ASSEMBLY COMMITTEE ON APPROPRIATIONS Lorena Gonzalez, Chair
SB 290 (Dodd) – As Amended August 12, 2019

Insurance
Governmental Organization

State Mandated Local Program:

Vote: Reimbursable: No

This bill authorizes the Governor to purchase insurance, reinsurance, insurance linked securities or other related alternative risk-transfer products for the State of California to help mitigate against costs incurred by the state in response to a mudslide, wildfire or flood. It also:

1. 1) Specifies the Office of Emergency Services, or another agency designated by the Governor, shall work with the Treasurer and the Insurance Commissioner to determine the appropriate products to be purchased. Allows these entities to consult with an existing working group examining climate change risk mitigation.
2. 2) Allows the Department of Finance to allocate funds from the Special Fund for Economic Uncertainties to the Governor to purchase insurance products.

FISCAL EFFECT:

1. 1) Likely minor and absorbable costs to the affected agencies (OES, the Office of the Treasurer, and Department of Insurance). If significant analysis was conducted of a potential reinsurance purchase decision, it would likely result in GF or special fund staff cost, contract costs, or both, to one or more of these entities, likely in the low hundreds of thousands of dollars one-time.
2. 2) Significant unknown GF costs and potential savings if reinsurance is purchased. The potential costs and savings depend upon the product design and on the incidence of catastrophic events. The bill indicates costs can be paid out of the Special Fund for Economic Uncertainties, but on a practical basis the costs would be borne by the GF.

COMMENTS:

1) **Purpose**. The author notes the recent Camp Fire underscores the state's enormous financial exposure from catastrophic events. The author contends tailored financial solutions for public sector entities blunt budgetary and fiscal strain by way of immediate payment of agreed upon sums in response to agreed upon circumstances, allowing recovery and rebuilding efforts to commence while reducing or eliminating any need to draw upon critical reserves or rainy-day funds. This bill is co-sponsored by Fiona Ma, California State Treasurer, and Ricardo Lara, California Insurance Commissioner, and supported by the insurance industry.

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2) **Background**. Last year was California's deadliest year for fires, with more than 100 fatalities. The Camp Fire in the fall, which burned through the town of Paradise, killed 85 people and burned 153,000 acres. In 2018 California spent $947 million on wildland firefighting through emergency funds – over $450 million more than budgeted.

Reinsurance is a risk management tool used by insurance companies to protect themselves from large financial losses—in other words, reinsurance is insurance for insurance companies. Insurance providers pay premiums to reinsurers. In exchange, reinsurers provide coverage for losses incurred by insurance providers up to a specified amount negotiated by both parties. The state of Oregon and the federal government have used reinsurance to manage risk. For instance, the National Flood Insurance Program (NFIP) Reinsurance Program helps the Federal Emergency Management Agency (FEMA) manage the future exposure of the NFIP through the transfer of risk to private reinsurance companies and capital markets investors.

3) **Staff Comments**. Staff notes the following:

a) **Delegation of Legislative Authority**. Reinsurance reduces risk, but generates up-front costs. This bill grants Legislative approval for transferring potentially large sums of money to purchase insurance products instead of paying directly for actual disaster response. In addition, passing this bill would allow the administration, working with other statewide elected officials, to make determinations about risk tolerance that would otherwise be at Legislative discretion. The bill does not provide guidance on the level of risk mitigation the Legislature desires and nor does it allow for Legislative input on trade- offs.

b) **Legislative Oversight**. The bill allows for the purchase of reinsurance using continuous appropriation authority from the Special Fund for Economic Uncertainties without robust reporting, analytical or oversight requirements. Allocations made from to the fund currently only require 30-day notification to the Joint Legislative Budget Committee.

The fund is quite sensibly continuously appropriated without regard to fiscal year because disaster relief expenditures are inherently unpredictable. Reinsurance premiums, on the other hand, are predictable and serve to minimize risk. It is not necessary to grant continuous appropriation authority with minimal oversight for such expenditures.

c) **Missing a California-Specific Analytical Basis**. This bill is not based on an analysis of the necessity or benefit of reinsurance for the state.

4) **Opposition**. The Department of Finance (DOF) opposes this bill, citing existing authority to make expenditures for emergency response and preparation. DOF also notes paying regular and ongoing expenses from the Special Fund for Economic Uncertainties violates the spirit of the fund, which is a discretionary reserve with funds continuously appropriated to it for disaster relief purposes. DOF expects insurers to be wary of wildfire risk and that premiums would likely be high and financially unsustainable.

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