STATE FARM

LIBERTY MUTUAL INSURANCE

PROGRESSIVE

MERCURY

NATIONWIDE

NAMIC

Testimony of Rex Frazier, Personal Insurance Federation of California
before
Senate Insurance Committee
May 8, 2019 – Sacramento, California

Madam Chair and Members,

Thank you for the opportunity to testify today about homeowners' insurance regulation and affordability. Issues with homeowners' insurance availability, which the next panel will discuss in greater depth, have their roots in several past regulatory decisions. It is important to identify these policy choices, and acknowledge their direct consequences.

An insurer's ability to serve communities threatened by wildfire 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.

Over the past ten years, the Department has 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%.

Hurricane-exposed states, such as Louisiana and Florida, now have average premiums almost double that of California.

With restrained rates, there is generally a market response related to availability. Even before the 2017 fire season, the homeowners' insurance market was already reacting. According to the State's Fourth Climate Change Assessment, the statewide number of surplus line and FAIR Plan policies in high-risk areas had already started to increase by 2014. While the absolute numbers were small, the trend was real and predictable – and could accelerate following the massive 2017 and 2018 fires.

While admitted market carriers have been concerned about rate inadequacy, local government officials and residents in high fire risk areas have voiced the opposite, with complaints about high prices. This is a disconnect worth

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significant consideration. While the Gulf States have already had a climate-driven increase in insurance rates, California has not. California regulations, but no statute, 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 regulatory 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 rating rules continue the legal fiction that insurers do not buy reinsurance.

If insurers cannot achieve rate adequacy in high risk areas, availability issues could worsen. And, measures to force insurance renewals in areas with inadequate rates risk shutting down the new business market entirely because few insurers would likely risk entering into new contracts with indefinite durations at a loss.

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 Committee's willingness to explore the complicated, and competing, interests in the residential property insurance market in California. Thank you.