WILDFIRE RISK AND THE COST OF HOMEOWNERS' INSURANCE

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Personal Insurance Federation of CA

The Sea Ranch Forum

Sept. 23, 2023

1) Background on PIFC
2) Key California Legal Provisions
3) Changing Understanding of HO Insurance
4) Premium Allocation & Average HO Premium
5) Key Issues
    A. Rate Approval Times in High Inflation
    B. Modern Rating Practices
    C. CA FAIR Plan Growth
6) Rating Agency View of Nat’l HO Insurance
7) Mitigation: Parcel Level & Community wide
8) Recent Governor and CDI Actions

PIFC

Member Companies

Allstate

CONNECT
POWERED BY AMERICAN FAMILY INSURANCE

KEMPER

FARMERS INSURANCE

Liberty Mutual. INSURANCE

MERCURY INSURANCE

Nationwide

PROGRESSIVE

StateFarm

Associate Members

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NAMIC
NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

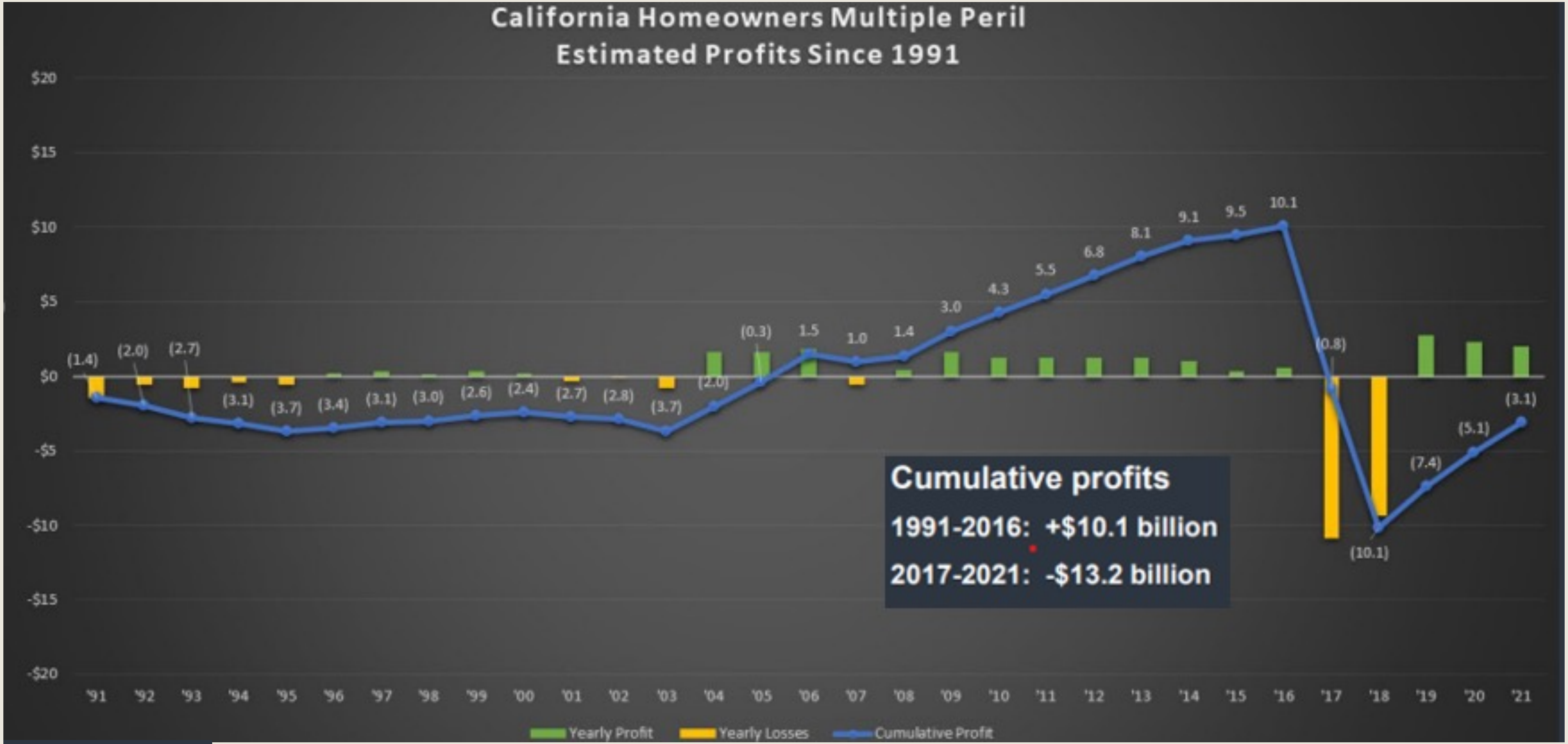
AUTOMOBILE CLUB AAA SOUTHERN CALIFORNIA

68.2% of HO Insurance Market Share

Key California Legal Provisions

- Elected Insurance Commissioner (was Governor appointee from 1868 to 1990)
- Prior Approval Ratemaking (Insurance Commissioner must approval rate increases/decreases)
  - "No rate shall be approved or remain in effect which is **excessive, inadequate, unfairly discriminatory** or otherwise in violation of this chapter. In considering whether a rate is excessive, inadequate or unfairly discriminatory, … the commissioner **shall consider** whether the rate mathematically reflects the **insurance company's investment income**."
- Public Participation (Groups may qualify to participate and earn compensation)
  - "Any person may initiate or intervene in any proceeding permitted or established pursuant to this chapter, **challenge any action of the commissioner** under this article, and enforce any provision of this article… The commissioner or a court shall award **reasonable advocacy and witness fees and expenses** to any person who demonstrates that (1) the person represents the interests of consumers, and, (2) that he or she has made a substantial contribution to the adoption of any order, regulation, or decision by the commissioner or a court."
- California FAIR Plan Association (Establishes public right to fire insurance)
  - "**All insurers** licensed to write… basic property insurance…, **shall establish an industry placement facility**, the California FAIR Plan Association, to formulate and administer a program for the equitable apportionment among insurers of basic property insurance that may be afforded to persons… who, after diligent effort…, are unable to procure insurance through normal channels from an admitted insurer or a surplus line broker. **Each insurer**, as a condition of its authority to transact those kinds of insurance in this state, **shall participate** in an industry placement facility program… Rates for the FAIR Plan shall not be **excessive, inadequate, or unfairly discriminatory**, and **shall be actuarially sound** so that premiums are adequate to cover expected losses, expenses and taxes, and shall reflect investment income of the plan… The program may provide, with the approval of the commissioner, for **assessment of all members in amounts sufficient to operate the facility**…"

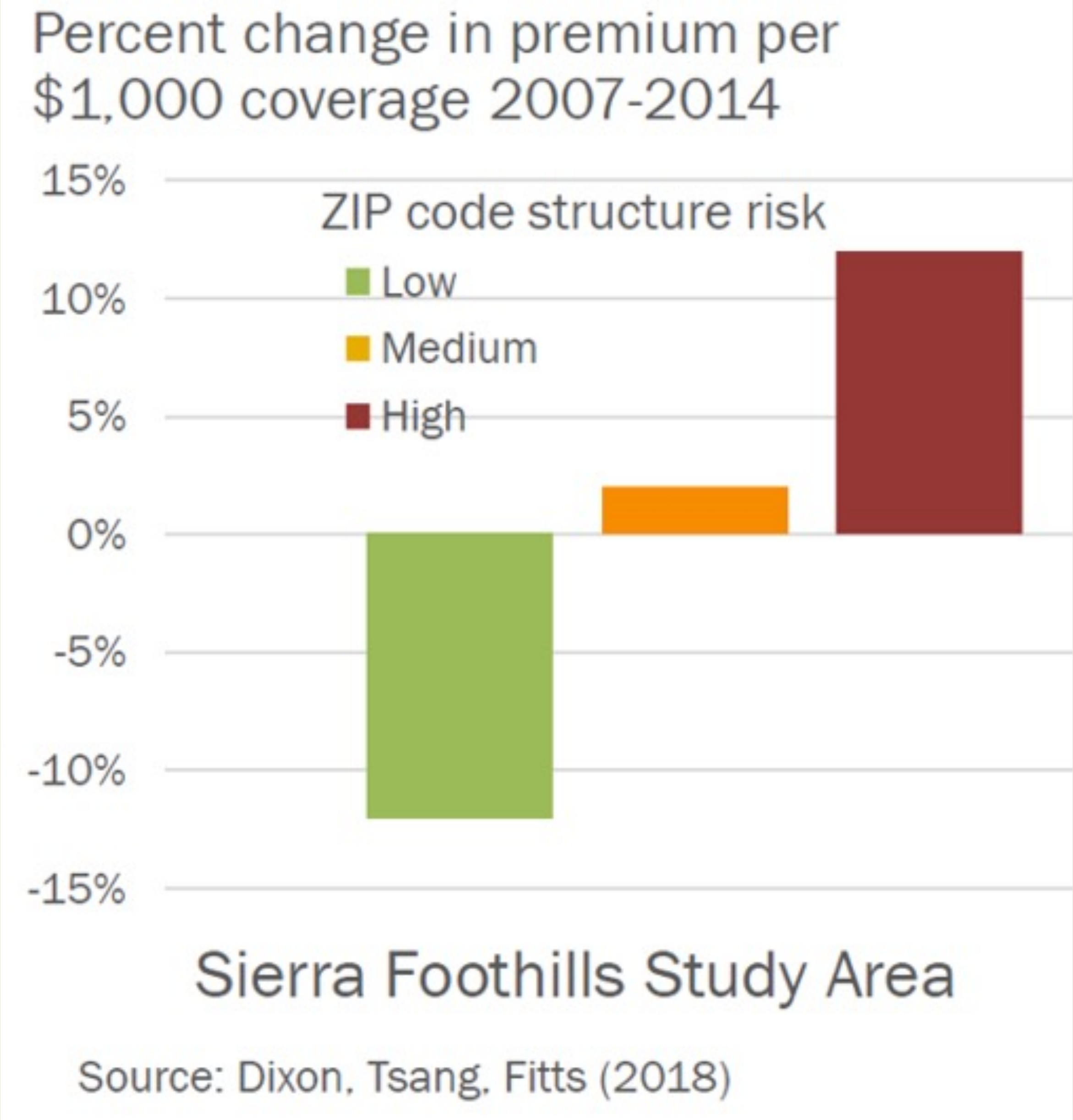
Insurers' Understanding of Catastrophic Fire Risk Has Changed:



Milliman

From Ho-Hum Predictable… to Profitable… to Climate Vulnerable & Uncertain

Big Shift in Allocation of Premiums to High Risk Areas…



But Total Premiums Slow to Rise...

Homeowners' Insurance Average Premium

State	2020	Rank	2010	Rank	% Change ('10-'20)
Florida	$2165	1	$1544	3	40.2 %
Louisiana	$2038	3	$1546	2	31.8 %
Texas	$2000	4	$1560	1	28.2 %
Colorado	$1667	7	$926	19	80.0 %
California	*$1241*	*24*	*$939*	*17*	*32.2 %*
United States	$1311		$909		44.2 %

Source: *Property Insurance Report*
Most Recent Data Available from National Association of Insurance Commissioners

Key Issues:

- Speed of Rate Filing Review & Approval
- Use of Modern Rating Methods
  - *Catastrophic Modeling*
  - *Reinsurance*
- FAIR Plan Growth Jeopardizes Industry Solvency

California Department of Insurance slow to approve homeowners rate filings

	Number of filings approved	Average time to approval (days)
2020	97	274
2021	47	309
2022	41	349

Source: S&P Global Market Intelligence

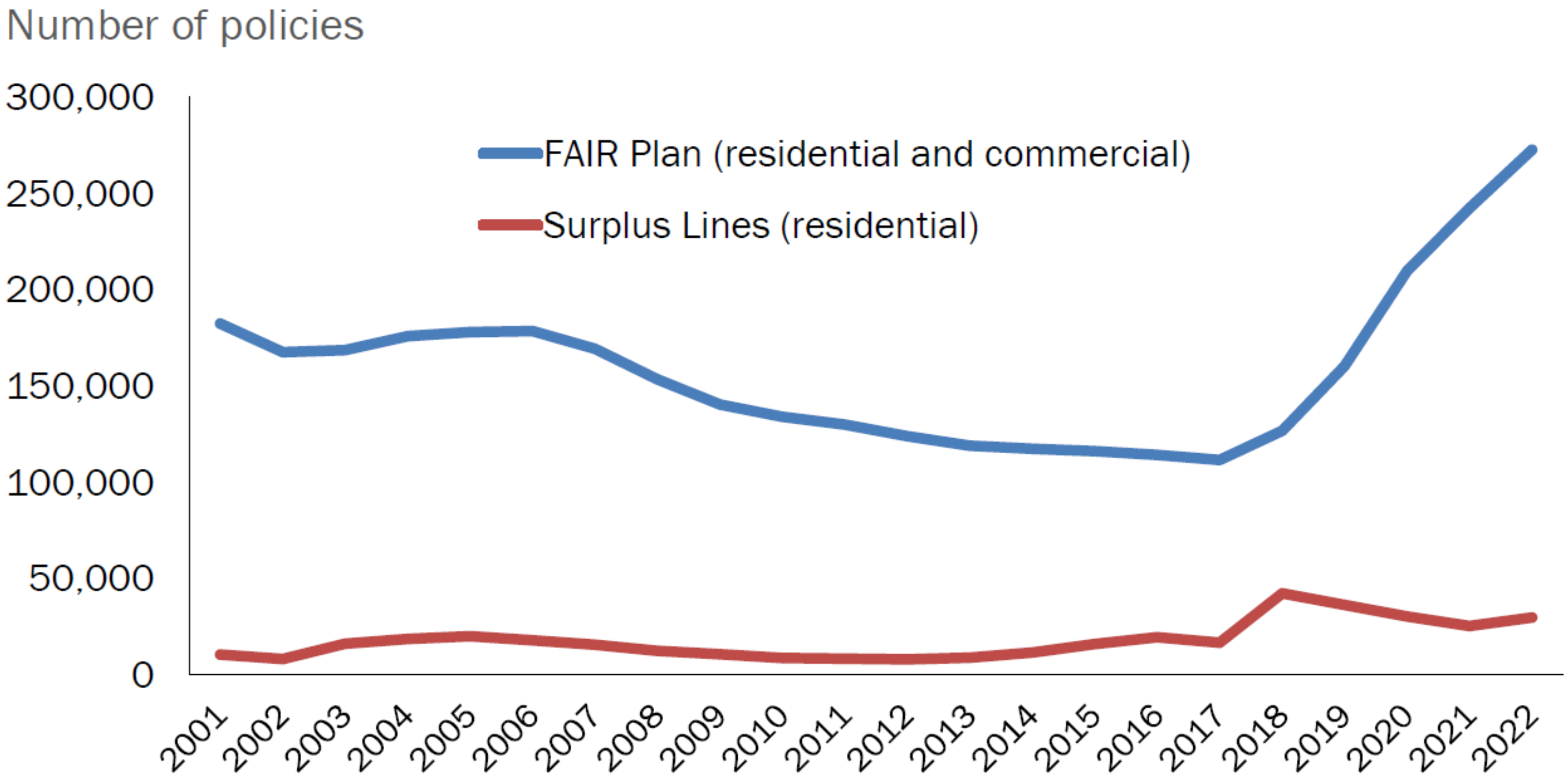
Key California Regulatory Provision from the Early 1990's (Not Required by Statute):

- Projecting Fire Losses by Historical Losses
  - *(10 CCR §2644.4 & §2644.5) – Insurers must estimate their future catastrophic fire losses using the average historic losses for at least the last 20 years.*
    - Prior low loss years produce low prospective rate indications -- regardless of clear changes in underlying risk conditions.
    - If climate change, high fuel loads or housing development in WUI create high risk of future insured fire losses, **insurance rates must ignore**.
  - Low historical losses placed insurers "in a hole" prior to the 2017/18 fires, so insurers reacted by restricting availability while starting to "dig out."
  - Use of Historical Losses **ignores** Mitigation (Home Hardening / Defensible Space)
- An Alternative? Projecting Losses Based Upon Current and Future Conditions
  - Insurers are seeking authority to formulate rates using probabilistic models that assess a home's location, fuel risk, and condition (including mitigation features).
  - California is the **Only State to Prohibit** Use of these Models. Allows for earthquake.

Key California Regulatory Provision Inherited By Current Administration (Not Required by Statute):

- Reinsurance Costs
  - *(10 CCR §2644.25) – Ratemaking shall be on a "direct basis, with no consideration for the costs or benefits of reinsurance… except for earthquake and medical malpractice" reinsurance.*
    - Insurers pay a premium to other insurers (aka, reinsurers) to sell in-force business and socialize California wildfire risk around the world.
    - Insurers must maintain sufficient capital to pay claims, and must adhere to a "leverage ratio" measuring their in-force premium to underlying capital (aka, "surplus"). When an insurer hits its leverage ratio, it must either stop writing new business or sell business to a reinsurer to free up capacity to write new business.
- An Alternative?
  - Insurers are seeking authority to formulate rates using actual, documented California reinsurance costs.
  - California is the **Only State to Prohibit** Use of these Models. Allows for earthquake.

FAIR Plan growing rapidly



Source: Dixon, Tsang, Fitts (2018), FAIR Plan, Surplus Lines Association of California

Why the concern about the FAIR Plan?

- Total exposure growing rapidly with substantial concentration
- Insurers will be begin to be assessed even for modest-sized events
- 48.8% rate increase requested in 2021 filing, but 15% approved in July 2023
- CDI would likely need statutory authority to allow assessments to be directly passed on to policyholders

Total exposure $264 billion as of August 2023

CALIFORNIA FAIR PLAN PROPERTY INSURANCE

BEST'S MARKET SEGMENT REPORT

Our Insight, Your Advantage™

September 18, 2023

Market Segment Outlook: US Homeowners

The outlook is moving to Negative from Stable owing to deteriorating underwriting performance

AM Best has revised its outlook for the US homeowners segment to Negative from Stable, based on the following factors:

- Net underwriting results deteriorated owing to elevated natural catastrophes and secondary perils.
- Rising loss costs, inflation, and supply chain disruptions are pressuring earnings, making it difficult to maintain rate adequacy.
- Reinsurance market conditions remain firm, with material changes in pricing, terms and conditions, and attachment points.
- Several market leaders have curtailed new business in catastrophe-exposed states.

Mitigation in Rating Plans and Wildfire Risk Models

REG-2020-00015 from California Department of Insurance effective October 2022

- Applies to any insurer that uses a rating plan that segments, creates a rate differential, or surcharges the premium based upon a policy's wildfire risk
- Within 180 days, insurers must:
  - File rating plans that incorporate CDI specified wildfire safety and mitigation efforts, both at community and property level
  - Establish a process for releasing wildfire risk determinations to policyholders
- Any Wildfire Risk Model used in rating plan shall be provided and available for public inspection regardless of whether model is confidential, proprietary, or trade secret

insurance.ca.gov

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It's a new day for wildfire safety in California. I am requiring insurance companies to give discounts to homes & businesses under our new #SaferfromWildfires regulation. My regulation is the result of listening closely to the needs of consumers. insurance.ca.gov/0400-news/0100 ... (1/2)

12:21 PM · Oct 17, 2022

Mitigation:

- The Science of Fire Mitigation is Getting Better, But Not Settled
  - *Insurance Institute for Business and Home Safety (IBHS)* is the primary research organization that influences insurer filings.
  - **“Wildfire Prepared Home”** provides parcel-level guidance
- What Is Getting Recognized by Insurers?
  - Building year of home (if older, compliance with California WUI Building Code, Chapter 7A
  - Parcel level actions consistent with IBHS research
  - If home is in community with mitigation commitment (e.g., Firewise)
  - CDI Regulations are contrary to IBHS Wildfire Prepared Home standards
- What Is Next?
  - Standards for Community Mitigation

Recent Governor Executive Order (9/21/23)

EXECUTIVE DEPARTMENT
STATE OF CALIFORNIA

EXECUTIVE ORDER N-13-23

This executive order requests that the Commissioner of Insurance take swift regulatory action to strengthen and stabilize California's marketplace, with the following goals:

- **EXPAND CHOICES, STABILIZE MARKET.** Expand coverage choices for consumers, particularly in underserved areas of the state. Maintain the long-term availability of homeowners and commercial property insurance coverage.
- **BETTER RATE APPROVAL PROCESS.** Improve the efficiency, speed, and transparency of the rate approval process. Tailor the rate approval process to account for all factors necessary to promote a robust, competitive insurance marketplace.
- **STRONGER FAIR PLAN.** Maintain the solvency of the FAIR Plan to protect its policyholders and promote long-term resiliency in the face of climate change, including by identifying mechanisms to reduce its share of the overall market in underserved areas and move its customers into the admitted insurance market.
- **ACCELERATE IMPLEMENTATION.** Direct the Department of Finance to consult with the California Department of Insurance to support the rulemaking process and help accelerate implementation of potential regulations.

Recent Insurance Commissioner Action (9/21/23)

Commissioner Lara announces Sustainable Insurance Strategy to improve state's market conditions for consumers

Key regulatory elements of the plan include:

- Executive action by Commissioner Lara to transition homeowners and businesses from the FAIR Plan back into the normal insurance market with commitments from insurance companies to cover all parts of California by writing no less than 85% of their statewide market share in high wildfire risk communities. For example, if a company writes 20 out of 100 homes statewide, it must write 17 out of 100 homes in a distressed area;
- Giving FAIR Plan policyholders who comply with the new Safer from Wildfires regulation first priority for transition to the normal market, thus enhancing the state's overall wildfire safety efforts;
- Expediting the Department's introduction of new rules for the review of climate catastrophe models that recognize the benefits of wildfire safety and mitigation actions at the state, local, and parcel levels;
- Directing the FAIR Plan to further expand commercial coverage to $20 million per building to close insurance gaps for homeowners associations and condominium developments to help meet the state's housing goals and to provide required coverage to other large businesses in the state;
- Holding public meetings exploring incorporating California-only reinsurance costs into rate filings;
- Improving rate filing procedures and timelines by enforcing the requirement for insurance companies to submit a complete rate filing, hiring additional Department staff to review rate applications and inform regulatory changes, and enacting intervenor reform to increase transparency and public participation in the process;
- Increasing data reporting by the FAIR Plan to the Department, Legislature, and Governor to monitor progress toward reducing its policyholders; and,
- Ordering changes to the FAIR Plan to prevent it from going bankrupt in the case of an extraordinary catastrophic event, including building its reserves and financial safeguards.

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PIFC

Q & A

- How do you want to be involved?
- What are the next steps?

Thank you!