The Honorable Senator Susan Rubio

Chair, Senate Insurance Committee / District 22

1021 O St, Ste. 8710

Sacramento, CA 95814

Dear Senator Rubio:

On behalf of the independent Insurance Agents and Brokers of California (IIABCal), we are thankful that both the Senate and Assembly held informational hearings on the crisis in the California property insurance marketplace.

As we testified, independent insurance agents and brokers across the state tell us that problems of availability and affordability, in both the personal and commercial property insurance markets, are the worst they have seen in their careers.

This last week our members suffered another major blow to their businesses and to consumer choice with the announcement that Nationwide Insurance Company's Small Commercial products are not writing any additional business in California after March 31, 2023.

The emergence of the threat of catastrophic wildfire losses--$40 billion in insured losses since 2017, solely in California, solely attributable to wildfire—has dramatically, and inexorably, changed the business model for insuring property, especially in the wildland / urban interface (WUI).

Global warming is changing weather patterns and exacerbating drought; it is now apparent that there have been decades of forest mismanagement; public utilities have allegedly been negligent in maintaining high-voltage power lines; and California has seen significant growth in building and population in WUI areas. Each of these factors is highly significant, but in combination they create an environment—as we have witnessed--in which a single spark can create a mega fire that destroys entire neighborhoods and towns and can produce billions of dollars in insured losses.

In this environment, California's historically low property insurance costs are no longer sustainable. The California Insurance Commissioner inherited all of these unenviable problems, and more, but there are solutions that could quickly restore a competitive market in California for property insurance.

Testimony provided at the March 1st and March 8th hearings was amazingly consistent with regard to what changes need to be made in regulations governing the insurance rate application procedures to restore a competitive property insurance market for California consumers.

First, reinsurance. California is the only state in the United States that does not recognize the reinsurance costs incurred by insurers in ratemaking formulas. This incomprehensible prohibition is not found in any statute; rather, it is based on a policy long ago adopted by CDI.

By ignoring the expense of reinsurance—which is an essential component of an insurer's ability to spread potentially catastrophic losses as widely as possible—the Commissioner's formula produces an indicated rate level that is inherently inadequate. A fair calculation of rate adequacy requires inclusion of all necessary expenses.

The Commissioner has objected to this criticism by arguing that insurers buy reinsurance based upon their entire, nationwide book of business, and that California policyholders should not be required to pay for reinsurance on risks outside California. We agree. That is why our proposal expressly requires that only California exposures be factored into the reinsurance costs paid by California consumers.

Second, cost of capital adjustment. Admitted insurers that choose to retain wildfire risks rather than reinsure them potentially incur a cost of capital with respect to the assets supporting such risk in excess of historical averages permitted under current CDI regulations. An authorization to adjust the cost of capital component utilized for ratemaking to be commensurate with actual market conditions is appropriate and not inconsistent with any provision of Proposition 103.

Third, risk modeling. California requires insurers to base their rates, actuarially, solely on their own historic loss costs—not on scientifically-based models of expected loss. This forces insurers to base their rates not on the losses they can reasonably be expected to incur, but only on historic data, which can produce an inaccurate rate indication.

In many ways, the catastrophic exposure to wildfire losses bears similarity to the catastrophic exposure to earthquake losses in California. Predicting the frequency and severity of losses caused by earthquakes necessitated the development and ongoing refinement of insurance ratemaking, including the use of sophisticated catastrophe models, which is the predominant approach used to calculate catastrophe insurance rates. Under existing law, the Insurance Commissioner is required to review catastrophe models used to develop earthquake insurance rates for adherence to the best available scientific information. Casualty Actuarial Society Actuarial Standards of Practice require the best available scientific information be used and also recommend the use of catastrophe models for catastrophe ratemaking.

The same framework is appropriately applied to sophisticated catastrophe models used by insurance companies in predicting losses from wildfires—models already being used by the California FAIR Plan, CalFire and other state agencies.

At the March 8th hearing of the Assembly Insurance Committee, Commissioner Ricardo Lara testified that such models are "new and untested," which is demonstrably untrue. He also

indicated he was" not comfortable allowing [insurers to use] a tool that would increase costs" to policyholders.

While we appreciate the Commissioner's candor in that instance, we respectfully urge that the crisis in availability will not improve, and only get worse, so long as the regulator attempts to artificially suppress rate adequacy. Of course, no one wants to pay more for insurance. But the reality is that California property owners are ALREADY paying exponentially more for insurance in WUI zones, in many cases with substantially less coverage, and from non-admitted insurers exempt from most California law, including the guaranty association that protects consumers in the event of an insurance company insolvency—IF they can find an insurer willing, at any price, to offer any coverage.

Our proposal is to allow insurers to use scientifically based risk modeling, subject to the Commissioner's approval.

Fourth, long delays. Section 1861.05(c) of the California Insurance Code includes a provision designed to require CDI to promptly review and rule on insurers' rate applications. The statute says, "… a rate change application shall be deemed approved 180 days after the rate application is received by the commissioner (A) unless that application has been disapproved by a final order of the commissioner subsequent to a hearing or (B) extraordinary circumstances exist. …. This provision is colloquially known as the "deemer clause."

Unfortunately, this provision has become meaningless. The Department routinely pressures insurance companies to waive this statutory protection. Because insurers can charge no rate unless approved by the commissioner, and are totally dependent upon remaining in his good graces for that approval, insurers feel they have no way to refuse the commissioners request without jeopardizing their rate application.

As a consequence, insurers routinely report that rate decisions can be held up in the Department for long periods of time, by which point the original rate application is customarily outdated and utterly insufficient.

The commissioner argues that insurers are primarily responsible for any rate inadequacy by failing to request the rates actuarially suggested; that insurers repeatedly request rate increases under 7%, in order to avoid mandatory prior approval hearings under Prop. 103.

There is an element of truth to this argument. Insurers do, routinely, file for rate increases under 7%, even though their own data suggest much larger increases are necessary. However, there are perfectly rational reasons for that conduct by insurance companies: 1) adversarial rate hearings can take years to complete; 2) they can be outrageously expensive (because of compensation insurers are required to pay intervenors); 3) the results are often unpredictable or, insurers believe, politically motivated.

But there is an even more critical reason why the Commissioner's complaint is misdirected.

California law imposes upon the Commissioner three mandatory duties in evaluating insurance company rate applications. Section 1861.05(a) states clearly and unambiguously that, "No rate shall be approved or remain in effect which is excessive, **inadequate**, unfairly discriminatory, or otherwise [set forth in Prop. 103] (emphasis added).

Nothing in Prop. 103 or anywhere else in California law permits the Commissioner to ignore that obligation, solely because insurers didn't request higher rates.

The delays discussed herein can be addressed by specific changes to the non-Proposition 103 statute governing the timing for rate filing approvals.

As we testified at both the Senate and the Assembly oversight hearings, we recognize that no one wants to see substantially higher rates for insurance, but we believe common sense dictates that consumers would be better off paying more for insurance if that restores a vibrant, highly competitive market where consumers have multiple options for purchasing coverage. As it is now, too many consumers are stuck with the two highest-priced options—in the California FAIR Plan, or with unregulated surplus line insurers—for purchasing insurance, often with inadequate limits or coverage.

IIABCal strongly urges legislators, the regulator, and the industry to engage in a series of formal talks to look at every conceivable option to address this availability crisis. California consumers deserve the highest level of attention to this issue that even now has statewide consequences and will only grow larger with the anticipated effects of climate change. IIABCal has specific proposals prepared to address each of the above-referenced issues, whether by modify department regulations or by statute.

Very truly yours,

John A. Norwood

cc: Krystal Moreno, Legislative Director