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NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

SHAPING OUR MUTUAL FUTURE®

DATE: January 3, 2018

TO: Senate Insurance Banking and Financial Institutions Committee
Assembly Insurance Committee
Governor's Tree Mortality Task Force

RE: CDI White Paper on Availability and Affordability of Coverage for Wildfire Loss in Residential Property Insurance in the Wildland –Urban Interface and Other High-Risk Areas of California: CDI Summary and Proposed Solutions

We write in response to California Department of Insurance's (CDI) white paper on availability and affordability of insurance coverage in high risk wildfire areas. Not only do we disagree with the assumption that there is a systemic availability problem, we take issue with the authors' misstating the industry's written position on many of the issues outlined in the paper. We also believe the proposals are unnecessary and premature given the work in progress by the Governor's Tree Mortality Task Force Insurance Subgroup (TMTF), which includes County officials from high risk wildfire areas, CALFIRE, the insurance industry and CDI; the TMTF is currently in the middle of analyzing and addressing many of the issues in the white paper. Finally we oppose any efforts to unnecessarily expand CDI's authority beyond Prop 103, which has resulted in over-regulation of the industry.

<u>Availability</u>

There is little market evidence of an availability issue in high risk wildfire areas. The CDI paper refers to its consumer complaint data relating to non-renewals. However, the complaint data is unconvincing. The complaint data shows a "jump" from 41 complaints in 2010 to 143 complaints in 2016. (See Appendix D of the CDI white paper). 143 complaints out of an estimated 4.6 million or more residential policies in high risk wildfire areas in California does not demonstrate an availability issue. Further, CDI's numbers on new, renewed and nonrenewed policies (Appendix E), refute their assertion that there is a problem: of the 714,547 policies in selected counties with the highest percentage of high fire areas, just over 1 percent of these policies were non-renewed by the insurer, while 5 percent were non-renewed by the policyholder. The remaining 94% were renewed.

If an insurer is overexposed in a high risk wildfire areas, it jeopardizes all consumers in the event of a catastrophic fire. For this reason, insurers must act responsibly and spread the risks they insure appropriately. Still, CDI's extremely low number of complaints suggests homeowners are finding insurance. Homeowners in high risk wildfire areas may need to shop around more, but this does not equate to an availability issue. Even when CDI points to nonrenewals of homeowners' policies by some companies that may be overexposed, there has been no follow-up to determine if these homeowners have found insurance elsewhere. The low number of complaints suggests they have.

For homeowners needing assistance in shopping around, the TMTF has initiated a pilot project that matches homeowners with insurance companies, agents and brokers offering insurance in their areas. The program is advertised on the FAIR Plan's website. We encourage CDI to also direct homeowners to this program on CDI's website. This was recommended at a TMTF meeting.

Finally, in the event that a homeowner cannot find insurance coverage after shopping around, they can obtain insurance through the California FAIR Plan (www.cfpnet.com), which offers insurance at rates pre-approved by CDI. The legislature created the FAIR Plan to provide a backstop for the public by making insurance available in all high-risk areas. Interestingly, the FAIR Plan has not experienced an increase in fire polices. At a recent informational hearing held by the Senate Insurance Committee, the FAIR Plan's Executive Director testified that the marketplace is healthy, and that in fact if an availability problem existed, we would see an uptick in the number of FAIR Plan policies.

Affordability

CDI's white paper questions the affordability of homeowners' rates that CDI preapproves in recognition of the higher cost of insuring high risk areas. Insurance rates must be actuarially sound to protect all consumers, statewide, from insurer insolvency. Thus, insurers must ensure that the cost of insurance reflects the actual risk in high risk areas, and that homeowners in low-risk areas are not forced to subsidize those in high-risk areas. Per statute, all insurance rates must be pre-approved by CDI, must be actuarially sound, and cannot be inadequate, excessive or unfairly discriminatory. In high risk areas, this necessarily means that premiums will cost more so that insurers can pay claims in the event of a catastrophe such as the wildfires we are currently experiencing. As demonstrated above, however, although homeowners understandably would like to pay less, risk-appropriate rates are not resulting in homeowners not purchasing insurance.

Unfortunately, the wildfire risk is increasing due to drought, the bark beetle infestations, climate change, and years of mismanaging our forests. Further, as more people move into the wildland urban interface and other high risk areas, the overall risk increases, and insurers must act responsibly. In high risk wildfire areas, due to the volatility and high risk of devastation, the cost of insurance is necessarily and lawfully reflected in the rates. If insurers are forced to reduce rates, many of which are already inadequate for insurers, then availability may indeed become a real issue.

CDI Authority

There is no justification for CDI to increase its authority over underwriting and expand its already broad regulatory authority (CDI already has some of the highest levels of regulatory authority in the nation). The marketplace is working as it should -- insurance is available at risk-appropriate rates. No evidence exists to support giving CDI even more authority to regulate the market. CDI, through its legislative proposals outlined below, demonstrates its desire to solve an unproven problem by forcing insurers to offer insurance, dictating what products insurers must offer, and even regulating outside vendors, and how insurance companies determine if they can responsibly write insurance in certain areas. Requiring insurers to underwrite in ways that do not make business sense will only drive insurers out of the marketplace and harm consumers. Insurers should be permitted to competitively control their own underwriting, in order to ensure that consumers continue to benefit from a large number of companies participating in the California insurance market.

Legislative Proposals

CDI's white paper suggests that insurers would support legislative "solutions," for issues it has not demonstrated are a problem. The insurance trade letter attached as Appendix F to CDI's white paper explicitly states that industry would strongly oppose efforts to force them to "take all comers" or to grant unsubstantiated price discounts. Any such efforts not only threaten the stability of the marketplace, but are premature. Below we respond to the legislative concepts proposed by CDI:

- *Take all comers legislation*:
  The insurance industry strongly opposes take all comers mandates, requiring insurers to offer homeowners insurance to all homeowners, regardless of the risk, or the insurers' exposure in the high risk area. This will drive insurers out of the marketplace. Case in point, prior to the Northridge earthquake in 1994, the State of California required insurers to offer earthquake coverage every time they sold a homeowner's insurance policy. Following the Northridge earthquake, most insurers stopped writing new homeowners' insurance policies in the state because they could not responsibly continue to write earthquake insurance policies. As the problem wore on, the real estate industry began to experience difficulties with escrows. The California economy was affected. After creating the largest earthquake insurance facility in the world, the California Earthquake Authority, homeowners' insurance availability returned with full force. The lesson is that the State of California cannot mandate particular behavior that is not grounded in fundamentally sound public policy and economics – and which would ignore the existence of a mechanism (the FAIR Plan) that already provides guaranteed access to fire insurance.

  The CDI's proposal would provide an exception for insurers that offer a difference in conditions policy (DIC) and/or a premises liability insurance policy. Many insurers already offer these products to supplement the FAIR Plan's fire insurance policies should homeowners choose the coverage. Forcing insurers to offer products (some of which may not even be products that some insurers provide) is not acceptable. Further, for those insurers that do not have the products to offer, this does not provide them an "exception" from the broader take all comers requirement.

- *Mandatory Premium Credit*
  Insurers already consider mitigation in their underwriting and rates where appropriate. Homeowners, however, should not be given false expectations that mitigation efforts will *necessarily* result in a significant wildfire risk exposure reduction, when greater and less controllable factors impacting the risk must be considered such as the type and extent of available wildfire fuel, surface composition, slope aspect, and road access. Insurers need the ability to determine how much, if any, mitigation may truly reduce the policyholder's wildfire risk profile so as to justify providing the policyholder with any insurance credit, especially since rates are already inadequate for many insurers (insurers cannot even consider the actual cost of catastrophe reinsurance in their rates). Also, as discussed earlier, for some companies, over-exposure in particular areas will negate the usefulness of mitigation.

Regardless, insurers are always looking for more information to help them compete. Before insurers can consider mitigation assessment resources, such as those being considered by the TMTF, they need to see the backup data to study it and determine its usefulness for underwriting and/or rating for their specific companies. The TMTF has asked CALFIRE to work with IBHS' assistance on a tiered system to provide insurers an optional underwriting resource. The TMTF's concept is based on the IBHS's "Fortified Home" program which can assist insurers in assessing wind risk by standardizing mitigation efforts and classifying them into consumer understandable levels (bronze, silver, and gold). We cannot emphasize enough, however, that assessing fire risk is extremely different from assessing wind risk. In fact, IBHS has stated they do not endorse a Fortified program for fire, because it is such a *fundamentally* different risk from wind and does not have an enforcement mechanism (see attachment).

IBHS was able to create a program for wind because it has been proven that homeowners can make actual structural improvements that will make a significant difference in withstanding wind damage. In fact, wind risk damage mitigation is primarily a single risk variable – wind proof structural integrity of the house. However, in contrast to wind, protecting a property from fire is a multi-variant, moving target given that a major factor in protecting homes from fire is managing ever-changing vegetation, unpredictable temporary weather patterns, and the established topography of the area. Both CALFIRE and IBHS have stated at the TMTF meetings that this is a very real challenge. Further, CALFIRE has stated (at both the TMTF and at a recent legislative informational hearing) that they only inspect about a third of the properties in WUI areas every three years, and that even then, they are not issuing fines for violation of the Public Resources Code Section 4291.

Finally, as mentioned above, other factors, such as fuel, surface composition, slope aspect, and road access must be considered. Such factors can negate, or significantly diminish, the impact of mitigation efforts. Take access, for example (i.e. whether road access is wide enough): If there is a cul-de-sac, firefighters will require being able to pull the fire engine in and turn it around so they can get out quickly for safety reasons. If that is not the case, then they will not even go to those homes to save them, so the amount of risk mitigation done by the policyholder is for all practical purposes irrelevant to the policyholder's risk-of-loss profile. As another example, a homeowner could have a mitigated house next to a less cared for structure, or adjacent to state or federal land that have not been maintained to reduce wildfire fuel sources, which would put the mitigated house at higher risk.

Insurers always look for ways to fine tune their risk assessment to provide consumers with rates that accurately and comprehensively match the consumer's risk of loss exposure and to be competitive in the marketplace where possible. Though some insurers may decide to consider more mitigation efforts, this should be an individual business decision based upon market competition, and controlled by the individual insurer's book of business and ability to address insurance consumer needs in the entire state. The insurance industry always welcomes more scientifically based information that it can voluntary use. We look forward to working with the TMTF to explore if useful wildfire risk mitigation information can be collected to assist insurers in their risk analysis, on a voluntary basis.

- *Wildfire Risk Models*
  CDI is authorized to regulate insurers, not the outside vendors insurers use. Broadening CDI's authority to regulate non-insurance businesses expands the authority far beyond the CDI's purview, and expertise.

  We disagree with CDI that these tools are inaccurate. On their own, insurers will demand that such models be state of the art. The goal of insurers is to have the most accurate information and data possible. The risk modeling tools actually provide the industry more accuracy – thus the reason for their increased use. The tools look at many factors to help insurers more accurately assess risk. Depending on the modeling company, the factors considered include fuel (vegetation), surface composition (type of vegetation), slope, aspect (the slope's direction), and road access (for emergency vehicles).

  Before such models were available as a useful tool, the industry assessment of risk was less accurate. Though the tools have been criticized for resulting in nonrenewals or declinations, as explained above, insurers must responsibly take into account risk and exposure. Further, some insurers write more insurance in high risk areas due to a better understanding of the risk, where before they were not willing to chance the risk. If a homeowner questions the result, an insurer can always ask the modeling company to take a second look.

  The CDI legislative proposal also mandates modeling companies consider mitigation. To the extent an insurer is in a position to maintain or add policies in high-risk areas, mitigation is already taken into account. Insurers are always looking for more information to assess risk, however, it is unclear why CDI believes that consideration of mitigation activity is better done within a modeling tool as opposed to any other method.

- *Right of Homeowner to Appeal a Score or Factor Determined by a Wildfire –Risk Model*
  The industry is already in discussions with CDI on how to address this issue, per CDI's request. Given that these discussions are underway, it would be premature to legislate. Further, the risk modeling companies already will review individual cases submitted by an insurer for reconsideration.

- *Creating an exposure risk manual*
  Creating an exposure risk manual similar in concept to the risk and severity bands manual used by auto insurers in developing private passenger auto rates does not make sense for the homeowners line of business. Data may incorrectly indicate that certain high risk areas are not risk based on the fact that a fire has not occurred in decades. For wildfire risk, insurers need to look back and prospectively. The challenge with just looking backwards is that the data is not available to get a full representation of the activity or risk, regardless of whether it's combined industry data. Further, with climate change, looking solely backwards understates the prospective risk. Insurers must look prospectively as well. Modeling tools help them achieve this.

<u>Similar Legislative Proposals from United Policyholders</u>
United Policyholders (UP) suggests legislation that again rests on the faulty premise that an availability and affordability issue exists. Similar to the CDI proposal, they advocate for mandates on insurers that

will undermine their ability to underwrite responsibly, and force artificial discounts. As discussed above, such policies only result in driving business out of the state. It should also be noted that much of the legislation suggested by UP is based on laws in place for states with wind/hurricane risk. Fire is a very different story. As discussed above, in contrast to wind, protecting a property from fire is a moving target due to ever-changing vegetation. Homeowners are faced with the need to constantly manage changing vegetation, the mismanagement of forests surrounding their homes, and their neighbor's actions.

Conclusion

The proposals outlined in the white paper have not been demonstrated by CDI as needful or likely to be effective, and are premature given the Governor's Tree Mortality Taskforce and other regulatory activity in progress. It is understandable, given the recent devastating fires in California, that homeowners may be concerned. However, insurance is available and priced appropriately. No issues have occurred to justify such drastic legislation, which has the strong potential of disrupting a marketplace that works.

We appreciate your attention to these issues. Please contact Kara Cross at the Personal Insurance Federation (916-442-6646/kcross@pifc.org) or Christian Rataj at the National Association of Mutual Insurance Companies (303-907-0587/crataj@namic.org) should you want to discuss.

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