Comments of Consumer Watchdog
Fourth Workshop Regarding Catastrophe Modeling and Ratemaking:
Insurer Commitments to Increase Writing of Policies in High-Risk Wildfire Areas
(REG-2023-00010)
June 26, 2024

Commissioner Lara proposes to allow insurance companies to use unverifiable third-party models to set rates, charge consumers for unregulated reinsurance, and roll back regulatory oversight that has protected consumers for nearly four decades.

These insurance industry solutions, proposed in response to an availability crisis the industry created, will make insurance premiums even more unaffordable for consumers across the state.

Similar concessions to those in the Commissioner's plan have failed to stabilize the insurance market in Florida. Floridians' home insurance rates are two-and-a-half times higher than in California.[1] Florida's insurer of last resort, Citizens, has four times as many policyholders as the FAIR Plan.[2] Insurance companies have still abandoned the state.

This regulation—based on a legislative proposal negotiated between Commissioner Lara and insurance companies behind closed doors last year—was supposed to make insurance companies give something back by requiring them to sell home insurance again to Californians they have abandoned.

It is deeply disappointing that the long-awaited text of the regulation fails to deliver on making insurance more available for Californians.

The Commissioner has stated publicly that his plan will require insurance companies to increase sales to homeowners in "distressed areas." **However, the text of proposed regulation 2644.4.8 does not require a single insurance company to return to areas of the state it has abandoned.**

The proposal does not require the sale of policies with comprehensive coverage; would not require insurance companies to charge a price that consumers are able to afford; and contains so many loopholes that insurance companies' "commitment" to sell insurance in distressed areas can be waived for any insurer that claims it cannot, or later opts not to, meet it. But when insurance companies fail to expand coverage, they will still get to keep the double-digit price hikes that will result from allowing insurance companies to use unverifiable secret algorithms to set prices.

[1] https://content.naic.org/sites/default/files/publication-hmr-zu-homeowners-report.pdf
[2] https://floir.com/tools-and-data/residential-market-share-reports

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The proposed regulation will drive up rates for every Californian, not just those in wildfire areas.

While the coverage "commitments" do not begin for two years, insurance companies would be able to raise rates using black box models immediately.

The proposed regulation allows insurance companies to use black box catastrophe models to set rates for every Californian. The next regulation on deck will allow insurance companies to charge all policyholders for the unregulated (and skyrocketing) cost of global reinsurance—which no other California commissioner has ever allowed. These two changes will raise rates not just in riskier areas, but for home, condo, and apartment insurance across the state. That means every Californian will pay more for an empty promise to get homeowners in wildfire areas insured.

The majority of the public does not support that tradeoff, even if it were successful in getting people insured again. A poll conducted by FM3 Research for Consumer Watchdog found that Insurance Commissioner Lara's plan to allow insurance companies to increase premiums for all Californians in exchange for a promise to insure homeowners in higher wildfire risk areas is opposed by a 2 to 1 margin, 62% opposed to 30% in support. Only 9% of voters register in strong support.[3]

As we note in our testimony at the prior modeling workshops[4], private models are notoriously inaccurate and inconsistent and contain biases that threaten to restore redlining and other notorious discriminatory practices. Catastrophe models will simply be tools for insurance companies to charge more unless California mandates transparency into how they impact prices, imposes rules of the road requiring review and approval of their design and use, and requires that insurance companies use them to provide consumers and communities with actionable information about their own climate risk.

A public model that is testable and fully open to public scrutiny would best serve these goals. We were pleased to hear Commissioner Lara finally endorse the idea of a public model for the first time in an Assembly Insurance Committee hearing in April. We urge the Commissioner to put this regulation on hold until a public model is created that the public can have confidence is not unfairly inflating prices, and to endorse a mandate that insurance companies sell to Californians who do the right thing and protect their homes from fire. This is the most practical and most certain way to guarantee Californians access to affordable coverage.

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[3] https://consumerwatchdog.org/insurance/new-poll-shows-voters-oppose-insurance-commissioners-home-insurance-plan-by-2-to-1-overwhelming-support-requiring-insurers-to-cover-all-who-fire-proof-their-homes/

[4] https://consumerwatchdog.org/wp-content/uploads/2024/04/Consumer-Watchdog-Testimony-Catastrophe-Modeling-Workshop-04-23-24.pdf; https://consumerwatchdog.org/wp-content/uploads/2023/07/Consumer-Watchdog-Testimony-Catastrophe-Modeling-Workshop-7-13-23.pdf; https://consumerwatchdog.org/wp-content/uploads/2023/09/Consumer-Watchdog-Testimony-9-28-2023-2nd-CDI-Catastrophe-Modeling-Workshop.pdf

Insurance companies do not have to sell comprehensive coverage to meet their commitments.

Ever since Commissioner Lara announced his deal with the insurance industry last September, Consumer Watchdog has asked him to confirm exactly what kind of policy insurance companies would have to sell. This question was urgent because the deal the Commissioner made with the insurance industry during the last legislative session would have allowed the sale of bare bones, FAIR Plan–equivalent policies, not the standard, full-benefit home insurance that Californians need.[5] The Commissioner never answered.

Now we know this regulation has the same loophole. Nothing in the text of the regulation specifies that the policies insurance companies are committing to sell must be standard, full-benefit insurance coverage that will make sure people can fully rebuild their property and replace their possessions if they experience a loss.

This directly contradicts public expectations and assertions by the Commissioner and Department staff that the policies will be comprehensive.

Section 2644.4.8(d). The regulation directs companies to commit to sell "policies" with no description of the scope of that coverage.

Section 2644.4.8. The only other term used in the regulation is "qualifying residential property insurance," as defined in Ins. Code Section 10087, excluding condo owner and tenant policies. That term broadly means a "policy insuring individually owned residential structures of not more than four dwelling units, individually owned condominium units, or individually owned mobilehomes, and their contents, located in this state and used exclusively for residential purposes or a tenant's policy insuring personal contents of a residential unit located in this state."[6]

"Qualifying residential property insurance" could mean an HO-3 comprehensive homeowners policy. It could also mean the "basic property coverage" sold by the FAIR Plan.

A standard HO-3 policy for homeowners covers far more than the limited-benefit FAIR Plan coverage. Among the perils that HO-3 policies cover but are excluded by the FAIR Plan, even with optional add-on coverage, are:

- Theft
- Liability
- Falling objects, such as a tree on the roof
- Non-flood water damage, such as pipes bursting
- The weight of ice or snow

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[5] https://consumerwatchdog.org/wp-content/uploads/2023/11/LtrGovLeg11-1-23.pdf

[6] https://california.public.law/codes/ca_ins_code_section_10087

- Glass breakage
- Damage to others' property

When Commissioner Lara recognized the importance of comprehensive policies to homeowners and ordered the FAIR Plan to offer broader coverage, the order specified that FAIR must offer "the option of an HO-3 policy or a policy with coverages equivalent to those included in an HO-3 policy."[7]

If the Commissioner's intent is to require insurance companies to sell full-benefit coverage under their commitment, this regulation must also specify the type of policies insurance companies must issue. Why does this regulation not do so?

Consumers can already buy limited-benefit coverage from the FAIR Plan. This is the jam consumers are trying to get free of. If insurance companies' only commitment under this regulation is to sell bare-bones coverage in return for unjustified rate increases, consumers will be no better off than they are today.

There is no requirement that insurance companies expand sales to sell at least 85% of their statewide market share to people in distressed areas.

Section 2644.4.8(d). The text of the regulation is clear. Rather than make the 85% percent commitment in *(d)(1)*, an insurer "may instead commit" to increasing its policies in distressed areas by as little as 5% of its current business in those areas, on a one-time basis under *(d)(2)*.

Section 2644.4.8(f). A 5% increase is also the only commitment that commercial insurers must make.

This "five percent increment" could amount to very little change for an insurance company that has already dropped most of its customers in fire zones. It perversely rewards those companies that have already abandoned Californians, instead of those that have stayed in the market, because if a company's baseline number of policies is small, a 5% increase will be marginal too.

The 5% increase is not limited to small or regional companies.

The Commissioner and Department staff have stated that the 5% increment is limited to small and regional companies that could not meet the 85% standard.[8]

The text of the regulation does not contain any such limitation. Regional companies are not mentioned in the regulation at all.

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[7] https://www.insurance.ca.gov/0250-insurers/0500-legal-info/0700-commissioners-orders/upload/FAIR-Plan-Order-2019-2.pdf

[8] https://www.insurance.ca.gov/01-consumers/180-climate-change/upload/California-Department-of-Insurance-Presentation-on-Insurance-Commitments-in-Wildfire-Distressed-Areas.pdf

Section 2644.4.8(e). Small companies are mentioned—but not in the context of the 5% standard. Small insurance companies with gross premium of less than $10 million are exempted entirely from the regulation. They may use models to increase rates without expanding sales in the state at all.

Even the 5% commitment is an illusion, because insurers have the option of making an "alternative commitment" to choose their own standards.

Section 2644.4.8(j). At any time, insurance companies may tell the Department of Insurance they cannot meet either their 85% or 5% commitment and propose a different commitment.

The justifications for an insurer seeking an "alternative commitment" are undefined. For example (j)(1)(C) cites "the frequency or severity of recent events impacting the insurer" as a basis for proposing an alternative commitment. This text does not even specify that the recent events must have caused the insurance company financial harm. Such vague terms open the door for any insurance company to demand the right to opt for a lesser "alternative" to either the 85% or 5% increment.

The regulation contains no standards that an acceptable "alternative commitment" must meet.

The regulation states, in one sentence with no further qualification, that the Commissioner will evaluate an insurance company's proposed alternative commitment based on whether it "appropriately depopulates the FAIR Plan and/or increases availability of qualifying residential property insurance and/or commercial property insurance."

Could an insurance company offer to sell a few more policies in a single ZIP code? Increase sales only in non-distressed areas? Start selling Difference In Conditions wraparound coverage, but drop more homeowners' full-benefit policies?

An insurance company could apply for an alternative commitment from Day One. Or it could invoke this alternative commitment option at the two-year mark when it fails to meet the 85% market share or 5% increase commitments. This option creates one avenue to never-ending revisions of an insurance company's commitments.

This "alternative commitment" loophole eliminates even the minimum commitments the regulation otherwise purports to impose.

Multiple additional loopholes and off-ramps let insurance companies off the hook if they fail to meet their commitments.

Section 2644.4.8(i). An insurance company that has not met the 85% or 5% commitment after two years has only to file an "insurer attestation" that it "is taking reasonable steps to fulfill its insurer commitment." As the regulation does not define what an "insurer attestation" contains, it could be as little as a sentence informing the insurance commissioner whether a company met its commitment or not. “Reasonable steps” is also not defined.

After the attestation, the insurance company is granted an indefinite extension with no requirement or deadline for future reporting or compliance.

Section 2644.4.8(h)(1). Another section directs insurance companies to submit a lower “modified commitment” if their market share has decreased.

This encourages insurance companies to continue on the path they’re on today. An insurance company that intentionally reduces market share by dropping policyholders would then trigger a re-evaluation (lowering) of the insurance company’s commitment. There is no limit on the number of times these commitments can be reduced. Yet the regulation would allow the company that is actively choosing to non-renew policyholders to retain the financial boon of using private models to increase rates.

Section 2644.4.8(j). A third section allows insurance companies that can’t meet their goals to propose the “alternative commitments” outlined above.

There are no timelines for meeting an insurer’s commitments, or even reporting on an insurer’s progress beyond the first two-year mark, if it says it is “acting in good faith” to comply.

One reason insurance companies are unlikely to meet these commitments is that policies in fire areas will be too expensive for most homeowners to afford.

A very likely outcome of this regulation is that insurance companies will technically offer policies in distressed areas, but that they will price them so prohibitively high that no one will be able to afford them. Insurance companies will then be able to claim they are “taking reasonable steps to fulfill” their goals—because they are offering the policies—but are unable to comply ***because no one can afford to buy them.***

There are no penalties for failure.

In the closed-door press briefing announcing this regulation, Insurance Commissioner Lara mentioned multiple enforcement mechanisms that are at his disposal: market conduct exams, rate reviews, even refunds.[9] The text of the regulation, however, does not name mandatory or even potential consequences if an insurance company does not meet its commitment at the two-year mark, or at any point in the future, as long as it says it is taking “reasonable steps” to fulfill it.

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[9] https://calmatters.org/economy/2024/06/california-pushes-insurers-to-cover-more-homes-in-these-areas-is-your-zip-included/

The regulation does not require the commissioner to investigate failures, order refunds, or take any other enforcement action against an insurer that fails to meet its commitments.

Section 2644.4.8(h)(2). The regulation does say that an insurance company that "renounces" its commitment shall no longer use catastrophe models. But since there is no timeline for an insurance company to meet its commitments, plenty of leeway to reduce its commitment when it fails to meet the mark, and no penalty for failure, there is no reason to expect an insurer will ever choose to renounce its commitment.

Companies will not have to prove they met their commitments publicly.

Section 2644.4.8(c). The only information under the proposed regulation insurance companies must file publicly as part of a complete rate application is notification of what commitment—85%, 5%, or some alternative—they have chosen.

Section 2644.4.8(g). The proposed regulation requires insurance companies to maintain a "wildfire risk portfolio register" that is meant to track an insurance company's progress on its commitment. But the regulation does not require the portfolio register to be made public in rate filings or at any other time. The public, policymakers, and the press will have no way of verifying if an insurance company is meeting its commitments.

One potential benefit of such reporting—if it were public, and if insurance companies were in fact meeting their commitments—would be new data to fill the massive existing information gap regarding Californians' access to coverage. That information could be used to better illuminate for policymakers and the public whether access is improving or getting worse in areas across the state. But no such disclosure is required.

The Commissioner has not disclosed details about how "distressed areas" were identified.

Section 2644.4.8(a) The regulation defines "distressed areas" to include undermarketed ZIP codes with high fire risk where at least 15% of all policies are with the FAIR Plan, or where policies in lower-income ZIP codes cost more than $4 per $1000 in coverage. It also includes counties where 20% of dwellings are high risk. However, no data has been released to show how the Department identified the ZIP codes and counties that meet these metrics. The public needs more evidence of how those areas were identified. The data used by the Department to make these determinations should be made public, after being cleaned to remove any personally identifiable information about insurance policyholders.

This regulation will not get homeowners in fire areas in Californians insured again. That is why consumer groups have urged you to press the creation of a public wildfire model in California, and to endorse a mandate that insurance companies sell to Californians who do the right thing and protect their homes from fire.