

**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



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JIM WOOD

## **Assembly Insurance Committee Oversight Hearing**

### **California Department of Insurance: Sustainable Insurance Strategy: Progress Wednesday, May 15, 2024**

I. *Introduction:*

This Assembly Insurance Committee Oversight Hearing is a follow up to the hearing the Committee held in December of 2023. The December hearing was an overview of the Insurance Commissioner’s game plan and strategy for stabilizing California’s insurance market also known as the Sustainable Insurance Strategy (SIS). The SIS was in response to the Governor’s Executive Order. A number of actions have taken place since the committee’s last oversight hearing. This hearing will go through the actions taken to date and evaluate next steps as the December 31, 2024 deadline nears.

II. *Background:*

On September 21, 2023, Governor Newsom issued an Executive Order that “ordered” 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. The Commissioner is requested to consider the following goals in crafting an appropriate regulatory response:

- a. Expand coverage choices for consumers, particularly in the underserved areas of the state.

- b. Improve the efficiency, speed, and transparency of the Department’s rate approval process.
- c. Tailor the rate approval process to account for all factors necessary to promote a robust, competitive insurance marketplace, including through potential revisions to the way catastrophe risks and insurer costs are accounted for.
- d. Maintain the long-term availability of homeowners and commercial property insurance coverage.
- e. 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.”

Following this Executive Order, on the same day, the Insurance Commissioner held a press conference announcing the SIS. The Insurance Commissioner has the authority to complete such administrative actions (with transparency) and make such decisions outside the Legislature.

These announcements came after a historically tumultuous year in the California insurance market.

### III. *What is the SIS?*

According to the California Department of Insurance (CDI) the three main goals of the SIS are:

- 1) Accessible Insurance for Californians
- 2) Create a Resilient Insurance Market
- 3) Protect Communities from Climate Change

In order to achieve these goals CDI framed the SIS to include the following:

- 1) Executive action by the Commissioner to transition homeowners and business 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;
- 2) Giving FAIR Plan policyholders who comply with the new Safer from Wildfires regulation first priority for transition to the normal market;

- 3) Expediting CDI's introduction of new rules for the review of climate catastrophe models that recognize the benefits of wildfire safety and mitigation actions at the state, local, and parcel levels;
- 4) 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;
- 5) Holding public meetings exploring incorporating California-only reinsurance costs into rate filings;
- 6) Improving rate filing procedures and timeline by enforcing the requirement for insurance companies to submit a complete rate filing, hiring additional CDI staff to review rate applications and inform regulatory changes, and enacting intervenor reform to increase transparency and public participation in the process;
- 7) Increasing data reporting by the FAIR Plan to CDI, Legislature, and Governor to monitor progress toward reducing its policyholders; and,
- 8) 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.

#### IV. *Why the SIS?*

Last year will go down in history as a perfect storm, so to speak, building over many years (wildfire losses, inadequate rates, lack of innovation) which led many insurers to withdraw or pause from doing business in California. Seven of the top twelve insurance companies (representing 85% of the homeowners' insurance market) paused or restricted new business. These companies included: State Farm, Farmers, Allstate, USAA, Travelers, Nationwide, and Chubb.

#### V. *What is the status of the SIS reforms?*

Since this Committee held the first oversight hearing about the Insurance Commissioner's SIS a number of announcements have taken place by CDI. Reforms made public to date propose to address:

##### **1) *Rate Approval Process***

On February 9, 2024, the Insurance Commissioner announced the first of many regulatory reforms of the SIS. The first proposal addressed CDI's rate application approval process. CDI held the public comment hearing on March 26, 2024.

At the oversight hearing of the Assembly Insurance Committee in December 2023, the Insurance Commissioner highlighted issues regarding CDI receiving "incomplete" rate applications, which, therefore, caused delayed approvals of rate filing applications. The first announced regulatory reform of the SIS is in response to this concern with the intent of clarifying exactly what information is necessary to evaluate a rate application. That being said, this reform received an immense amount of scrutiny and negative feedback by various stakeholders who participated in the public hearing.

The reform applied to auto, home, business, and other property and casualty insurance rate applications. According to CDI, the intent of the rate application reforms is to eliminate confusion, reduce delays, and enhance public participation in the ratemaking process. According to CDI, key components of the regulations include:

- *Clarity in Submission Requirements:* Insurance companies will have clearer instructions about what must be submitted with a complete rate application, with necessary materials and information clearly specified by regulations. This clarity will provide insurance companies with certainty regarding the documentation required for initial rate submissions.
- *Front-Loading the Delivery of Key Information:* The proposed regulation will eliminate lengthy exchanges between CDI and insurers about incomplete applications before the rate review process may actually begin. These amendments will also provide consumer representatives more opportunity to timely review insurer rate applications in order to decide whether to intervene in the rate review process.
- *Inclusion of Criteria and Guidelines:* The proposed amendments mandate what insurers must provide so the Insurance Commissioner may assess whether requested rates are appropriate and not excessive, inadequate, or unfairly discriminatory. This includes any and all criteria, guidelines, systems, manuals, models, and algorithms used to assess risks or modify coverage options, as set forth in California Insurance Code section 1861.05.

## **2) Catastrophe- Modeling**

On March 14, 2024, the Insurance Commissioner announced the next phase of the SIS, which included releasing proposed regulations on the use of catastrophe modeling. CDI does not allow admitted insurers to use wildfire catastrophe models

for ratemaking. California requires (under CA Code of Regulations 2644.5) that insurers use a minimum 20-year average of historical catastrophe losses to calculate catastrophe loads for the CDI ratemaking process. Catastrophe models simulate real world events using data such as, topography, vegetation type, and the wind conditions of a certain area. Having this information gives insurers a better picture when they are setting rates for their customers, allowing them to use a more precise approach when determining how much risk they are willing to take on.

Catastrophe modeling allows insurers and reinsurers, financial institutions, corporations, and public agencies to evaluate and manage natural and man-made catastrophe risk from perils ranging from earthquakes and hurricanes to floods and wildfires.

The proposed regulations creates a new process for review of models by a panel of experts overseen by CDI before insurance companies can use them in a rate filing. The panel would evaluate the appropriateness and soundness of each model and a CDI official would determine what information about the model must be included in rate applications.

According to CDI, the catastrophe-modeling proposed regulations will:

- Allow policyholders to have more stable costs than under current regulations, which have resulted in sudden and steep increases for those at higher risk of wildfire.
- Incentivize insurance companies to increase their writing because they can better anticipate future losses, rather than making abrupt decisions to non-renew higher-risk policyholders, pause writing, or rapidly increase rates.
- Allow CDI to have public oversight of modeling, which is already being widely used by insurance companies outside of rate-making and across the nation. CDI will have access to models and build expertise, so California can continue to lead on consumer protection.

CDI held a public workshop on the proposed regulations on April 23, 2024. Similar to the public hearing on the rate approval process, this hearing also received scrutiny from a number of stakeholders with concerns about transparency and utilization of the catastrophe models.

## VI. *Conclusion*

This Assembly Insurance Committee Oversight Hearing (the second to date on the SIS) is an opportunity for Assemblymembers and the public to receive an update from California's Insurance Commissioner about the SIS. It's true; the SIS lays out historic reforms that attempts to adapt a 36-year-old initiative to the new era of

climate change. While reforms are necessary and imminent, the implementation and finalization remain cloudy. Timing is everything and recovery is crucial.

**UPDATE:** On Friday, May 10, the Governor, as part of the May Revision announced a legislative proposal that will expedite the insurance rate filing process. At the time this background went to print, the trailer bill language was not public but anticipated. This oversight hearing will provide an opportunity to discuss how the Governor's proposal would work in tandem with the Insurance Commissioner's work on the SIS.