



Date: March 10, 2021

To: The Honorable Susan Rubio and Members of the Senate Insurance Committee

From: Pacific Association of Domestic Insurance Companies (PADIC)
Zenith Insurance Company
California Insurance Wholesalers Association (CIWA)
First American Financial Corporation
Independent Insurance Agents and Brokers of California (IIABCal)
American Fidelity Assurance Company
American Property Casualty Insurance Association (APCIA)
Personal Insurance Federation of California (PIFC)
National Association of Mutual Insurance Companies (NAMIC)

Re: SB 440 California Earthquake Authority – Oppose

The above-captioned groups must regretfully oppose SB 440. While we agree with the goal of the author to provide long term funding for home hardening against wildfire and earthquake risk, we believe there is another, better source of revenue to fund this important purpose.

SB 440 would create a new statewide hardening program in a round-about manner – using the California Earthquake Authority (CEA). The bill would require all property and liability insurance policyholders in California to be assessed (up to 2% of the policy premium, for ten years) if the CEA runs out of other money. With the money that the CEA would save on reinsurance because of this free source of assessment revenue, it would shift CEA policyholder premiums to fund wildfire and earthquake hardening. It would also set aside up to \$10,000,000 annually from the newly created utility Wildfire Fund, which is funded by contributions from

electrical corporations and revenues generated from a surcharge on ratepayers, for mitigation grants and related research and educational activities.

For a similar bill (SB 254/Hertzberg), Legislative Counsel informed the Senate Insurance Committee that because “the assessment would be collected on ‘assessable insurance policies,’ which by definition do not include earthquake insurance policies, and because the money would be used for funding of the CEA and, thereby, to benefit holders of earthquake insurance policies, the assessment would be a tax pursuant to Section 3 of Article XIII of the California Constitution.” Legislative Counsel also noted that because it grants the CEA the sole authority to determine the amount of the tax, the bill may raise the issue of unlawful delegation of Legislative taxing authority.

While we strongly agree with the goal of SB 440, to reduce risk and loss by increasing wildfire resiliency, we must respectfully oppose this bill for the following reasons:

- **Unfair to millions of Californians.** Only 13% of California residential homeowners have earthquake insurance, but this bill would impose a tax on tens of millions of policyholders for the insurance on their homes, cars, and their businesses (e.g., restaurants, nail salons, gyms, trucking companies, wineries, and farms) in order to make sure the small minority who are fortunate enough to afford earthquake insurance can rebuild after a catastrophic earthquake. *The 87% of homeowners who do not have earthquake insurance, plus every car owner and business in California, who may not be able to rebuild, will be forced to pay a new insurance tax to cover the claims for those few who can.*
- **Reduces Ability to Pay Victims of Utility-Caused Wildfires.** The Wildfire Fund is a \$21 billion catastrophe fund that provides payment of claims arising from wildfire caused by any large electrical utility that meets specified requirements. The utility Wildfire Fund is intended to protect the solvency of California utilities as well as provide mechanism to help victims of wildfires receive appropriate compensation to help them recover. *This bill would transfer money from that fund, potentially jeopardizing its actuarial soundness and impairing its ability to compensate victims of catastrophic wildfires.* It should be noted that insurers also seek recoveries from the fund to offset losses that would otherwise result in higher premiums and reduced insurance availability for California homeowners in fire-threat areas.
- **Could Worsen Insurance Affordability and Availability Challenges.** The CEA commenced operations in 1996 as a not-for-profit, publicly managed, privately funded entity. Residential property insurers could offer their own earthquake insurance or become a CEA participating insurance company. These participating insurers, provided the initial funding of over \$700 million for the CEA, have long term contingent liabilities (\$1.7 billion) to provide additional funding to support the CEA, and the customers of these insurers are subject to assessment (a surcharge on CEA policies up to 20% of the annual premium) by the Authority when there is a catastrophic loss. *Because this bill*

would reduce the amount of reinsurance purchased by the CEA, it would have the perverse effect of increasing the likelihood of that contingent liability being triggered, which, in turn, would worsen the challenges of affordability and availability of homeowners insurance in fire-threat areas. There is also a significant issue of whether the Legislature may unilaterally modify the existing contracts between participating insurers and the CEA, which are protected under the state and federal contracts clauses.

The CEA has been in existence 25 years. It is time that the Authority demonstrates it can stand on its own by meeting its basic capital requirements without relying on financial gimmicks, policyholder assessments, and insurer subsidies. Insurers have long been interested to see a report demonstrating that the CEA products are appropriately priced to reflect the risks it faces and understand how its prices compare to unsubsidized private sector competitors. A better pricing structure could reduce reinsurance costs without necessitating a new tax on struggling Californians.

- **Violates Foundational CEA Principles.** The CEA only provides earthquake insurance to the customers of its participating member companies. *A critical principle in creating the CEA was that non-participating property insurance companies and their policyholders have no financial obligation to support the Authority.* Instead, non-participating insurers must develop their own plans to offer earthquake insurance to their residential property policyholders, and the policyholders of non-participating insurers are ineligible to purchase earthquake insurance from the CEA. The same principle applies to commercial insurers and their customers, as well as with insurance placed with non-admitted insurers.

- **A Better Solution to Fund Wildfire Resiliency.** To the extent community home hardening is a statewide priority, and we agree it should be, there is currently a \$15.5 billion state general fund surplus, several multi-billion dollar wildfire bond proposals moving in the legislature, and approximately \$800 million of Federal Emergency Management Agency (FEMA) Hazard Mitigation Grant Program (HMGP) funds available to address this need. As noted by the Legislative Analysts' Office:

“Under the Governor’s budget, the state would end 2021-22 with \$18.9 billion in total reserves, an increase of \$7.5 billion over the last year’s enacted level. This increase is the result of constitutionally required reserve deposits, which reflect much stronger than anticipated revenue growth. In addition, we estimate the Governor had a significant windfall—\$15.5 billion—to allocate in developing his 2021-22 budget proposal.”

Thus, we believe *the overly complex and burdensome financial scheme proposed by SB 440 is inappropriate and unnecessary.* There is no need to arbitrarily tax tens of millions of insurance policies to fund a core state public safety and public health function. Instead, we would appreciate the opportunity to work with the author to ensure California prioritizes federal HMGP and Building Resilient Infrastructure and Communities (BRIC) funds for the purposes envisioned by this measure.

For these reasons, we must respectfully oppose SB 440 as currently proposed. However, we support development of a program to assess, inspect, enforce, and verify appropriate mitigation for home and community wildfire resiliency as well as an appropriate funding source to financially assist homeowners with related compliance costs.

CC: Senator Bill Dodd, Author
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