**INSURANCE COMMISSIONER RICARDO LARA**
**TESTIMONY ON SUSTAINABLE INSURANCE STRATEGY**
**BEFORE ASSEMBLY COMMITTEE ON INSURANCE**
**WEDNESDAY, DECEMBER 13, 2023 AT 1PM**

Good afternoon, Chair Calderon, Vice Chair Essayli, and Committee Members! Thank you for inviting me here today.

California is at an insurance crossroads and for many Californians, this is an insurance emergency. Consumers are experiencing the impact of growing climate threats, historic inflation, and outdated regulations.

As the state's insurance regulator, my focus is safeguarding the integrity of the insurance market, which includes protecting consumers and businesses. In September, I announced my Sustainable Insurance Strategy, which is the largest insurance reform since voters passed Proposition 103 nearly 35 years ago. There is no question that the risks that existed when voters passed Proposition 103 are not the same risks we are facing today. The insurance market we are dealing with today necessitates urgent measures that even the Governor recognizes, as set forth in his Executive Order issued on September 21st.

My strategy is based on a thorough assessment of today's insurance landscape with input from wildfire survivors, ranchers and farmers, supportive housing groups, REALTORS, homeowners and condo associations, new home builders, and other insurance consumers most affected.

We are moving with urgency and deliberately, based on the facts, and we won't be pressured by entrenched groups seeking to defend a broken status quo that puts their interests ahead of the public's benefit.

It is clear that insurance reforms are long overdue and the current system does not address the insurance challenges of today. I am taking action to implement lasting changes that will make Californians safer through a stronger, sustainable insurance market.

As I will discuss in greater detail in my testimony, my strategy consists of the following components:

- Streamlining the rate application process
- Introducing risk management tools such as catastrophe modeling and net cost of reinsurance, with a commitment from insurance companies to write at least 85% of the homes and businesses in distressed areas
- And Strengthening the FAIR Plan.

Currently in the property insurance market, 7 of the top 12 insurance groups in California paused or restricted new business in the past year. Insurance company actions after multiple years of major wildfires and winter storms have pushed more people to the FAIR Plan, which has become the only option instead of the last option.

For many people who cannot obtain insurance at any price, except from the California FAIR Plan, this truly is an insurance emergency.

The FAIR Plan has grown 20 percent this year alone, now at more than 330,000 residential policies.

Why does this matter?

Put simply, increasing the number of policyholders in the FAIR Plan threatens the solvency of insurance companies in the voluntary market. If the FAIR Plan experiences a massive loss and cannot pay its claims, by law, insurance companies are on the hook for the unpaid FAIR Plan losses. While this assessment on insurance companies hasn't happened in nearly 30 years, this uncertainty is driving insurance companies to further limit coverage to at-risk Californians. This is why my strategy seeks to increase insurance availability while reducing the pressure on a growing FAIR Plan and on California consumers.

We must reverse this trend of a growing FAIR Plan if we are going to safeguard the state's insurance market as a whole.

We also cannot stabilize the current insurance market without recognizing the impact of climate change. Consumers are experiencing the impact of growing climate threats and outdated regulations.

California is leading nationally and globally in preparing insurance markets for climate change. California's Department of Insurance is the first in the nation to have a branch focused on climate change that I created when I first took office in 2019. We are working collaboratively with other state insurance departments through the National Association of Insurance Commissioners, where I co-chair its first Climate Risk and Resilience Task Force. Through those national efforts, we have moved forward in a bipartisan way to strengthen our oversight of insurance markets.

We also are working directly with the United Nations – and in the recent climate meetings in Dubai, I met directly with other national insurance leaders who are pressing the agenda on reducing climate emissions and improving community resilience. I was one of only three department leaders in California (along with the Natural Resources Agency and the Air Resources Board) to receive a credential to attend the recent climate conference in Dubai, where we announced that this spring we will host the United Nations Principles for Sustainable Insurance in Los Angeles.

Insurance is now squarely on the agenda for global climate action, which was not the case when I took office more than four years ago.

All these efforts inform the work that we are doing here in California to create a Sustainable Insurance Strategy.

Now I want to discuss the components of my strategy in more detail, starting with the Rate Application Review Process.

My Department is experiencing the same shortage of actuaries and analysts that other companies and government agencies are experiencing since the pandemic. We are focused on strengthening our Rate Regulation Branch so that we can meet the current demands of rate applications before the Department, and to implement regulatory changes to improve rate filing procedures. To put this in perspective, my Department currently is reviewing 95 rate and rule filings for homeowners and commercial property insurance.

My strategy is aimed at improving all areas of rate review, including tightening up procedures to expedite rate applications. This process extends beyond the Department. We expect all participants in this process, including insurance companies and intervenors, to work with us towards improving our review and approval of rate filings, which is an essential part of how we keep insurance available in our state.

From insurance companies, we intend to enforce the requirements that a complete rate application is submitted to the Department *before* the clock on reviewing the application begins. In the past, we have allowed insurance companies to submit their applications without the complete data needed. When market conditions are changing rapidly, we don't have the luxury of time for a lengthy back and forth about incomplete applications. We expect insurance companies to provide the Department with the complete information upfront needed to make a determination on the requested rate – and our Department will provide a rate reconciliation tool to assist that.

Similarly, we will allow third party intervenors in a rate application to only raise issues that are relevant in an application. Raising unrelated or irrelevant issues only serves to slow down the process, which has a direct impact on consumers and insurance availability, especially when there are other avenues to raise these issues. Overall, I believe that the goal of a more streamlined, efficient, and transparent approach will better represent the interests of California's consumers.

Another component of our strategy is allowing new risk assessment tools that can support greater availability of insurance. For the past 30 years, the Department has used historical losses as the method for estimating catastrophe adjustments in the California rate approval process. However, historical losses do not account for the growing risk caused by climate change, nor does it take into account risk mitigation measures such as home hardening, prescribed fire, and healthy forest projects.

My Department has been engaged in ongoing conversations and public workshops with the public, academia, insurance companies, and consumer groups regarding the use of catastrophe models in the rate approval process. Allowing insurance companies to use catastrophe modeling in their rate calculations will give them the ability to better anticipate future potential catastrophe losses. The use of catastrophe models will be informed by California's goals of fairness, availability, and affordability.

I recognize that time is of the essence, but this is not something that can happen overnight. The process of incorporating catastrophe models into California's rate approval process is a complicated one, and involves multiple branches of my Department to work together on a solution.

- <u>Legal</u> – My legal team is working on how the introduction of catastrophe models to the rate approval process will meet the public inspection requirement set forth in Insurance Code section 1861.07. It is important to consider California's public inspection requirement and the extent to which the inner workings of catastrophe models can be publicly disclosed.

- <u>Climate</u> – My climate team is working on how the Department will engage with experts to strengthen our understanding of wildfire modeling factors and approaches. My climate team is also using a data-driven process to define what will constitute a "distressed area" for purposes of meeting an insurance companies' commitment to increase their market share in distressed areas.

- <u>Rate Regulation</u> – My rate regulation team is working on the regulatory text which will set forth how the models will be used in the rate calculations in a rate application. The current ratemaking process formula is not structurally set up to accept modeled losses.

In addition to the above work, my Department is examining the use of both private and public models. Based on conversations and workshops with the public, we recognize the benefits of both private and public models and are pursuing both tracks. I look forward to introducing this regulation for public input and adoption in 2024.

Reinsurance is an increasing expense incurred by insurance companies as part of the cost of writing home and business policies. Insured natural disaster losses have increased 5-7% annually for the last 30 years – and insurance companies are taking on more reinsurance to cover these increases.

California is one of the few states in the nation that does not allow insurance companies to recover this expense, which contributes to their decisions to reduce new policies or to restrict writing to the lowest-risk policies. We recently reviewed insurance companies' annual climate risk disclosures made through the National Association of Insurance Commissioners. Our 2023 analysis shows that reinsurance is an important component of how insurance companies manage their risk – enabling them to write policies despite growing threats. This is why my Department is examining how to allow insurance companies to recover their California-only net cost of reinsurance.

Our goal is for consumers to have insurance options. By allowing insurance companies to recognize and recover their California-only net cost of reinsurance, and letting them reflect that in their rates, this will encourage carriers to re-enter and expand their business in the California property market with rates that more accurately reflect the cost of doing business in California.

Our current regulatory structure does not allow insurance companies to reflect the true cost of writing business in California, and that is helping contribute to the current insurance availability issue. Insurance companies will not return to California unless they are able to charge rates that are justified to cover their risks and provide the opportunity to earn a fair return.

Will Californians see increased insurance costs in the future? The only realistic answer is yes. I have been clear that increasing availability of insurance is how we will protect affordability. We need to focus on getting insurance companies back to writing policies in California and to a point where they are competing for your business.

As the largest insurance market in the nation, California’s insurance rates are far lower on average than in many large states that face growing risks from climate change, particularly hurricanes on the East Coast and Gulf Coast.

But if you ask people in South Lake Tahoe, in Paradise, in Lake Arrowhead, or all the other places where the FAIR Plan is going up, they already are paying more and not getting anything in return. Those premium increases are happening under our current regulation – which clearly is not working for those areas.

Most importantly, the two risk assessment tools I have just discussed – catastrophe modeling and reinsurance – are significant because to use them to set future rates, insurance companies must satisfy two commitments. The first is that they must increase writing, at least 85% of the homes and businesses in a distressed area. The second is that they must help depopulate the FAIR Plan. Insurance companies that cannot meet this commitment will not be able to use either catastrophe modeling or reinsurance as part of their rate application. Insurance companies that fail to follow through on their commitment will have their rate re-assessed by the Department.

While we focus on shrinking the FAIR Plan, it will still be a temporary option in the short term for many Californians. We need to make improvements to the FAIR Plan so that it can serve its legislatively intended purpose of creating stability in the property insurance market – while providing consumers with the best possible customer service.

When I took office, one of my first actions was to undertake reforms to the FAIR Plan. The FAIR Plan had been neglected for many years under multiple insurance commissioners. Many people did not understand why we pushed for these reforms in 2019. But now it is clear why we did that – and how necessary those reforms are for Californians, especially now.

We increased coverage limits for the first time in two decades – going from $1.5 million to $3 million for residential policies, and from $3.6 million for its businessowners policy and $4.5 million for its commercial property policy to $20 million for both options.

We ordered the FAIR Plan to accept monthly payments and credit card payments.

We worked with the Legislature and Governor's Administration to allow for coverage of farm buildings.

Without those changes, the problems today would be worse.

- Homeowners and businesses would be underinsured for hundreds of thousands, if not millions of dollars.
- More retirees would be unable to afford six-month premiums that have only gone up.
- More farms would be uninsured and facing catastrophic losses.

There are more changes to the FAIR Plan that are needed.

As part of the strategy, we will be working to increase coverage to $20 million *per building* for our larger homeowners associations, condo associations, farms and other businesses.

Last month, a court upheld my order that the FAIR Plan offer a more comprehensive homeowners policy – instead of forcing consumers to purchase a separate policy at an additional cost. It's time that the FAIR Plan now end their challenge of my order and work to implement it.

These actions are also included in our strategy.

My Department has a goal of submitting each of the different regulatory efforts associated with the different components of the strategy by the end of 2024.

Each component requires careful analysis by all parts of my Department – including my Legal Branch, Climate Branch, Rate Regulation Branch, and Special Counsel's Office. I do not want another insurance commissioner to be back in front of you in 5 or 10 years because these regulations did not stand the test of time.

How do consumers benefit?

Under the strategy, there is a clear benefit for consumers in areas where the FAIR Plan has become the only option. Consumers get greater insurance availability.

To reach the 85% target, insurance companies must take policyholders from the FAIR Plan, using the clearinghouse programs created by bills passed by the Legislature and signed by the Governor.

This is groundbreaking because currently there is no requirement under Proposition 103 or any law for insurance companies to write policies in an area – a limit that was enforced in court under former Insurance Commissioner Garamendi.

The Legislature's support is essential for my on-going efforts. Your groundbreaking budget investments, along with Governor Newsom's Administration, in wildfire safety are transforming our existing communities. My Department is finalizing my Safer from Wildfires regulation discounts which will amplify the benefits of wildfire safety spending.

Your support for additional staff and support for our Department in the recently signed budget will be critical to implementing these crucial regulatory changes.

Your continued involvement and partnership are essential to support investments in wildfire safety and to work with our federal partners to better manage federal lands and increase funding for the home hardening and community grants administered by the State of California. Risk reduction is central to safety and long-term insurance sustainability.

The conversations we had in the recent legislative session as we developed our strategy show we are seeing the problems clearly, and you share my need for urgency.

I will continue to partner with all those who want to constructively work towards real solutions.

I look forward to continuing to work with you to identify innovative ways to create more resilient communities to withstand climate change.

Thank you.