PIFC

California Senate Insurance Committee
Senator Susan Rubio, Chair

Informational Hearing:
Wildfires and Homeowners' Insurance: Availability in High Risk Areas
February 12, 2020, 1:30 pm, Room 112

Panelist Statement:
Rex Frazier, President, PIFC

Madam Chair and Members, my name is Rex Frazier. I am the President of the Personal Insurance Federation of California. Thank you for the opportunity to testify today. Before I begin, please allow me to compliment the committee staff for preparing such a thorough, and thoughtful, background report.

While homeowners' insurance is broadly available statewide, the residents of several counties – possibly upward of 10 - 12 of California's 58 counties – have experienced, and continue to experience, the anxiety of being unable to obtain a policy from the regular, or "voluntary," market. By this, I refer to a fully-regulated insurance company that voluntarily offers a new or renewal policy. While the percentage of residents in high risk areas unable to find a voluntary market solution remains low, that is little comfort to each resident facing this problem.

For those unable to find a voluntary market policy, there are two, temporary options that assure availability until the market rebounds: the surplus line market and the insurance industry-backed California FAIR Plan. The surplus line market will always be more expensive than the voluntary market; its prices are not state-controlled. But, surplus line insurers can enter the market quickly when the voluntary market constricts.

The FAIR Plan, likewise, is always more expensive than the voluntary market because it is a high risk pool that suffers from adverse selection. It is also a small operation that cannot achieve the economy of scale cost savings of larger, voluntary market insurers. In general, the cost of just the FAIR Plan's fire-only insurance policy will be more expensive than a voluntary market insurer's price for the entire homeowners' insurance policy – which covers fire, water losses, liability claims (like a slip and fall), and theft. No responsible, long-term solution to a voluntary market disruption will rely upon either the non-admitted market or the FAIR Plan.

A long-term solution for high fire risk areas must involve restoration of the voluntary market, which requires a thoughtful balancing of underwriting, rating and claims. The committee backgrounder covered well the complicated push-and-pull this involves. Restricting one of these factors will lead to a reaction in another. If rates are held too low, then an insurer will generally pull back on underwriting – meaning keeping fewer high risk properties in order to stay solvent. Mandating increased claims payments will require an insurer to seek higher rates which, if denied, will lead to stricter underwriting. In the end, an insurer cannot safely operate at low rates while taking all risks and paying ever-increasing claims. So, the California Department of Insurance (the "CDI") has a complicated job.

The current availability issues for high fire risk communities are directly related to unsustainably low statewide average price levels. As illustrated in Slide 1, California's average homeowners' insurance premium is 17% below the national average, and almost one-half of the average price in hurricane states, like Louisiana and Florida – even though it is significantly less expensive to rebuild a home in those lower cost Gulf states. While the average price of homeowners' insurance in the United States has risen 53% in the last 10 years, it has risen 10.6% in California. Slide 2 shows how California has diverged from the rest of the country over this time.

Not allowing prices to increase with the economy may work in the short term but, over time, will lead to much higher catch-up increases later that are a shock to ordinary household budgets. As Slide 3 illustrates, starting in 2008 and ending in 2016, the insurance industry, as a whole, faced a period of low catastrophe losses that each year generated a modest industrywide underwriting profit and, when combined, led to a cumulative $10.2 billion dollar historic profit. During this time, the CDI became concerned that homeowners' insurance prices were too high relative to these lower losses and began asking insurers whether their prices were too high. In 2016, the CDI even ordered the state's largest homeowners' insurer, State Farm, to reduce its rate level by 7% -- even though the company was seeking a 6% increase – that matter is still in litigation and State Farm is currently charging the same price it was first permitted to charge in 2014. What company can continue business as usual without a price increase in 5 years?

As Slide 3 also indicates, things changed dramatically during 2017, when the cumulative industrywide underwriting profit dating back to 1991 was erased in a single year. The large red bar represents industrywide loss for 2017, and then a repeat in 2018.

Given the expected acceleration of catastrophic fire losses related to climate change, and the decision by Moody's Investors Services to elevate wildfire to a top-tier credit rating factor, there is significant insurer concern about the sustainability of currently-approved price levels in California. This concern will likely constrain availability in high fire risk areas until it is addressed.

As Slide 4 shows, the situation is complicated. In the last two years, over 50 insurers have sought rate increases from the CDI. While the average rate increase that has been justified under the CDI's rules has been 27%, the average rate increase actually sought by insurers has been 6.3%. This is a real problem. Why wouldn't an insurer seek a larger rate approval? The answer is that, under state law, a public intervenor group can demand and receive a public hearing on any rate filing that is 7% or more. These public hearings involve the appointment of an administrative law judge, and an average processing time of 14 months – instead of the 5 months that Slide 4 indicates is normal. Over time, it has become commonplace for insurers to file for 6.9% or less.

This system, obviously, has a down side. If insurers cannot get to rate adequacy quickly, then it will take longer for an insurer to be fully open for new and renewal business. A system that allows an insurer to safely and quickly achieve rate adequacy will benefit the public immensely – instead of the current system that forces too many residents in high risk areas into the FAIR Plan or the non-admitted market while voluntary market pricing slowly adjusts to the risk of the "New Normal." Anecdotal evidence suggests that the CDI's processing time is starting to slow, not only due to the large workload, but also an emerging CDI practice of withholding approvals of undisputed rate increases until the insurer agrees to reduce its non-renewals or agree to other, non-rating issues. Each additional case of delay further reduces the ability of an insurer to commence fierce competition.

We look forward to collaborating with the Legislature, the Governor and the Insurance Commissioner on the best way forward. This hearing starts an important discussion, particularly with respect to what role catastrophe models and the net cost of reinsurance could play in rating. Thank you, I'd be happy to answer any questions.

Slide 1

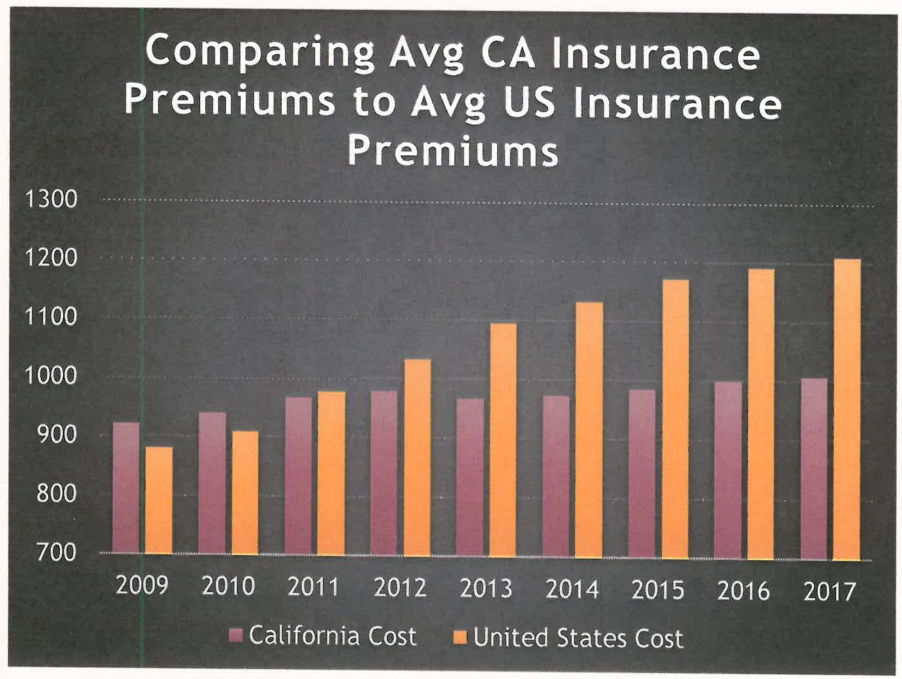
Homeowners' Insurance Average Premium

State	2017	Rank	2010	Rank	10 year change
Louisiana	$1968	1	$1546	2	70.4 %
Florida	$1918	2	$2014	1	40.4 %
Texas	$1893	3	$1578	3	29.7 %
Colorado	$1495	8	$926	19	77.6 %
California	***$1008***	***32***	***$939***	***17***	***10.6 %***
United States	$1211		$909		53.1 %

Source: *Property Insurance Report*
National Association of Insurance Commissioners Data, January, 2020

Slide 2
CA Homeowners' Insurance Rates

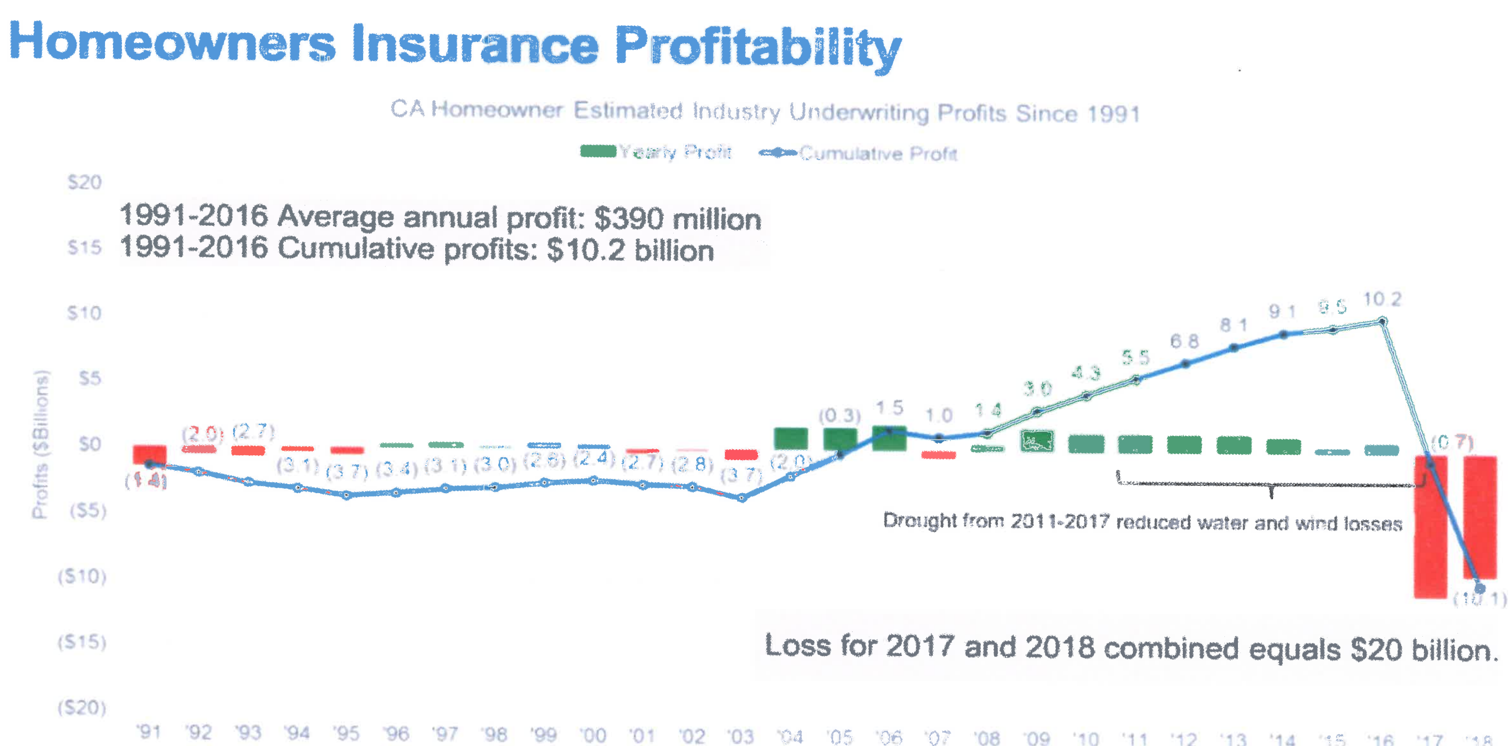
- Regulated California insurance premiums ***significantly lagged behind United States*** premium trends



Source: National Association of Insurance Commissioners

Slide 3

History of Underwriting Loss in California



Source: *Milliman Estimates, based on P&C Combined Industry Annual Statement data from SNL and data from the California Department of Insurance*

Milliman

Slide 4

CDI Rate Filing Activity (1/1/18-12/31/19)

Type of Insurance	Number of CDI Filings	Average of Rate Indication (%)	Average of Rate Change (%)	Average of Days to Implement
Homeowners	51	27.07	6.31	145.96 (approx. 4.9 months)

Source: Ratefilings.com

Thank You!

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