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Assembly Insurance Committee Oversight Hearing

California Department of Insurance

Sustainable Insurance Strategy: More Progress

Tuesday, September 17, 2024

I. *Introduction*:

This Assembly Insurance Committee Oversight Hearing is the third hearing in a series of hearings to provide oversight of the Insurance Commissioner's Sustainable Insurance Strategy (SIS). The December 2023 hearing was an overview of the Insurance Commissioner's game plan and strategy for stabilizing California's insurance market, also known as the SIS. The hearing held in May 2024 was a follow-up hearing to ensure the Insurance Commissioner was on track to achieve the timeline provided to complete the SIS. A number of actions have taken place since the committee's last oversight hearing, which this background will discuss. This hearing will go through the actions taken to date, review what action items are left, and discuss next steps as the Insurance Commissioner's December 31, 2024 deadline to implement the SIS nears.

II. *Background*:

On September 21, 2023, Governor Newsom issued an Executive Order that requested the Insurance Commissioner to take the following actions:

> "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 (***details are public***) ;

2) Giving FAIR Plan policyholders who comply with the new Safer from Wildfires regulation first priority for transition to the normal market (***details are public***);

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 (***details are public***);

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 (***details are public***);

5) Holding public meetings exploring incorporating California-only reinsurance costs into rate filings (***anticipated between now and end of year***);

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 (***details are public***);

7) Increasing data reporting by the FAIR Plan to CDI, Legislature, and Governor to monitor progress toward reducing its policyholders (***details are public***) ; 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 ***(details are public***).

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?*

Reforms made public to date propose to address the following in the insurance market:

<u>Rate Approval Process</u>

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. Proposal 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.

Governor's Trailer Bill

On Friday, May 10, 2024, the Governor, as part of the May Revision announced a legislative proposal that would have expedited the insurance rate filing process. The proposal could be viewed by the public under the California Department of Finance's website. Once public, the proposal was met with accolades and criticism, and did not move forward due to various reasons during this legislative cycle.

Instead, on August 9, 2024, the Insurance Commissioner and the Governor announced moving forward with the rate review reforms through administrative action. To summarize again, the rate review reforms are intended to expedite the rate approval process. Under the existing Proposition 103 framework, rate applications should be approved or denied within a 60-day timeline but this timeline can be drawn out due to many reasons including whether the application is intervened or whether the application is deemed "incomplete." The reform also includes the creation of a data reconciliation tool which will provide more transparency in regards to information still needed and status of the application.

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. Currently, 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 create 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.

On June 12, 2024, CDI announced an important piece of the SIS, distressed areas. A statewide map showing areas where wildfire risk is high and FAIR Plan policies are overly concentrated. As part of the SIS, insurers commit to write in high wildfire risk areas (distressed areas) in order to use catastrophe modeling in the rate filings. The regulation requires insurers to detail in the rate filing what distressed areas they will write at least 85% of their policies. The regulation is customized to each type of insurer, whether a large corporation or a mom and pop insurer. This customization allows all insurers the ability to use catastrophe modeling if they meet the threshold of writing in distressed areas. CDI announced another public workshop on June 26 to receive public feedback on the regulation.

On August 16, 2024, the Insurance Commissioner announced the final phase of the catastrophe modeling regulation. The Office of Administrative Law published the regulation online. Next step, following another public comment period, will be a hearing on September 17, 2024 (same day as the Assembly Insurance Committee hearing). On its face, the regulation appears to meet and address the feedback from all stakeholders. It is important to note that the regulations provide an opportunity for public review of models which was a key point made throughout the public workshops.

(To learn more about catastrophe modeling, please use the committee's background from a previous informational hearing. The background can be found here [Microsoft Word - 6.14.23 Joint Informational Hearing background (ca.gov)](#).)

FAIR Plan Modernization

On July 26, 2024, the Insurance Commissioner announced the FAIR Plan modernization reforms. One focus of these reforms was to address the lack of insurance availability for homeowner and condominium associations by increasing FAIR Plan limits. The Insurance Commissioner and the FAIR Plan came to an agreement. The FAIR Plan will be required to issue a new Plan of Operation incorporating these changes. (The FAIR Plan issued this new Plan of Operation in August to CDI.) According to CDI, the stipulation requires the following for homeowners and business owners:

- Expanded coverage: Establishing a new “high-value” commercial coverage option with limits up to $20 million per building, with a total aggregate of $100 million per location.

    - CDI anticipates this new limit to be active in July 2025 after the FAIR Plan submits a new rate filing and the CDI has time to review.
    - New high-value policy may sunset on December 31, 2028 but policies entered into by the sunset may continue for one additional year, roughly until December 31, 2029.

- Financial stability: Creating a sound financial formula to protect policyholders in extreme loss scenarios.

    - Under the existing structure of the FAIR Plan, should the FAIR Plan “run out” of funds to pay claims, the FAIR Plan may assess the member companies to ensure those claims are paid. Under these new reforms, a new structure is set up in case the FAIR Plan gets to a point where an assessment is necessary. The FAIR Plan will pay out all of its retained earnings, reinsurance, and other backstop funds first. The member insurers and consumers would share any additional costs up to $2 billion. The Insurance Commissioner must approve any assessment on policyholders.

- Improved transparency: Requiring increased public reporting on FAIR Plan activity and customer service metrics.

(To learn more about the FAIR Plan please use the committee’s background from a previous oversight hearing, the background can be found here Microsoft Word - 3.13.24 Asm. Ins. FAIR Plan background final (ca.gov).)

VI. Assembly Legislative Action:

It should be emphasized that during this legislative year that the spotlight was rightfully so on the SIS. That being said, a number of Assembly proposals moved through the legislative process that complimented the work of CDI. These proposals provided more FAIR Plan accountability, more oversight, more transparency, more consumer awareness, and more progress as this hearing title notes. Those proposals were:

- *AB 1844 (Calderon):* Would have allowed the Speaker of the Assembly and the Chairperson of the Senate Committee on Rules to serve as nonvoting, ex officio members of the Fair Access to Insurance Requirements (FAIR) Plan Governing Committee, and would authorize each to name a designee to serve in their place.

  Status: Removed from the consent calendar and pulled from the hearing at the request of the Senate Insurance Committee.

- *AB 1933 (Calderon):* Would have required the California Department of Insurance to report to the Assembly Committee on Insurance and the Senate Committee on Insurance regarding wildfire risk models, on or before, January 1, 2026, and annually thereafter.

  Status: Not set for a hearing in the Senate Insurance Committee.

- *AB 2260 (Calderon):* Would have required the FAIR Plan to provide specified information to the Insurance Commissioner, Senate Committee on Insurance and the Assembly Committee on Insurance.

  Status: Not set for a hearing in the Senate Insurance Committee.

- *AB 2983 (Calderon/Rodriguez):* Requires the California Department of Insurance to be added to the California Wildfire Mitigation Program (CWMP) Board and requires the CWMP to assess the extent to which a project or proposal under the program would increase the availability of insurance policies covering damage from fire.

  Status: Pending before the Governor

  AB 2416 (Connolly): Would have Required, by January 1, 2030, and every five years thereafter, the Department of Insurance to consider whether to update the Safer from Wildfires regulations to include certain building hardening measures.

  Status: Moved to Inactive by the Senate

- *AB 2996 (Alvarez):* Would have Authorized the California Infrastructure and Economic Development Bank upon the request of the FAIR Plan to issue bonds to finance the costs of claims, to increase liquidity, and claims-paying capacity of the FAIR Plan, and to refund bonds previously issued for that purpose. AB 2996 also required the FAIR Plan, with the approval of the Insurance Commissioner, to assess all members to pay all loan payments and the costs and expenses relating to a loan agreement with IBank, as well as to assess all members to repay a line of credit and its related costs and expenses.

  Status: Moved to Inactive by the Senate

VII. Conclusion

As the legislative year came to a close and the year 2024 comes to end, this third oversight hearing is yet again, another opportunity to learn about the progress made on stabilizing California's insurance market. The Insurance Commissioner publicly announced a date of December 31, 2024 to have the SIS complete. With a little over 3 months left, it is not out of the realm of possibilities that the Insurance Commissioner's SIS may be complete. The hearing will shed more light on whether this will become a reality. As far as the results expected, this may take longer. Considering the insurance crisis today was many years in the making, it may take many years to dig our way out. Insurers do not take withdrawing and non-renewing lightly, nor will they take returning to business as usual, lightly either. (Climate change is unpredictable.) After all this work, is California any closer to returning to a more stable and competitive insurance market? Californians want to know. Meanwhile, Californians wait, hoping for a renewal notice (if received, likely with higher premiums), or dreading seeing the words *non-renewed* but *welcome* to the FAIR Plan.