LEGISLATIVE OFFICE BUILDING
1020 N STREET, ROOM 369
SACRAMENTO, CA 95814
(916) 319-2086
FAX (916) 319-2186

CHIEF CONSULTANT
KATHLEEN O'MALLEY

PRINCIPAL CONSULTANT
CLAIRE WENDT

COMMITTEE SECRETARY
TIFFANY MORRISON

Assembly
California Legislature

ASSEMBLY COMMITTEE ON INSURANCE
LISA CALDERON, CHAIR
ASSEMBLYMEMBER, FIFTY-SIXTH DISTRICT

Assembly Insurance Committee
Oversight Hearing
California FAIR Plan

Wednesday, March 13, 2024
10:00am
State Capitol, Room 126

Introduction

Much has changed since the Assembly Insurance Committee's last informational hearing on the California FAIR Plan. (3/8/23 Agenda) While it has only been a year, the California insurance landscape depicts a very different picture today. What many may not realize, California's insurance market has been in this position before, hence why the FAIR Plan was created almost 60 years ago. In times of insurance market turmoil, the FAIR Plan is the safety net for [wild] fire coverage. The FAIR Plan was a legislative solution at a time when the insurance market was in disarray. Since the FAIR Plan does not fall under the provisions of Proposition 103 (likely due to the fact it was created well before the passage of the initiative), over the years, it's been far easier to expand and transform the FAIR Plan to fill in the necessary insurance coverage gaps. Solutions that involve encouraging FAIR Plan policyholder growth usually coincides with much angst among the admitted market. (Discussed further below.)

This oversight hearing is a sequel to the hearing a year ago with the sole focus on the "association." All eyes are on the FAIR Plan as it continues to absorb more policyholders who are unable to find insurance in the admitted market. Still serving as a safety net but with the added complexities of having to implement new requirements, hire more staff, address customer service complaints, and adjusting to a new IT system. (Please keep in mind, the FAIR Plan is not a state agency and not state-or taxpayer funded.) This hearing will evaluate whether the FAIR Plan is still the insurer of last resort and if not, when will it, if ever, return to its stated purpose. The fact remains; a determinant to gauge whether California's insurance market is stabilizing is in the numbers. The fewer number of FAIR Plan policyholders, the healthier the California admitted insurance market. With a heavy sigh, the number of FAIR Plan policyholders continues to grow.

What is the California FAIR Plan?

The California FAIR Plan – "Fair Access to Insurance Requirements" – is an "association" of all insurance companies licensed by the California Department of Insurance (CDI) that provides basic property and casualty insurance in California. It was created in 1968, following urban disturbances, notably the Watts Riots in Los Angeles.

What is the purpose of the California FAIR Plan?

"To assure stability……
To assure the availability……
To encourage maximum use…..
To provide for equitable distribution among admitted insurers of the responsibility for insuring qualified property for which basic property insurance cannot be obtained through the normal insurance market." (CA Ins. Code 10090)

Simply stated, the purpose of the FAIR Plan is to be the "insurer of last resort" for "basic" property insurance in the event of a market failure. At inception, that was essentially urban commercial property. Ultimately, it has expanded to include homeowners' insurance anywhere in the state, provided that the insurance "cannot be obtained" in the normal manner in the market. At origination, the FAIR Plan was not intended to compete with the admitted market but that point is now debatable.

The FAIR Plan was established to ensure that urban property owners, mostly businesses, would have "fair access" to the property insurance necessary to continue to operate in a market that insurers viewed as too risky to cover. That risk evaluation resulted in a substantial market withdrawal by insurers from the urban property market. Despite its initial creation as an urban/business "insurer of last resort," the FAIR Plan expanded to provide coverage in "designated" brush fire regions of the state. It operated fairly well in this manner until the mid-1990's, when, as a consequence of the genuine homeowners' insurance crisis that followed the Northridge earthquake in 1994, the entire state was designated as the appropriate FAIR Plan coverage region.

FAIR Plan Policies & Rates

"Rates for the FAIR Plan shall not be excessive, inadequate, or unfairly discriminatory, and shall be actuarially sound so that premiums are adequate to cover expected losses, expenses and taxes, and shall reflect investment income of the plan." (CA Ins. Code 10100.2)

FAIR Plan policies are capped at $3.3 million for residential properties and $20 million per structure for commercial properties. (Please note, the $20 million per structure is still in the process of being implemented.) These caps were increased by the Insurance Commissioner in 2020 for residential and 2023 for commercial. Commercial went from $8.4 million per location in 2021, to $20 million per location in 2023, to $20 million per structure subsequently in 2023.

FAIR Plan commercial policies can cover homeowners associations, condo associations, farms, and businesses.

By statute, the FAIR Plan policy is not as broad as traditional homeowners' policies, it is nonetheless a fully sound and guaranteed policy that satisfies lenders' security requirements and protects the property against the primary risk factor faced by homeowners, which is [wild]fire. Other coverages are readily available in the market (typically through the purchase of a "difference-in-conditions" or "DIC" policy), which provide wraparound coverage that, coupled with a FAIR Plan policy, results in the same protection provided by a standard homeowner's policy. Because the FAIR Plan's role is to provide coverage when the regular market won't, it is not necessarily the role of the FAIR Plan to provide DIC policies when there is a healthy market for those policies.

CDI, over the last 5 years, has attempted to address homeowners having to seek a DIC in addition to a FAIR Plan policy, by requiring the FAIR Plan to expand the coverage it offers beyond just fire insurance. CDI would like the FAIR Plan to offer additional homeowners coverage including but not limited to: theft, on-property liability, water damage, and snow damage. The last 5 years has been consumed by back and forth litigation between CDI and the FAIR Plan. In late 2023, a Los Angeles Superior Court Judge ruled (again) in favor of CDI, that the Insurance Commissioner does have the authority to order the FAIR Plan to expand what it offers for coverage. The FAIR Plan appealed the latest ruling in February 2024, so the back and forth litigation continues.

Historically, the FAIR Plan is stereotyped as having rates 3 times as much, if not more, than the admitted market but recently the rates of the FAIR Plan have come under scrutiny as being equal to or in some cases less than the admitted market. As stated above, the FAIR Plan was not created to compete with the admitted market. Similar to arguments made by the admitted market, obstacles that the FAIR Plan faces to achieve rate adequacy stems from the inability to include the cost of reinsurance or catastrophe modeling in the rate filings.

<u>FAIR Plan Market Activity</u>

According to the FAIR Plan, they have more than 350,000 policies in force, a 22% increase in 2023. The FAIR Plan claims they receive nearly 1,000 applications a day, as well as registered agents, brokers, and other contacts increased from 9,000 to over 54,000.

The FAIR Plan's risk exposure is $311 billion as of December 2023, which is up from $50 billion in 2018. According to the FAIR Plan, at this point in time, the association has sufficient funds to run the operation with about $200 million in surplus.

Homeowners are required to conduct a diligent search of the private market for new coverage before resorting to the FAIR Plan. After receiving a non-renewal notice, some homeowners will find coverage from the admitted market in the course of that diligent search. However, where there are significant increases in FAIR Plan policy counts, it is a sound assumption that there has been an increase in the number of non-renewal notices sent to homeowners.

As the number of FAIR Plan policyholders grow, so does the threat of the FAIR Plan assessing the admitted market. A factor that is likely contributing to many insurers from pressing pause or restricting new business (or leaving entirely) in California. As it works right now, if there is a catastrophic event in an area where the FAIR Plan is heavily concentrated, and if the FAIR Plan is unable to pay claims, with prior approval from the Insurance Commissioner, the FAIR Plan has the ability to assess the admitted market. The admitted market is the financial backstop to the FAIR Plan in case of an "emergency." The amount of the assessment is based on the insurer's market share. From 1968 to today, the FAIR Plan has assessed twice, between 1993 and 1995 for about $260 million total. Notably due to the Northridge earthquake. Hence, when solutions encourage FAIR Plan policyholder growth, the admitted market is likely not thrilled. It should be noted that the FAIR Plan inherits the riskiest properties, those that were presumably non-renewed by the admitted market.

The Sustainable Insurance Strategy (SIS) and the FAIR Plan

On September 21, 2023, Governor Newsom issued an Executive Order that directed the Insurance Commissioner to "take prompt regulatory action to strengthen and stabilize California's marketplace for homeowners insurance and commercial property insurance, and to consider whether the recent sudden deterioration of the private insurance market presents facts that support emergency regulatory action."

A part of the executive order included: to maintain the solvency of the FAIR Plan to protect its policyholders and promote long-term resiliency in the face of climate change, including identifying mechanisms to reduce its share of the overall market in underserved areas and move its customers into the admitted insurance market.

The Insurance Commissioner responded promptly by announcing the SIS. Provisions of the SIS specific to the FAIR Plan include:

- Transitioning homeowners and businesses from the FAIR Plan back into the normal insurance market with commitments from insurance companies to cover all parts of California by writing no less than 85% of their statewide market share in high wildfire risk communities;

- Giving FAIR Plan policyholders who comply with the new Safer from Wildfires regulation first priority for transition to the normal market;

- Directing the FAIR Plan to further expand commercial coverage to $20 million per building to close insurance gaps for homeowners associations and condominium developments to help meet the state's housing goals and to provide required coverage to other large businesses in the state;

- Increasing data reporting by the FAIR Plan to the Department, Legislature, and Governor to monitor progress toward reducing its policyholders; and,

- Ordering changes to the FAIR Plan to prevent it from going bankrupt in the case of an extraordinary catastrophic event, including building its reserves and financial safeguards.

The Insurance Commissioner is in the process of implementing these reforms with the expected completion date of December 2024.

FAIR Plan Residential and Commercial Clearinghouse Programs

A significant provision of the SIS is depopulating the FAIR Plan through the clearinghouse programs.

The FAIR Plan residential clearinghouse program was created in 2021. Statute places the responsibility on the FAIR Plan to develop the clearinghouse program with these goals: reduce the concentration of policies and push the use of the regular insurance market; lower the quantity of policies in the FAIR Plan; and provide the insurers the ability to take on additional business. The intent of the program is to get FAIR Plan policyholders back into the admitted market. The policies in the clearinghouse are initially limited to the admitted market for the first 30 days, at which point nonadmitted insurers may also participate by offering a homeowners policy to someone in the FAIR Plan.

The commercial clearinghouse program was established via legislation in 2023, which requires the FAIR Plan to develop and implement a commercial clearinghouse program on or before, July 1, 2024, identical to the residential clearinghouse program.

Although the programs are new, the purpose and success of them are now under a microscope. The question of whether the residential clearinghouse program is up and running as intended is challenging to gauge. While the FAIR Plan has until July of this year to develop the commercial clearinghouse program, further oversight is necessary to examine whether these programs are successfully moving FAIR Plan policyholders back into the admitted market.

The FAIR Plan Governing Committee

The FAIR Plan is administered by a Governing Committee, and subject to the supervision of the Insurance Commissioner. The Governing Committee consists of nine voting insurers, and four non-voting members appointed by the Governor, which includes one representative of insurance agents, one representative of insurance brokers, one representative of the public, and one representative of surplus line brokers. The purpose of the Governing Committee is to ensure the requirements laid out in California Insurance Code 10090 are followed (referenced above). Legislation (signed by the Governor), or by rule, regulation or administrative determination by the Insurance Commissioner requires the FAIR Plan Governing Committee to amends its plan of operation.

Recent Legislative Actions Impacting the FAIR Plan

AB 1816 (Daly) Chapter 833, Statutes of 2019, expands the regions of the state in which an insurer can accrue "writeout credits" FAIR Plan to include areas designated by CalFire as high or very high fire risk. Also, requires the FAIR Plan to periodically provide data regarding the use of writeout credits by insurers to the Legislature, Governor, and CDI.

AB 3012 (Daly & Wood) Chapter 258, Statutes of 2020, directs the Fair Plan to implement a clearinghouse program whereby property insurers will be provided information about FAIR Plan policies, for the purpose of encouraging those insurers to offer regular private insurance to FAIR Plan policyholders.

SB 11 (Rubio) Chapter 128, Statues of 2021, authorizes the FAIR Plan to sell commercial coverage to farms.

SB 505 (Rubio) Chapter 180, Statutes of 2023, requires, by July 1, 2024, FAIR Plan to establish a clearinghouse program for commercial insurance policies.

Pending Legislation

AB 1844 (Calderon) This bill would require the Speaker of the Assembly and the Chairperson of the Senate Committee on Rules to serve as nonvoting, ex officio members of the governing committee, and would authorize each to name a designee to serve in their place. Pending before the Assembly Insurance Committee.

AB 2260 (Calderon) This bill would require the FAIR Plan, until December 31, 2027, to quarterly provide specified information about policies and clearinghouse program progress to the relevant policy committees of the Legislature and to post the information on the association's public internet website. Pending before the Assembly Insurance Committee.

Conclusion

In the last 5 years, primarily in response to catastrophic wildfires and admitted market withdrawal, legislation and actions taken by CDI has resulted in the FAIR Plan going through a complete transformation. To summarize, these actions include:

- Increasing FAIR Plan residential limits to $3.3 million.
- Increasing FAIR Plan commercial limits to $8.4 million per location, to $20 million per location to the $20 million per structure (which is still being implemented).
- Potential expansion and requirement to offer homeowners a more comprehensive coverage aka HO-3 light policy (pending litigation).

- Expanding commercial coverage to farms, ranches and other agricultural businesses.
- Developing residential and commercial clearinghouse programs.
- Implementing “Safer from Wildfire” discounts to FAIR Plan policyholders.

The FAIR Plan was created as a temporary safety net for policyholders. The goal should continue to be moving FAIR Plan policyholders back into the admitted market, hence the creation of the clearinghouse programs. Fortunately, the Insurance Commissioner’s Sustainable Insurance Strategy seeks to tackle the bigger insurance market picture in its entirety. Actions taken that continue to encourage FAIR Plan growth should be considered temporary solutions, if the goal is to return the FAIR Plan back into the “insurer of last resort.” When the growth of the FAIR Plan begins to stabilize or decrease, that will be the signal that the admitted market is back in business.