June 6, 2019

To: Governor's Office of Planning and Research
P.O. Box 3044
Sacramento, CA 95812-3044

PIFC

STATE FARM
LIBERTY MUTUAL INSURANCE
PROGRESSIVE
MERCURY
NATIONWIDE

Commissioner Carla Peterman, Chair
Commissioner Dave Jones
Commissioner Michael Wara
Commissioner Michael Kahn
Commissioner Pedro Nava
Evan Johnson, Executive Officer

From: Rex D. Frazier, President
Seren Taylor, Senior Legislative Advocate

Dear Commissioners:

The Personal Insurance Federation of California (PIFC) is a trade association that represents five of the nation's largest insurance companies (State Farm, Liberty Mutual Insurance, Progressive, Mercury, and Nationwide), as well as associate member National Association of Mutual Insurance Companies (NAMIC), who offer personal line auto and home insurance in California. We write regarding the insurance provisions of your May 29, 2019 draft Commission report. PIFC is also part of a coalition of wildfire victims, cities and counties, consumer attorneys, and insurers that submitted a letter to the Commission on June 4, 2019 detailing our strong opposition to the proposed changes to wildfire utility liability laws contained in the Commission's draft report.

In this letter, we focus on Appendix III: Homeowners Insurance and Mitigation Workgroup Report, of the draft report. This section includes a series of recommendations related to residential property insurance. We concur with some of the draft recommendations, believe others deserve further discussion, and find some to provide no benefit for, or may in fact be harmful to, consumers.

Below please find our feedback to the fourteen recommendations in Appendix III:

Recommendation 1. Doing nothing to improve insurance conditions in the state is not a good option.

We agree with this recommendation.

Over the last decade, California insurance regulators have approached rate regulation in a manner very different from the rest of the country. 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%.

As early as 2014, the admitted market started reacting to this rate suppression, and both the FAIR Plan and the non-admitted market started to show small increases in market share. Admitted insurers facing rate suppression in high risk areas face difficult choices for how to remain generally open for

business while also remaining solvent. The failure of Merced Property & Casualty highlights the real risks of operating in high fire risk areas.

Adopting additional law or regulation changes to address problems created by previous state regulation, however, is not the right "fix."

If the Commission is concerned about the ability of the admitted market to serve high fire risk communities, it would recommend a "risk based approach to pricing home insurance," which the Commission recommends in Recommendation 2, but, then, proceeds to undermine with subsequent recommendations.

Recommendation 2. California should preserve its risk based approach to pricing home insurance.

We urge the Commission to adopt this recommendation. However, we urge the Commission to substitute the words "adopt a" in place of using the words "preserve its" in Recommendation 2. As noted above, California should embrace risk-based pricing of insurance, particularly for climate-related risk. Presently, California ignores climate risk in pricing.

Recommendation 3. Improve the California FAIR Plan.

The California FAIR Plan is a highly functional organization. We urge the Commission to modify this recommendation as follows: "Ensure the FAIR Plan can continue to serve all communities as the insurer of last resort."

The California Department of Insurance (CDI) is in active discussions with the FAIR Plan (i.e., admitted insurers) about the aggregate coverage limit. Because the FAIR Plan receives no state funding and is entirely funded by policyholder premiums and, if necessary, involuntary capital contributions from admitted insurers, it is important to work through the many complex issues involved with raising the coverage limit, particularly the reinsurance implications. Overall, admitted insurers understand, and accept, the necessity of working through these issues.

We agree with the report recommendation that the FAIR Plan, itself, should not be subsidized and that price should continue to be based on risk.

Recommendation 4. Improve the California Insurance Guarantee Association (CIGA).

We have no feedback on this recommendation. CIGA is a highly functional organization.

The CDI is in active discussions with CIGA (i.e., admitted insurers) about the current $500,000 guarantee for policyholders claiming to an insolvent insurer. Because CIGA receives no state funding and is entirely funded by partial recoveries from insolvent insurance estates and, if necessary, involuntary capital contributions from admitted insurers, it is important to work through the many complex issues involved. Overall, admitted insurers understand, and accept, the necessity of working through these issues.

Recommendation 5. Require Fire Risk Underwriting Models used by insurers to be filed and approved by CDI.

This recommendation could trigger the very availability crisis that the Commission says it fears. This is not a new recommendation and has been raised previously in the Legislature. We strongly urge rejection of this recommendation.

This recommendation is, further, contrary to the Commission's Recommendation 2 to "preserve" risk-based pricing. If the CDI obtains even more power to restrict rates in high risk areas, it will push carriers to react even further – including increased non-renewals or the cessation of new business in high risk areas. Then, presumably, there will be calls for even more regulation once escrows start getting delayed.

Recommendation 6. Set standards for home fire risk reduction and community risk reduction, with input from insurers, and require insurers to write insurance where the home owner and the community both meet standards.

We urge the Commission to modify this recommendation as follows: "Develop data linking parcel-specific and communitywide mitigation efforts to reduction in fire risk."

The draft Recommendation 6, again, contradicts Recommendation 2 – the Commission's purported commitment to risk-based pricing. There is currently no data set that quantifies fire insurance risk reductions related to parcel-level or community-based mitigation efforts. A single homeowner could diligently adhere to defensible space best practices but still, unfortunately, fall prey to a massive wildfire. Communities could create fire breaks that are, themselves, incapable of stopping flying embers from igniting structures.

If implemented, this recommended mandate on insurers would create an availability problem, not solve it. If an insurer must surrender its right to manage risk appropriately because a homeowner has performed a particular retrofit, the insurer would simply stop offering new business in risky areas. An insurer would not run headlong into uncontrolled exposure and forced policy renewals – just as California saw in 1995 and 1996 following the Northridge earthquake, where state law required insurers to offer new earthquake policies each time they sold a homeowners' insurance policy. Insurers stopped selling new homeowners insurance rather than subject themselves to unmanageable earthquake insurance risk.

Insurers would happily participate in efforts to develop public data resources which could be the basis for each insurer to develop its model for underwriting and rating purposes. Insurers have long funded research and supported legislation to develop model defensible space programs and improved building standards. Hardening of homes has been a valuable tool in wind- and earthquake-prone areas where specific actions can be clearly linked to a reduction in insured losses. The same linkages have not yet been established for fire risk.

Recommendation 7. Require insurers to implement a tiered mitigation credit based on the level of home hardening.

We urge the Commission to reject this recommendation that is recycled from previous rejected efforts.

Governor Brown's Tree Mortality Task Force debated this issue extensively based upon advocacy by the CDI, but it did not move forward. This proposal is based upon research by the Insurance Institute for Business & Home Safety (IBHS), which felt compelled to respond to misuse of its research for this

proposal as follows: "Any use of IBHS hurricane or high wind standards – as well as related public policy or risk modeling – for wildfire risks is unfounded and inappropriate... [B]ecause of the importance of a variety of ever-changing property maintenance items (including, but certainly not limited to, growing vegetation) as they relate to wildfire risk, a building-specific standard for wildfire will not be accurate over time. As a result of these factors, inspection and validation components that are central to the [IBHS] hurricane and high wind standards are not transferrable to the wildfire context."

A healthy insurance market needs to be supported by sound science, not a hope that something may work.

Recommendation 8. Require insurers to calculate and provide a replacement housing estimate in writing to insureds annually and before entering into an insurance contract.

We urge the Commission to reject this recommendation, just as the Legislature did in 2018.

As noted in your report, under current law enacted less than a year ago, an insurer must provide an insured-to-value estimate every two years. However, the insurer may alternatively satisfy this requirement if (1) a policyholder has requested and the insurer has provided coverage limits greater than the previous limits, or (2) the insurer on an every other year basis offers the policyholder the right to have a new estimate, and a renewal is based on an inflation factor.

While the additional administrative burden on insurers will certainly raise costs for policyholders, it is unclear how your recommendation to provide consumers with yet another piece of paper they can ignore will achieve the desired result of homeowners purchasing higher levels of insurance coverage for their homes.

Further, based upon data from the State of California's Fourth Climate Change Assessment report sponsored by the Natural Resources Agency, there is no evidence that "under insurance" is a significant problem. It may be the case that surge pricing after a catastrophe is the real issue and pushing people to buy higher levels of insurance is unwarranted.

That said, we are very supportive of efforts to help consumers make good decision about the level of coverage they need. Towards that end, we are presently engaged in discussions with the new Insurance Commissioner on more productive ways to achieve that goal.

Recommendation 9. Require insurers to file annually with CDI for review and approval the insurers' replacement cost estimating models/tools and the inputs they are using as well as a comparison of recent loss experience to estimates based on these tools.

We urge the Commission to reject this recommendation.

The CDI already has regulations entitled "Standards for Estimates of Replacement Value" (10 CCR 2695.183). These regulations prohibit an insurance licensee from communicating a replacement cost estimate unless it contains a specified list of elements.

Is creating a massive new workload for the CDI and insurers really going to increase the amount of insurance that consumers purchase? Consumers make their own decisions about how much insurance they can afford. This proposal would impose additional bureaucratic and operational costs, delays, and uncertainty for insurers that would not benefit consumers in any way.

Recommendation 10. Require CDI to undertake a data call on the insurers' subrogation claims.

We urge the Commission to reject this recommendation.

The CDI already has full access to each insurer's complete financial picture. Under Proposition 103, the CDI can not only reject rate applications it believes would lead to excessive rates, the CDI can challenge (and prospectively order a change to) any rate in effect it believes is excessive. If the CDI believes that an insurer's rates do not properly reflect subrogation recoveries from utility-caused fires, the CDI has more than enough power to remedy that problem.

Focus on subrogation is a complete misdirect. Subrogation has been part of the insurance business for hundreds of years. Subrogation is not the cause of utilities' financial problems.

Homeowners' insurance rates are demonstrably low in California. Does the Commission really believe that scrutiny of subrogation recoveries is going to lead to even lower rates and, somehow, to wider availability of homeowners' insurance? Where is the commitment to risk-based pricing mentioned in proposed Recommendation 2?

If the Commission is actually committed to risk-based pricing, it should recommend elimination of the CDI regulation that continues to prohibit insurers from using climate change modeling in pricing. 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 fire 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.

Recommendation 11. Require CDI to undertake a data call on the insurers reinsurance cost and availability.

We urge the Commission to modify this recommendation as follows: "CDI should convene a working group to examine how to allow reinsurance costs and prospective modeling in insurance rates."

The CDI already has access to all the information needed to analyze the impact of allowing the net cost of reinsurance to be included in rates. Using the current CDI rules, on a direct basis, from 2000 to 2018, the insurance industry has broken even in homeowners insurance, with a combined ratio of 99.6%. However, this direct basis result is fictional because insurers actually pay reinsurance premiums and have reinsurance recoveries.

On a net basis (real world results), insurers did not make money before the fires and have difficult prospects of recovery without rate increases. Over the entire period, the combined ratio is 102.3%. Even with the reinsurance recoveries of the past two years, insurers have paid $152 billion in reinsurance premiums since 2000, and received $67 billion in recoveries. Net of reinsurance premiums and losses, the industry is in a $26 billion deficit this century.

If the goal of this proposal is to address the fundamental flaw in current regulatory rate approval practices, it may merit further discussion. However, if the only goal is to impose yet another administrative burden to gather information to be ignored – that would be unfortunate.

Recommendation 12. Require homeowners insurers to offer a one-year notice of non-renewal, in addition to the existing 45-day notice, when there is no change in the risk presented at the insured

property within the homeowners' control, or if the insured has been with the same insurer for 5 years or more.

We urge the Commission to modify this recommendation as follows: "CDI should survey the notice of non-renewal requirements in other states and determine what period of time longer than 45 days would be appropriate."

There are already problems with rate inadequacy in California. If state law impairs the ability to use underwriting to manage this rate inadequacy, there will be a crisis in new business. It would be appropriate to discuss a period longer than 45 days, but one-year does not seem like a responsible proposal.

Recommendation 13. Mandate all homeowners insurers offer a "Difference in Conditions" policy or a Comprehensive Personal Liability/Residential Workers' Compensation coverage.

We urge the Commission to reject this recommendation.

Very few homeowners are insured by the FAIR Plan and the CDI already has a list of insurers presently offering DIC policies to complement FAIR Plan. No barrier presently exists for a FAIR Plan insured to obtain a DIC policy.

Recommendation 14. Require that there be a valid quote for insurance coverage before any real estate offer is accepted.

We offer no feedback on this recommendation. If an individual owns real property outright and has no lender requiring insurance, it is that homeowner's decision about whether to purchase insurance. It is not clear whether the state could even require insurance as a condition of real property ownership.

In closing, the 2017 and 2018 wildfires were the largest and most destructive in California's history. The insurance industry has been working diligently to help customers rebuild their homes, replace their personal property, and return to their lives. PIFC member companies are committed to providing real solutions that will best serve Californians and we look forward to the work ahead.