February 25, 2025

The Honorable Ricardo Lara
Commissioner of Insurance
California Department of Insurance
300 Capitol Mall, 17th Floor
Sacramento, CA 95814
via email: commissionerlara@insurance.ca.gov

Re: State Farm General Insurance Company Request for Emergency Interim Rate Approval

Commissioner Lara,

We look forward to meeting with you tomorrow to answer your questions about our emergency rate request. Financial strength is a prerequisite for State Farm General's ability to support the 2.8 million policies currently remaining on its books. Our rate applications last summer were based on a critical need to shore up that financial strength. As the company's surplus continued to decline in 2024, the need had only become more urgent. Then the Los Angeles fires hit. We have paid $1.75 billion so far on around 9,500 claims filed and expect to ultimately issue approximately $7.6 billion in total claim payments.

While State Farm General remains solvent in the face of these fires thanks to robust reinsurance (with billions of dollars of reinsurance recoveries coming from its parent, State Farm Mutual Automobile Insurance Company), and we will continue to assist our impacted customers with their claims, we urgently need your help going forward. Our initial estimate of the net reduction in State Farm General's surplus, which stood at $1.04 billion at the end of 2024, is approximately $400 million due to the impact of these fires. And the other trends that led to declining surplus *before* the fires – by over $300 million during 2024 – have not gone away. In fact, some will only become more severe because of the company's heightened financial distress.

State Farm General's prospects for returning to financial health and continuing to insure so many California households depend on concrete evidence it can generate ***and sustain*** sufficient capital to support its risk profile. Once fully implemented, we anticipate your Sustainable Insurance Strategy will enhance those prospects into the future, but State Farm General is at an inflection point now. Emergency rate approval at this pivotal moment is the strongest indication you can provide that California is committed to supporting State Farm General's ongoing need to match the prices it charges to the financial risks it covers.

In your February 14 letter to us, you noted that "the burden is on State Farm to show why [this emergency rate increase] is needed now" and that "insurers must provide the Commissioner with the technical and analytical information necessary to obtain prior approval of an insurer's rate request." You have also emphasized the need for "full transparency from all parties in the rate-making process – including insurance companies and intervenors." We agree. We also agree with your Department that –

> [SFG] *has made a* ***preliminary showing*** *that it may be able to demonstrate, after a full rate hearing, that it may be entitled to a rate increase. Accordingly, the Department believes … that* ***based upon information currently available****, an interim rate increase, subject to refunds with interest pending a final determination by the Commissioner of its legality, is appropriate in this instance and would be*

> *lawfully issued … . The Department further believes* [that an Interim Rate Order] *is* ***in the public interest, in order to maintain maximum availability of homeowners insurance*** *options in California, and that taken as a whole it is fundamentally fair, adequate, and reasonable.* [1] (emphasis added)

We understand you have additional questions, and in light of expected time constraints during tomorrow's meeting we have provided (below our signatures) written responses to each of the questions in your February 14 letter. And we're prepared to participate in the full hearing when that time comes, absent an alternative resolution. We also urge you to act on your staff's recommendation, based on the information we've provided to them throughout the rate application process, to issue an interim rate order now.

Insurance rate increases can of course be a challenge for policyholders. But as more and more Californians would attest, paying much higher premiums with the FAIR Plan – for less coverage – isn't a welcome alternative. As you have pointed out, California residents are best served by a fair and well-functioning insurance market, a key component of which is that consumers understand and bear the economic reality of the true costs to insure their property. These fundamental economic truths must be confronted. For many years now, average homeowners insurance premiums in California have not only been much lower than other high-risk states, but lower even than the national average. The reality is insurance will cost more for customers in California going forward because the risk is greater in California. Without the prospect of rates sufficient to rebuild and maintain capital over the long term, the only meaningful measure remaining for State Farm General is continuing but more drastic reduction in overall exposure.

You have stated: "I … have the authority to grant the interim relief State Farm seeks. My primary responsibility is to maintain a stable insurance market in California and protect State Farm policyholders. Insurance companies are not legally obligated to provide coverage to everyone, and many Californians are currently facing challenges with insurance availability. State Farm's serious financial situation raises concerns for California's insurance market and its consumers."[2] We wish to emphasize that emergency interim rate approval is in the public interest, as it can help stabilize State Farm General's financial condition and the broader insurance market, not least because of what it signals to providers of capital about the state's commitment to solving the insurance crisis. Conversely, further delay sends the opposite signal. At a certain point, emergency approval delayed becomes emergency approval denied, and that point is rapidly approaching.

After your full review of the information we are providing in response to your questions, we urge you to seriously consider and adopt the recommendation of your Department to "grant[] State Farm an interim rate increase subject to refunds with interest[[3]] following a full rate hearing on the rate applications, and [to] do so as expeditiously as possible in response to State Farm's urgent situation."[4]

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[1] See page 6, stipulation paragraph 5, of attached *Stipulation to Interim Rate*, entered into and fully executed by your Department on February 7, 2025.

[2] See attached February 20, 2025 letter to Consumer Watchdog from the Commissioner.

[3] I.e., if the interim rates were to exceed the final rates approved after hearing.

[4] See attached February 7, 2025 letter to the Commissioner from CDI's Rate Enforcement Bureau.

Sincerely,

Dan Krause
President and Chief Executive Officer
State Farm General Insurance Company

Mark Schwamberger
Vice President and Treasurer
State Farm General Insurance Company

Keesha-Lu Mitra
Vice President and General Counsel
State Farm General Insurance Company

CC: Michael Martinez, Chief Deputy Commissioner, California Department of Insurance
Nikki McKennedy, Assistant Chief Counsel, California Department of Insurance
Pamela Pressley, Senior Staff Attorney, Consumer Watchdog
Vanessa Wells, Esq., Hogan Lovells

Attachments:

- February 7, 2025 letter to the Commissioner from CDI's Rate Enforcement Bureau
- February 7, 2025 executed Stipulation to Interim Rate Subject to Refunds with Interest Pending a Final Determination of the Legality of the Rate and accompanying [PROPOSED] INTERIM RATE ORDER SUBJECT TO REFUNDS PENDING A FINAL DETERMINATION OF THE LEGALITY OF THE RATE.
- February 20, 2025 letter to Consumer Watchdog from the Commissioner

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WRITTEN RESPONSES TO THE COMMISSIONER'S QUESTIONS FROM FEBRUARY 14

What, if anything, has changed for State Farm between June 2024 and now that necessitates emergency relief?

In short, State Farm General's (SFG) policyholder surplus and financial strength has further deteriorated from an already weakened position, its regulatory based financial solvency metrics have worsened, including its failure to meet the NAIC Risk-Based Capital (RBC) requirements as of year-end 2024, and SFG is currently managing the impact of the devasting and historical fires from January. In our March 2024 letter, we noted that "the swift capital depletion of SFG is an alarm signaling the grave need for rapid and transformational action" – it is now an urgent crisis.

The current estimate of direct losses for State Farm General from the Los Angeles fires stands at approximately $7.9 billion, including loss adjustment expenses, and taking into account both reported and not reported claims. Estimates for SFG's retained losses after reinsurance, and for SFG's share of total FAIR Plan losses, are approximately $212 million and $400 million, respectively. Based on these estimates, and after accounting for reinsurance recoveries, tax impacts and partial recoupment of SFG's allocation of the FAIR Plan's recent $1 billion assessment, the January fires will reduce SFG's surplus, which stood at $1.04 billion at the end of 2024 after a decline of over $300 million from year-end 2023, by approximately $400 million. These initial estimates will continue to be reviewed and updated, if needed, as we continue through the claim adjudication process and more information becomes available.

This is an unfortunate circumstance for our customers and all Californians, and only worsens SFG's financial position and related internal and external measures of financial strength and forward-looking claims-paying ability from what they were last June.

Our February 3, 2025 letter included an illustration of SFG's continuing financial deterioration and, most critically to the issue at hand, its current financial position necessitating emergency relief. SFG will again be required to file a plan with the Illinois Department of Insurance, SFG's domestic financial solvency regulator, due to its failure to meet NAIC Risk-Based Capital (RBC) requirements as of year-end 2024 – a situation that as described above is only worse due to the impact of the January fires. The purpose of RBC requirements is to identify weakly capitalized companies, which facilitates regulatory actions to ensure policyholders will receive benefits promised. Under the RBC system, regulators have the legal authority to take preventive and corrective measures. These preventive and corrective measures are designed to provide for early regulatory intervention to correct problems before insolvencies become inevitable, thereby minimizing the number and adverse impact of insolvencies.

In addition, the year-end 2024 policyholders' surplus to net premiums written ratio of 0.330 translates to an unusual value of 303% according to the NAIC Insurance Regulatory Information Systems (IRIS) manual (Ratio 2 – Net Premiums Written to Policyholder's Surplus). With the first quarter 2025 surplus deterioration from the Los Angeles wildfires, this IRIS ratio will move further beyond the usual range (or threshold) for the ratio.

If no rate increase is allowed until a final rate is approved after a hearing or settlement, which can take months or sometimes even years, SFG risks further downgrades of its financial strength rating because of its severe capital depletion from years of insufficient rates followed by the impact of these wildfires, as well as growing exposure due to inflationary loss trends (both catastrophe and non-catastrophe, including liability losses). As explained in our February 3 letter, "[i]f that were to happen, customers with a mortgage might not be able to use State Farm General insurance as collateral backing for their mortgage" and hundreds of thousands of them could be at risk of having to secure insurance from another carrier or the FAIR Plan, without any action on SFG's part. It's very important to here point out that this could not only be very damaging to current SFG policyholders, who may have difficulty finding a policy outside the FAIR Plan – which usually costs considerably more for considerably less coverage – but it could also be very damaging to non-SFG policyholders. To the extent that large numbers of former SFG customers are forced onto the FAIR Plan, this will likely increase the frequency or size of FAIR Plan losses shared by admitted carriers and their policyholders, which could further dampen carriers' willingness to write new business or renew existing business since FAIR Plan losses are allocated according to market share. In addition, and as stated in our February 3 letter, you as the Insurance Commissioner can have a very significant impact on SFG's ability to continue operating in California by immediately approving the requested interim rate changes. This is the most concrete evidence you can provide to solvency regulators, rating agencies and SFG leadership that SFG has a chance to begin rebuilding capital to sustain itself. Without rate, SFG must consider much more significant and necessary actions to manage its exposure and attempt to assuage solvency regulators, along with independent rating agencies whose necessary actions may create a much more disorderly impact on SFG and its customers.

If, on the other hand, interim rates *are* approved, there is little harm to SFG's policyholders even if they were to exceed the final rates approved after hearing because policyholders would in that case receive refunds, with interest. Nor is there any harm to the broader public.

The Department posed a similar question in its July 9, 2024 objection, asking "What has changed since the last rate increase (Non-Tenant and Condo rate approval of 20% effective March 2024) that is contributing to the deterioration of capital in 2024?"

SFG's August 27, 2024 response provided significant detail and explanation regarding the main contributors to the deterioration of capital since, and prior to the rate increase:

- The March 2024 20% rate increase (approved in December 2023) was originally filed in February 2023 (requesting 28%), and from there approved rate increases take a period of 2 years to be fully earned (i.e. not until March 2026 in this case).
- Material surplus growth during the years following the 2017/2018 wildfires has not been possible due to insufficient rates.
- The primary driver of capital deterioration, specifically in 2023, was an unexpected surge in high liability losses across multiple lines of business and the cost of rapidly increasing exposure as evidenced by a significant increase in reinsurance premium with no ability to fully reflect this cost of the increased risk in our rates.

SFG has also provided an updated rate indication using the Department's standard rate templates which included a new catastrophe provision that included estimates up through the most recent fires. Based upon the Department's rate template, the revised Non-Tenant Homeowners indication was +21.8%. For the Renters and Condominium Unitowners lines the revised indication was +16.6% and +20% respectively, and for the Rental Dwelling line, +42% was the revised indication. We expect first quarter 2025 loss data (once available) to support the interim rates even without any solvency-based adjustments to the rating template, due to the impact of the recent wildfires.

In the absence of [wildfire] catastrophic losses in 2022 and 2023 how does State Farm explain the significant decrease in its policyholder surplus?

The Department requested similar information in its November 22, 2024 objection, asking SFG to "Please explain what lines of business and perils were impacted [by "worse-than-average non-wildfire catastrophe loss amounts.]" SFG's response of December 13, 2024 reiterated information submitted in previous objection responses that showed the non-wildfire catastrophe experience over time. Wind and rain events, especially in early 2023, as well as increased liability claim costs in core product lines, including PLUP and commercial lines, were all referenced as drivers of surplus reduction in 2023.

In addition, as we noted in our March 2024 letter, due to SFG's continuing "[deterioration] in surplus and increase in exposure, the company necessarily has to rely increasingly on reinsurance cover, the cost of which puts further downward pressure on surplus without the needed additional premium to support this cost." This dynamic will only accelerate with the further massive decline in surplus from the impact of the Los Angles fires. These additional reinsurance costs are significant, amounting to hundreds of millions of dollars annually, but SFG has not been permitted to fully factor these costs into its rates through either an appropriate rate of return or as a direct cost component. Of course, as noted below, these very reinsurance costs are what give SFG the chance to remain solvent in the face of catastrophic events on the scale of the Los Angeles fires and allow SFG to insure significantly more property than would otherwise be possible.

What has State Farm done to prevent its surplus from further deterioration between May 2023 to present besides shed policyholders through ceased writings and non-renewals?

In addition to the June 2024 rate filings which are the subject of this interim rate request, State Farm has also requested and CDI has approved several rate increases across multiple lines of business, though the approved rate was often below SFG's requested change and some with significant delays. We are also filing later today for a PLUP rate increase of 39.0%. (Although a PLUP rate increase of 24.9% was approved for SFG on 11/27/2024, the company had requested 53.6% on 7/12/2024 due to increasing frequency and severity of liability losses.)

In addition, and as highlighted earlier, SFG did maintain its appropriate and critically important reinsurance program despite the fact that reinsurance costs were not permitted to be considered in the filed rates either through an appropriate rate of return or as a direct cost component. At present (i.e. considering the January fires), SFG would be insolvent without the benefit of its reinsurance recoveries. However, due to the existence of SFG's reinsurance program, most of these losses will be absorbed by State Farm Mutual as the primary reinsurer. State Farm Mutual provides the majority of SFG's reinsurance cover – providing it at a fair price that is well below what is available from external reinsurers and at an amount of coverage that external reinsurers wouldn't provide. In fact, SFG's reinsurance broker confirmed that external reinsurer capacity to underwrite significantly greater portions of SFG's massive risk portfolio at a reasonable price (or possibly, at any price) does not currently exist. This reinforces the significant support already provided by State Farm Mutual via this reinsurance program. Over the last 10 years and including the reinsurance recoveries projected based on current estimates for the January 2025 fires, SFG has benefited significantly from the totality of its reinsurance program. This financial benefit is in addition to the fact that this reinsurance program has allowed SFG to serve more Californians by insuring significantly more property in areas with significant risk such as wildfires than would otherwise be possible. As noted in our letter of February 3, this situation reinforces SFG's absolute disagreement with any characterization that its payments for necessary reinsurance are in any way inflated or that SFG may have 'engineered' its weakened financial condition – again, that is an irresponsible assertion and simply not true.

Has State Farm provided adequate documentation to the Department to support the current rate increase request for each line of business?

SFG's initial rate filings in June and July of 2024 included hundreds of pages of support for the requested rate. Further, every set of objections raised by the Department has been responded to with dozens of additional exhibits and pages of narrative. All questions by the Department have been responded to, including the Department's inquiry of September 30, 2024 which asked whether numerous financial documents would be "made publicly available in a complete and unredacted form." As seen in SFG's October 21, 2024 response, for those documents that SFG advised were confidential and trade secret, SFG attempted to provide relevant information and invited the Department to identify any specific items of additional needed information so that SFG could attempt to provide that information in a manner that maintained the confidentiality of the document but was still responsive to the Department's request. There has been no further correspondence from the Department on that issue since that response.

In that same September 30, 2024 objection, the Department clearly stated that while State Farm had "provided a substantial amount of filing support relating to its Variance 6 request," it had not, in the Department's view, satisfied a showing of financial condition or its plan to restore the financial condition.

SFG's October 21, 2024 response reminded the Department that the initial filing from June 2024 included a plan to restore the company's financial condition through a combination of reductions in exposure and increasing rate levels. Further, SFG's March 2024 letter explained the drastic drop in surplus and pointed to the tremendous growth in risk exposures in the last few years, with construction cost inflation being a major driver, along with unanticipated growth due to the rapidly tightening California market.

In addition to information about the Los Angeles fires, SFG's February 3 letter also provided an updated rate indication using the Department's standard rate templates which included a new catastrophe provision that included estimates up through the most recent fires. Using the Department's rate template, the revised Non-Tenant Homeowners indication was +21.8%. For the Renters and Condominium Unitowners lines the revised indication was +16.6% and +20% respectively, and for the Rental Dwelling line, +42% was the revised indication. SFG subsequently provided those templates and updated Exhibit 9 in all three filings in SERFF on February 5, 2025.

In that same February 3 letter, we also provided information regarding credit rating agency downgrades (including AM Best's March 2024 downgrade of SFG to B (fair) https://news.ambest.com/pr/PressContent.aspx?refnum=34559&altsrc=2) and the potential market impacts of further or other agency downgrades.

Other than rate increases, what other plans does State Farm have to address its financial challenges? For example, would State Farm's parent company, State Farm Mutual Automobile Insurance Company, be willing or able to provide financial support to State Farm [General] as it has in other similar situations?

As it relates to the first question, we would reinforce the point that matching price to risk (i.e. securing adequate rates for the exposure) is a core fundamental SFG must adhere to in order to ensure it has the financial strength to stand behind its promises. Claim-related costs and growth in underlying exposures are the core challenges SFG faces. We cannot escape those economic realities because they are what led us to where we are today. As we shared in our last letter, SFG's financial distress results from macroeconomic changes and market trends, including construction cost inflation and litigation, and the fact that "SFG's attempts … to both raise rates and restrict growth, in order to keep our risk profile in line with available surplus, were constrained by regulatory considerations and met with limited success." And "[t]his was due in no small part to intervenors in the rate review process, whose very efforts to delay and decrease needed rate adjustments prevented SFG from maintaining a capital position supportive of its risk profile and impaired its ability to support continued underwriting of California properties."

Beyond rate, other plans or actions alone would simply not suffice to restore SFG's financial condition. Without rate, SFG is prevented from maintaining a capital position sufficient to support its current book of business. Therefore, without the necessary financial strength or the demonstrated capacity to improve it, the only meaningful measure remaining is continuing but more drastic reduction in overall exposure. Consequently, the most effective remedy – and the surest path to the eventual restoration of general availability in the market – is to allow SFG to collect sufficient premiums to rebuild its capital.

In addition, and as we previously noted, a lack of approval for needed rate sends a strong message to SFG about the support it will receive to collect sufficient premiums in the future to protect Californians against the risk of loss to their homes, property, and other claims. SFG must be able to prospectively demonstrate its ability to generate sufficient capital to support its risk profile. Without this concrete evidence, it creates a situation and an insurance market where insurers, reinsurers and other capital providers, including State Farm Mutual, are reluctant to invest. However, when insurers are able to be self-sustaining, it drives further investment and competition in the state of California, which increases availability and supports a sustainable insurance market. We commend you and your staff for their ongoing work to implement your Sustainable Insurance Strategy. We especially look forward to seeing your plans come to fruition for faster and more efficient rate reviews, to allow for nimbler pricing in reaction to market changes. And we will cooperate with you and other public officials (including the Governor and legislators) on measures that bolster resilience through public investment in risk mitigation, improved community design and robust emergency response, to begin to address the cost curve for this wildfire peril. SFG is committed to continued engagement on these issues. Having said that, SFG remains acutely focused on the immediate need to rebuild its financial strength to ensure it remains viable. Your immediate approval of SFG's interim rate request is an indispensable and critical first step to eventually restoring the company's financial strength, potentially preserving coverage for millions of SFG's remaining customers, and working toward a more sustainable insurance environment in California.

What is State Farm doing to manage and restore its financial position given its statement that rate increases alone will not be sufficient?

The statement that rate increases alone would likely be insufficient to restore SFG's financial strength was included in our March 2024 letter. We noted the critical need for rapid review and approval of currently pending and future rate filings given SFG's financial position, which also necessitated our then current need to take action to reduce our overall exposure to be more commensurate with the capital on hand to cover such exposure, as most insurers in California have already done. In taking that March 2024 action, we recognized how difficult it will be for impacted policyholders, in addition to our independent contractor agents who are small business owners and employers in their local California communities. However, we also recognized that rebuilding capital, even with higher rates, will take time and we were striving to minimize the impact of the necessary actions that must be taken. SFG's financial position has worsened since that time, and we continue to be faced with very difficult decisions.

The Department posed several related questions in its July 10, 2024 objection, asking "what is SFG's capital shortfall remediation plan other than rate and underwriting" as well as a request for SFG to "list any other capital generation initiatives." SFG's August 27, 2024 response explained that there were no plans to seek financial support from State Farm Mutual based on the previously stated and communicated position of the State Farm Mutual Board as well as the tenet that SFG is an independent and self-sustaining legal entity within the State Farm group and is managed to meet solvency requirements on an individual entity basis without regard to the solvency or financial condition of any other affiliated entity. Just as the Department is acting to ensure that no California customer would pay for out-of-state reinsurance costs under its new Net Cost of Reinsurance regulation, SFG recognizes that State Farm Mutual must ensure that out-of-state customers do not subsidize California customers.

More specifically, SFG must have a reasonable opportunity to timely collect sufficient premiums to protect Californians against the risk of loss to their homes, property, and other claims. This allows SFG to prospectively demonstrate its ability to generate sufficient capital to support its risk profile. Without this concrete evidence, it creates a situation and an insurance market where insurers and other capital providers, including State Farm Mutual, are reluctant to invest.

Finally, SFG's February 3 letter further discussed the difficult decisions in May 2023 that it would stop writing any new policies in California, and in March 2024 that it would nonrenew 72,000 existing policies, approximately 29,000 of which are homeowners policies. That non-renewal process is ongoing. When asked by the CDI to pause non-renewals in wildfire moratoriums, we have abided by all requests. Further, following the recent wildfires, homeowners non-renewals in Los Angeles County were paused.

How would granting an emergency rate impact State Farm's business decisions to pause writing of new residential coverage and non-renew policies?

The Department posed a similar question in its September 30, 2024 objection, asking "Is State Farm able to support its rate need using the assumption that they would open up to new business?" SFG's October 21, 2024 response explained that, based on current assumptions, the projected surplus growth would not adequately support the larger book of business (including new business) and that the rate needed to support adequate surplus growth would be even higher than what is contemplated in the current rate filing, were SFG to open up to new business. On the other side of that question, it is worth noting that granting our requested emergency rate increase may preserve coverage for many more existing policies than any accommodation or agreement to write new business would allow.