STATE FARM
LIBERTY MUTUAL INSURANCE
PROGRESSIVE
MERCURY
NATIONWIDE
NAMIC

Testimony of Rex Frazier, Personal Insurance Federation of California
before
SB 901 Wildfire Cost and Recovery Commission,
April 3, 2019 – Santa Rosa, California

Commissioners,

My name is Rex Frazier. I'm President of the Personal Insurance Federation of California, representing admitted market insurers on residential property insurance issues, including the National Association of Mutual Insurance Companies. Thank you for the opportunity to testify today about current trends in the homeowners' insurance market as well as potential future challenges.

In the big picture, every Californian continues to have access to insurance that protects against fire risk, and the claims from the 2017 and 2018 fires are being paid. The admitted market continues to serve the vast majority, over 97%, of the insured structures in California. The private back-stop for high-risk properties, known as the FAIR Plan, has grown on a percentage basis, but still serves a small proportion of insured structures. The non-admitted market has also grown in the last several years but represents a small amount of the market. Each of these market segments serves California without concern about solvency or need for state help.

Despite catastrophic losses in the last two fire seasons, only one licensed insurer has failed. While it was small, Merced Property & Casualty was a venerable company operating since 1906. Even with an A- rating from A.M. Best, Merced was taken down by a single event, the Camp Fire in Paradise. Fortunately for Merced's policyholders, all other admitted insurers immediately stepped forward, through the California Insurance Guarantee Association, to pay claims for Merced and only later will they seek reimbursement from Merced's estate.

The insurance industry in California is resilient, but there are issues worthy of consideration. The industry's ability to serve high risk properties is directly related to its relationship with the California Department of Insurance, which has a dual role: on one hand, the Department is empowered to prevent excessive rates and can even order insurers to reduce previously-approved rates that it believes have become excessive over time; on the other hand, the Department must monitor solvency to ensure that insurers can pay claims. In this balancing act, if the Department restrains an insurer's rates too aggressively, it places financial pressure on that insurer, which will, then, reduce exposure to higher-risk areas.

As this Commission considers the ability of the insurance industry to serve homes in wildland-urban interface areas, it is important to examine California insurance regulation. According to the National Association of Insurance Commissioners, as of 2016, California had the 32nd highest average homeowners' insurance premium in the country (and, when adjusted for average household income, this dropped to 43rd). This lower premium level was a stark change from several years earlier when, in 2009, California had the 14th

highest average premium. During that period, the average homeowners' premium in the nation increased by 45%, while California's average only increased by 8.1%. Hurricane-exposed states, such as Louisiana and Florida, have average premiums almost double that of California.

With restrained rates, there is always a market response. Even before the 2017 fire season, the homeowners' insurance market was already reacting. According to the State's Fourth Climate Change Assessment, while the statewide number of surplus line and FAIR Plan policies had not increased for the previous fifteen years, total policy count in high-risk areas had already started to increase by 2014 – well before the 2017 fire season. This development was predictable.

As the admitted market reacted to concerns about price adequacy, local government officials in WUI areas became more vocal about the availability and affordability of homeowners' insurance. This is a disconnect of high importance. While the Gulf States have already had a climate-driven increase in insurance rates, California has not. California law continues to prohibit insurers from using climate change modeling in pricing – instead requiring insurers to predict future losses based upon the average of the last 20 years of losses. California's recognition of a "new normal" does not yet extend to insurance rates.

This climate change restriction is on top of California's continued prohibition on allowing insurers to include their actual cost of reinsurance in insurance rates. As the world reinsurance market recognizes California's climate risk and seeks higher prices from California insurers, California law continues the legal fiction that insurers do not buy reinsurance.

We are not here to criticize these California policy choices as long as policymakers accept the predictable consequences. But, policymakers periodically condemn insurers for being more selective about which homes and communities they will insure. There are even policy proposals to restrict the ability of insurers to reduce their risk to match their approved rates. Such proposals would only trigger the very market crisis that they purportedly address. While there is not presently a market crisis for homeowners' insurance, it is within government's power to create one.

During last year's hectic debate about utility-caused wildfires, few had time to understand the difficulties already present in the insurance industry. We are grateful for this Commission's willingness to explore the complicated, and competing, interests in the residential property insurance market in California. Thank you.