Consumer Watchdog

Date: February 26, 2025

To: Insurance Commissioner Ricardo Lara
All Parties

From: William Pletcher, Litigation Director
Pam Pressley, Senior Attorney
Ben Armstrong, Staff Actuary, FCAS, MAAA
CONSUMER WATCHDOG

Re: Consumer Watchdog's Review of Proposed Emergency Interim Rate Approval
PA-2024-00012/SFMA-134139896 – Homeowners;
PA-2024-00011/SFMA-134139931 – Renters and Condo; and
PA-2024-00013/SFMA-134139850 – Rental Dwelling

## INTRODUCTION

Consumer Watchdog submits this memorandum, which is based on the limited information State Farm has produced in this matter to date and its publicly available financial statements, to help identify the flawed justification behind State Farm General's (SFG) "emergency interim rate" approval request for homeowners, renters, and rental dwelling policies.

Consumer Watchdog has previously outlined its objections to State Farm's so-called "emergency interim rate" increase request in its February 5 and 19 letters to the Commissioner and in its February 7 letter to the parties (also provided to the Commissioner) with its accompanying actuarial analysis and rate templates indicating the *maximum* permitted rates under the regulations without any solvency variance (which has yet to be justified) are -0.1% for homeowners, +8.1% for renters and condo, and +30.6% for rental dwelling. As detailed in those letters, which this memorandum supplements, State Farm's proposed process, including this closed-door, non-public informal conference, violates Proposition 103's prior approval and public rate transparency requirements. California law does not allow an insurer to obtain a rate increase above 7% on its personal lines without a hearing upon a timely request, as here, absent a stipulation of all parties. While the "the commissioner has the power to grant interim relief from plainly invalid rates," (*Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805, 824–825), as we stated in our February 5 and 19 letters, there has been no showing that State Farm's current rates are "plainly invalid" or inadequate as calculated under the standard regulatory ratemaking formula. In fact, State Farm's own "interim" calculations show that the current rate falls in between the "maximum permitted earned premium" (10 CCR § 2644.2) and the "minimum permitted earned premium" (10 CCR § 2644.3). Therefore, according to the Department's rate review regulations, even using State Farm's updated "interim" rate calculation, the current rates are not "plainly invalid" or inadequate (10 CCR § 2644.1). Any "emergency interim rate" increase granted through this improper process would thus be unlawful.

That said, Consumer Watchdog, as an intervenor, stands ready to work with all parties on an urgent basis to evaluate SFG's rate applications, including any updated Rate Templates and Supporting Exhibits, which would need to be fully updated with data through at least year-end 2024 to be generally consistent with the data through early 2025 used in SFG's calculation of the revised catastrophe provision. This process must follow the law, requiring a properly noticed, expedited rate hearing and full cooperation and participation from SFG in both informal and formal discovery—something it has failed to demonstrate thus far. Even if conducted on an accelerated timeline, this approach would comply with Proposition 103, ensuring both due process and transparency for California consumers.

ACTUARIAL ANALYSIS

A thorough review of SFG's limited information produced to date in association with these rate applications and publicly available financial statements reveals that its supposed financial distress is largely self-inflicted. The company's reinsurance arrangements—structured to benefit its parent company at the expense of the California affiliate and California policyholders—resulted in unfavorable financial outcomes during high-loss years, such as the 2017 and 2018 wildfires. Instead of ensuring that policyholders' premiums were used to protect them, SFG funneled nearly $1 billion of subrogation recoveries to its parent company, State Farm Mutual Auto Insurance Company, rather than using those funds to offset California losses. There is no explanation why this $1 billion payment cannot be returned to SFG from among the parent company's over $134 billion in reserves – as State Farm has done for other catastrophes in other states – rather than require a sudden emergency bailout now.

Moreover, SFG insists that inadequate rates are the primary cause of its financial struggles, yet this claim does not withstand scrutiny. Despite receiving multiple rate increases in recent years—amounting to a cumulative 52.1% hike since 2014—SFG's surplus has continued to decline. This raises serious concerns about whether the company is mismanaging its reserves, engaging in financial manipulation to justify excessive rate hikes, returning excessive returns to its parent company through above-market rate reinsurance policies, or all of the above. Either way, there is absolutely no justification for treating this as an "emergency" when these rate filings have been pending since June of last year. If SFG were truly facing a financial crisis, it had ample opportunity to act with urgency. Instead, the company delayed, failing to diligently pursue its requested increases—including ignoring Consumer Watchdog's requests for information in the homeowners rate proceeding for over six months—and now seeks emergency relief with limited and inadequate scrutiny of its request to make up for its own inaction. The lack of timely action on its part undermines any claim that immediate rate hikes are necessary.

Granting an "emergency interm rate" increase under these circumstances would set a dangerous precedent, effectively allowing insurers to circumvent Proposition 103's prior approval requirements. It would encourage companies to strategically delay rate filings—or worse, transfer funds to parent companies to manufacture a financial crisis—only to later declare an "emergency" when their balance sheets show a disadvantageous condition. Regulators must not reward this kind of regulatory gamesmanship at the expense of California consumers.

Consumer Watchdog urges regulators to reject SFG's attempt to shift the burden of its financial mismanagement onto California policyholders. Before any further rate increases are considered, State Farm must provide full transparency regarding its reinsurance arrangements, subrogation recoveries, and surplus depletion. Anything less would amount to an unjustified bailout at the expense of consumers.

REINSURANCE

Historical reinsurance is addressed by SFG in their responses to CDI Objection D.3.d in the document NT 7-10-24 Objection Response part 2. Exhibit Q has the 2015-2024 reinsurance data for SFG. Note that "[f]or the occurrence reinsurance program, there is one prepaid reinstatement included in the coverage terms and premium." Also for Exhibit Q, "…Losses Recovered reflect any subrogation recoveries received. Considerable losses were recovered from the occurrence program following the 2017 and 2018 wildfires which were later subrogated with recoveries starting in 2020."

SFG's financial statements indicate that approximately $1.4B in subrogation was received by the company during calendar year 2020 for accident years 2017 and 2018. But almost $1B of that went to the parent company to reimburse them for reinsurance coverage paid out to SFG—only $400M reduced SFG's retained loss position.

Further, it is unclear how SFG is showing $126M of reinsurance recoveries for the 2018 treaty year on Exhibit Q, while their 2023 Schedule P shows only $54M in ceded loss & LAE for accident year 2018. Presumably treaty year 2018 includes some accidents occurring in 2019, but Schedule P has only $20M of ceded loss & LAE for accident year 2019 in total. If it were a risks-attaching treaty spanning a full year beginning sometime in 2018, theoretically some losses from the 2020 accident year could be included in that $126M figure, but it still seems suspicious.

Prospective reinsurance (i.e. for the period during which the proposed rates would be in effect, and beyond) is addressed by SFG in their responses to CDI Objection C.3 in the document NT 7-10-24 Objection Response part 2.

The following table summarizes ceded loss results (reinsurance) for several major CA homeowners insurers. Note that for the bolded, high wildfire loss years of 2017 & 2018, SFG showed a positive value for net minus direct & assumed in the rightmost column, indicating that their reinsurance arrangement was unfavorable to them (and thus favorable to their main reinsurer, the parent company State Farm Mutual Auto Insurance Company). In other words, SFG would have been better off financially in 2017 & 2018 had they not purchased reinsurance. This is in contrast to the other insurers shown, who have negative values for 2017 & 2018, indicating that their reinsurance arrangements operated as expected, i.e. resulting in a favorable financial outcome for them.

| Countrywide Data for All Lines of Business from 2023 Annual Statements, Schedule P, Part 1 |
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|---|---|---|---|---|---|---|
| | | | Incurred Loss & Loss Expense Ratio | | | |
| Company | State of Domicile | Calendar/ Accident Year | Direct & Assumed | Ceded | Net | Net minus Direct & Assumed |
| State Farm General | CA | 2014 | 59.2% | 6.9% | 63.5% | 4.3% |
| State Farm General | CA | 2015 | 69.7% | 5.3% | 74.9% | 5.2% |
| State Farm General | CA | 2016 | 67.3% | 8.0% | 71.7% | 4.4% |
| **State Farm General** | **CA** | **2017** | **138.2%** | **99.1%** | **141.4%** | **3.2%** |
| **State Farm General** | **CA** | **2018** | **105.4%** | **32.3%** | **112.1%** | **6.7%** |
| State Farm General | CA | 2019 | 76.4% | 10.1% | 83.3% | 6.9% |
| State Farm General | CA | 2020 | 115.4% | 49.6% | 123.5% | 8.1% |
| State Farm General | CA | 2021 | 76.0% | 10.6% | 86.6% | 10.6% |
| State Farm General | CA | 2022 | 71.0% | 15.7% | 81.0% | 10.0% |
| State Farm General | CA | 2023 | 76.5% | 4.7% | 94.9% | 18.4% |
| | | | | | | |
| CSAA Insurance Exchange | CA | 2014 | 71.2% | 32.2% | 72.3% | 1.1% |
| CSAA Insurance Exchange | CA | 2015 | 79.3% | 2.3% | 80.2% | 0.9% |
| CSAA Insurance Exchange | CA | 2016 | 74.8% | 21.9% | 76.0% | 1.2% |
| **CSAA Insurance Exchange** | **CA** | **2017** | **94.3%** | **423.3%** | **82.8%** | **-11.5%** |
| **CSAA Insurance Exchange** | **CA** | **2018** | **93.0%** | **434.3%** | **80.2%** | **-12.8%** |
| CSAA Insurance Exchange | CA | 2019 | 72.0% | 27.5% | 73.1% | 1.1% |
| CSAA Insurance Exchange | CA | 2020 | 63.5% | 15.7% | 65.1% | 1.6% |
| CSAA Insurance Exchange | CA | 2021 | 71.7% | 0.1% | 73.1% | 1.4% |
| CSAA Insurance Exchange | CA | 2022 | 74.5% | 0.0% | 76.1% | 1.6% |
| CSAA Insurance Exchange | CA | 2023 | 87.5% | 4.1% | 89.2% | 1.7% |
| | | | | | | |
| California Automobile Insurance Company | CA | 2014 | 81.5% | 996.8% | 81.1% | -0.4% |
| California Automobile Insurance Company | CA | 2015 | 81.0% | 145.7% | 80.7% | -0.3% |
| California Automobile Insurance Company | CA | 2016 | 77.4% | 81.5% | 75.9% | -1.5% |
| **California Automobile Insurance Company** | **CA** | **2017** | **83.6%** | **96.3%** | **79.0%** | **-4.6%** |
| **California Automobile Insurance Company** | **CA** | **2018** | **88.8%** | **107.6%** | **77.7%** | **-11.1%** |
| California Automobile Insurance Company | CA | 2019 | 76.5% | 67.1% | 84.2% | 7.7% |
| California Automobile Insurance Company | CA | 2020 | 67.7% | 49.2% | 79.5% | 11.8% |
| California Automobile Insurance Company | CA | 2021 | 73.1% | 69.5% | 76.6% | 3.5% |
| California Automobile Insurance Company | CA | 2022 | 72.3% | 72.0% | 72.5% | 0.2% |
| California Automobile Insurance Company | CA | 2023 | 76.1% | 68.3% | 81.5% | 5.4% |
| | | | | | | |
| Fire Insurance Exchange (Farmers) | CA | 2014 | 64.4% | 61.2% | 65.5% | 1.1% |

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|---|---|---|---|---|---|---|
| Fire Insurance Exchange (Farmers) | CA | 2015 | 67.5% | 63.3% | 68.5% | 1.0% |
| Fire Insurance Exchange (Farmers) | CA | 2016 | 70.2% | 68.6% | 70.7% | 0.5% |
| **Fire Insurance Exchange (Farmers)** | **CA** | **2017** | **78.7%** | **103.1%** | **69.7%** | **-9.0%** |
| **Fire Insurance Exchange (Farmers)** | **CA** | **2018** | **71.7%** | **80.2%** | **67.7%** | **-4.0%** |
| Fire Insurance Exchange (Farmers) | CA | 2019 | 68.1% | 67.8% | 68.2% | 0.1% |
| Fire Insurance Exchange (Farmers) | CA | 2020 | 67.2% | 71.3% | 65.5% | -1.7% |
| Fire Insurance Exchange (Farmers) | CA | 2021 | 73.8% | 75.3% | 73.0% | -0.8% |
| Fire Insurance Exchange (Farmers) | CA | 2022 | 76.0% | 72.3% | 78.1% | 2.1% |
| Fire Insurance Exchange (Farmers) | CA | 2023 | 73.6% | 68.2% | 76.5% | 2.9% |

SURPLUS/RESERVES

SFG stated the following in NT 7-10-24 Objection Response part 2: "The surplus of State Farm General after the 2017/2018 wildfires was in a tenuous position. The subsequent years following the wildfires was a critical time for State Farm General to replenish the surplus drain of these events. Despite relatively light catastrophe loss amounts in 2019-2022 (including subrogation recoveries), surplus decreased an additional $225 million from year-end 2018 to year-end 2022. Rate levels have been insufficient to result in any material surplus growth (see D.2 response for additional details)." The reference "D.2 response" points to Exhibit M, which shows 10 years of rate history. For the Homeowners line in total, the following is given:

| Effective Date | Requested Rate | Approved Rate |
|---|---|---|
| 5/15/2014 | +6.9% | -1.2% |
| 12/8/2016 | +6.9% | -7.0% |
| 7/15/2018 | +6.7% | +6.7% |
| 10/15/2020 | +6.7% | +6.7% |
| 4/1/2021 | +6.0% | +6.0% |
| 2/1/2022 | +6.9% | +6.9% |
| 6/1/2023 | +6.9% | +6.9% |
| 3/15/2024 | +28.1% | +20.0% |

Even with the decreases shown in the first two rows, SFG's rates have increased 52.1% since 5/15/2014. Despite SFG's claim that "rate levels have been insufficient to result in any material surplus growth", it must be taken into account that rate levels are not the only (and arguably not the primary) means of generating surplus. SFG should have received positive net gains from their reinsurance contracts in accident years 2017 and 2018, and subrogation amounts corresponding to those accident years should have primarily benefited SFG, not their main reinsurer SFMAIC.

Further, surplus is not the first line of defense for an insurer's claims payments—it's the amount left over after liabilities (including reserves) are subtracted from assets. Surplus acts as a backstop in the event that reserves, reinsurance, and subrogation recoveries are not sufficient to pay the entirety of claim amounts. If SFG's surplus position is tenuous, it is imperative to fully understand why the company's loss reserves, reinsurance arrangements, and subrogation recoveries were insufficient to the point that surplus was continually depleted over a period of years.