal government or regional groups of states to provide *some* of the catastrophic risk claim paying capacity that retail reinsurance currently provides all of. Low interest loan guarantees, Catastrophe Bonds, a Terrorism Risk Insurance Association[3]-like entity or a CAT fund modeled on the Florida Hurricane Catastrophe Fund[4] are all options that need to be considered.

Because the California Fair Plan is a “take all comers” plan with a public purpose, we support the concept of allowing it to have priority status in accessing a government-sponsored reinsurance facility. But with that priority status, the Fair Plan must become more transparent about its Governing Committee and operations, and there must be outside approval of their member distributions.

Other options that need to be considered are layered risk pool[5] concepts, parametric products for low dollar claims plus layered higher risk capacity and captive insurance models.

Sincerely,

Amy Bach

Amy Bach
Executive Director

[3] https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/federal-insurance-office/terrorism-risk-insurance-program
[4] https://fhcf.sbafla.com/
[5] https://www.agrip.org/home