CITY OF RIVERSIDE
City of Arts & Innovation

City Council Memorandum

TO:	**HONORABLE MAYOR AND CITY COUNCIL**	**DATE: OCTOBER 22, 2024**
FROM:	**CITY MANAGER'S OFFICE**	**WARDS: ALL**

SUBJECT: WORKSHOP – UPDATE ON CALIFORNIA INSURANCE CRISIS AND PROPOSED RESOLUTION CALLING FOR EMERGENCY ACTION TO STABILIZE THE HOMEOWNERS AND COMMERCIAL INSURANCE MARKETPLACE

ISSUE:

Receive an update on the California insurance crisis and consider a proposed resolution calling for the Insurance Commissioner, State Legislature, and the Governor to take emergency action to strengthen and stabilize California's marketplace for homeowners and commercial property insurance.

RECOMMENDATIONS:

That the City Council:

1. Receive and file an update on the current California insurance crisis; and

2. Conduct a workshop on the proposed Resolution and provide further direction relating to the insurance crisis in Riverside.

BACKGROUND:

The California Department of Insurance (CDI) is the state agency responsible for regulating the insurance industry in California and plays a crucial role in protecting consumers and ensuring a fair marketplace. Established to protect consumers from unfair practices, the CDI is responsible for licensing insurance companies and agents, reviewing and approving insurance rates to prevent unjustified increases, and enforcing compliance with state laws and regulations. Additionally, the department oversees the handling of consumer complaints and disputes and helps individuals navigate the claims process.

In 1988, California voters passed Proposition 103, which established a framework of consumer protections aimed at ensuring that insurance rates remain fair and affordable. The initiative emerged from growing concerns about increasing insurance rates and lack of regulation in the insurance industry. One of the most significant changes brought about by Prop 103 was the requirement that insurance companies justify and obtain approval from the CDI for rate increases.

Proposition 103 also expanded the California Department of Insurance (CDI) authority and changed the Insurance Commissioner from an appointee of the Governor to an independent statewide officer elected by popular vote. The office is currently held by Insurance Commissioner Ricardo Lara. In addition, Prop 103 provides the following:

- Rate increases of more than 7% annually must be reviewed and approved by the CDI
- Requires historical data be used in setting future rates (California is the only state with this requirement)
- Gives insurance companies the legal right to choose where they will write policies.

California Fair Access to Insurance Requirements (FAIR) Plan

The California FAIR Plan was established in 1968 to provide insurance coverage to homeowners in high-risk areas. The FAIR Plan is backed by all insurance companies in California and is available to anyone that has been unable to find coverage through a traditional plan, provided the property is in insurable condition, hasn't been vacant for more than a year, and no illegal activities take place at the property. The FAIR Plan is a last resort option and is intended to be a temporary solution for homeowners who need hazard insurance and have been unable to secure it through a traditional plan. Although the FAIR Plan functions as a crucial safety net for those unable to secure traditional coverage, it also comes with many limitations, making it the least desirable option. It provides the minimum required coverage for losses caused by fire damage and often comes at a higher cost than traditional plans. Coverage such as theft, flood, earthquake, vandalism, or personal liability are not covered under the plan.

DISCUSSION:

Understanding the Insurance Crisis

In recent years, many property owners across California have either experienced large increases in their insurance premiums, been dropped from their existing plans, or have struggled to find coverage at all. In August of 2024, the CDI approved Allstate to increase its homeowners' insurance rates by an average of 34.1%. State Farm followed by requesting a 30% increase and failing to renew roughly half of their policies. Those in high fire risk areas on the FAIR Plan are also affected, with rates increasing by an average of 15.7% in 2023. Starting in 2019, rates of nonrenewal in high- and very high-risk areas statewide grew to 14% compared with 3% and 2% for moderate- and low-risk areas.

Since 2022, 7 of the 12 major insurance groups in the state have paused or stopped writing policies completely in California. Data submitted to the state by the 10 largest home insurance companies from 2019 to 2024 shows that more than 100,000 Californians lost their insurance coverage over the past five years. Insurers have cited several reasons for the refusal to write new policies in the state, including:

1. California's insurance regulations – Prop 103 limits insurers' ability to profitably insure property in the state and requires a lengthy approval process for rate increase requests;
2. Increased wildfire risk – 8 of the 10 largest wildfires in the state's history have occurred since 2017, causing increased losses for insurers;
3. Inflation – California has higher prices for homes, supplies, and materials required for construction and has experienced recent labor shortages;
4. Increased reinsurance premiums – insurance companies are experiencing increases in the insurance that they are required to take out on their own policies.

Although the insurance crisis can be felt throughout the state, impacts are felt greatest in communities considered to be high wildfire risk areas. Insurers will not write in high-risk areas unless they can cover one hundred percent of consumer claims, their expenses, and earn a fair return. The Insurance Services Office (ISO) Public Protection Classification (PPC) is a rating system that some major insurance companies use to determine fire insurance rates. The ISO assigns a PPC rating from 1 to 10, with 1 being the best score. Communities with a good PPC rating historically have lower fire insurance rates than communities with a lower rating. Insurance companies use PPC information for underwriting however, not all insurers use ISO. Some large insurers are pricing wildfire risk for large areas, such as zip code level, while others are pricing at a much more granular level. This lack of transparency in the ways rates are determined are causing confusion for consumers.

Despite Riverside's Fire Department receiving an ISO Class 1 rating, Riverside's Fire Prevention team continues to receive reports of residents experiencing the impacts of the insurance crisis. According to data from the CDI's website, 15,923 policyholders were denied renewal by their insurance companies in the City of Riverside between 2015 and 2021. Property owners in the 92503 zip code were affected greatest with 4,368 nonrenewed policies during the same period. New FAIR Plan policies in Riverside rose from 3,412 in 2020 to 4,335 in 2022. Riverside residents impacted by the recent Hawarden Fire were also excluded from moratoriums on non-renewal or cancellations as well as available low-interest loan options for rebuilding due to failure to meet damage thresholds required for the state to declare a state of emergency.

The lack of access to affordable insurance coverage is greatly impacting homeowners and business owners. Many prospective homeowners find themselves unable to afford purchasing a home due to the high insurance premiums. To add to the complexity of the insurance crisis, the large increase of policyholders forced to use the FAIR Plan are creating risk for the entire market. As of June 2024, the FAIR Plan's total exposure has increased 38.3% since September 2023, accounting for 3% of the total market. Experts have warned that the FAIR Plan is one catastrophic loss away from becoming insolvent. If the FAIR Plan were to become unable to cover their commitments, traditional insurance companies must pay for the losses, putting all policyholders at risk.

Since Proposition 103 was enacted, the California homeowner's insurance market has changed drastically. Insurance companies argue that the outdated procedures required by Prop 103 are preventing them from maintaining sustainable premiums to meet increased risks and costs. Under Prop 103, when insurance companies submit requests for rate increases to the CDI for approval, the process is typically long and drawn out, sometimes taking as long as 6 months. In a process unique to California, consumers also have the ability to contest rate filings, often further delaying approvals. These issues contribute to insurers decisions to limit new policies in order to ensure they can meet their commitments to pay potential claims for existing policyholders. The CDI not only restricts insurer's ability to raise rates but also inhibits rate setting models. Insurers are limited to using historical data when determining rates and are unable to use forward thinking models to predict risk. The current regulations aren't working for homeowners or insurance companies, and major policy changes are needed to stabilize the market.

<u>Statewide Efforts</u>

In September 2023, Governor Newsom signed Executive Order N-13-23, which called for the Insurance Commissioner to take immediate action to address issues with the insurance market and expand coverage options for consumers, while maintaining strong consumer protections and keeping plans affordable. In response to this, Commissioner Lara announced that he reached an agreement with insurance companies to improve the state's market through the Sustainable Insurance Strategy.

Commissioner Lara's Sustainable Insurance Strategy aims to modernize California's insurance market by doing the following:

- Transition policyholders from the FAIR Plan back to traditional insurance market by requiring insurance companies to write no less than 85% of their statewide market share in high wildfire risk communities;
- Giving FAIR Plan policyholders who comply with Safer from Wildfires regulation first priority to transition to the normal market;
- Allowing the use of forward-thinking catastrophe modeling that uses scientific data and environmental conditions to set rates rather than relying on historical data (IF, and ONLY IF, they write at least 85% in high wildfire risk areas);
- Increasing FAIR Plan commercial coverage to $20 million per building;
- Improving rate filing procedures and timelines;
- Require increased public reporting;
- Ordering changes to the FAIR Plan to prevent it from going bankrupt in the case of a catastrophic event, including building its reserves and financial safeguards.

These actions build on previous regulations enacted by Commissioner Lara that include:

- Safer from Wildfire Regulation: mandates insurance companies to recognize and reward wildfire safety and mitigation efforts, including programs such as Firewise USA and the Fire Risk Reduction Communities List;
- Promoting Policyholder Security through Moratoriums on non-renewals and cancellations: prohibiting insurers from cancelling or non-renewing residential policies in certain areas within or adjacent to a fire perimeter for one-year after a declared state of emergency issued by the governor.

The Sustainable Insurance Strategy regulations are expected to take effect by December 31, 2024; however, experts expect the insurance market will take around two years to respond to the changes. Additional legislative action is required to provide timely relief to business owners and residents. Two legislative bills aimed at providing homeowners who invest in fire mitigation with reduced rates failed to pass in 2023. Assembly Bill 2416 would have required the CDI to review and update its regulations for fire insurance to include building hardening (fire resistance) measures every three years. Senate Bill 1060 would have required that insurers use risk models that account for wildfire risk reduction activities.

<u>What Can We Do?</u>

Climate change and increased development near wildland areas has made fire risk the main factor contributing to the insurance crisis in California. Within the confines of current regulations, the best option to increase insurability and lower rates is to focus on mitigating fire risk. The Safer from Wildfires program was initiated by the California Department of Insurance (CDI) to address the increasing risk of wildfires and to promote fire safety among homeowners and businesses. The program aims to encourage property owners to implement fire-resistant measures, thereby reducing their risk and improving insurability.

Under the **Safer from Wildfires Program,** homeowners are encouraged to adopt specific practices that enhance the fire resilience of their properties, such as:

- Installing Class-A fire-rated roofs (e.g., asphalt, concrete);
- Creating a 5-foot ember-resistant zone around the property;
- Ember- and fire-resistant vents
- Using non-combustible materials for 6 inches at the bottom of exterior walls;
- Enclosed eaves;
- Upgrading to multi-paned windows;
- Removal of combustible sheds and other structures to at least a distance of 30 feet;
- Defensible space compliance
- Clearing vegetation and debris from around structures.

The program recognizes two community-wide initiatives:

- **Firewise USA**: A nationally recognized program sponsored by the National Fire Prevention Association that involves collaborative effort involving residents, fire departments, and stakeholders to develop wildfire risk assessment plans and community action plans.
- **Fire Risk Reduction Communities:** A list of local agencies in high fire hazard zones (Riverside included) that meet best practices for fire planning maintained by the Board of Forestry and Fire Protection.

The CDI is requiring insurance companies to provide discounts to homeowners who comply with the Safer from Wildfire standards. Discounts are not standard across the board but are based on each property's individual characteristics and the mitigation actions taken. Insurance companies are required to calculate new rates incorporating discounts and submit their data to the CDI for review and approval. Those on the FAIR Plan are also eligible for discounts – a 10% discount for homeowners who harden their homes to be more resistant to wildfires and a 5% discount for making improvements to the area surrounding the home. An application must be completed to request an inspection to receive the discounts. Under the regulation, insurance companies are required to provide the "wildfire risk score" assigned to property owners when they apply for or renew a policy upon request after completing mitigation measures, along with suggestions for reducing it.

As a community, a collaborative approach is needed to improve insurance access and affordability. Property owners should notify their insurance companies any time they have made fire resistant updates to their properties. Property owners can also contact the CDI to share their experiences or file complaints of unfair practices. In addition, the nonprofit organization United Policyholders (UP) advocates for insurance consumers, helps navigate claims, and provides information and resources.

<u>Resolution</u>

Many local leaders have publicly recognized the urgent need for regulatory reform and community action and are advocating for regulatory changes at the state level. Recently, several jurisdictions throughout California have adopted a Resolution calling for the Insurance Commissioner, State Legislature, and the Governor to declare a state of emergency and take immediate regulatory action to address the property insurance crisis. The California Insurance Commissioner has broad authority under the Insurance Code to adopt emergency regulations to promote the public welfare and to adopt emergency regulations governing the prior approval process for insurance rate change applications. The draft Resolution (attachment) details the requests set forth and would advocate for better options for the residents of Riverside.

STRATEGIC PLAN ALIGNMENT:

This item contributes to Strategic Priorities No. 2 - Community Well-Being and Goal No. 2.6 - Strengthen community preparedness for emergencies to ensure effective response and recovery.

1. **Community Trust** – Addressing the insurance crisis demonstrates the City's commitment to transparency and builds trust by actively engaging with residents on their concerns.

2. **Equity** – The proposed resolution aims to ensure equitable access to affordable insurance for all residence, particularly in high-risk communities.

3. **Fiscal Responsibility** – Stabilizing the insurance market will help residents financially by helping to prevent potential uninsured losses.

4. **Innovation** – The resolution encourages innovative approaches to insurance practices and assessment, fostering modern solutions to current challenges.

5. **Sustainability & Resiliency** – Promoting fire safety and risk mitigation enhances community sustainability and resilience, ensuring that neighborhoods can better withstand and recover from future challenges.

FISCAL IMPACT:

There is no fiscal impact associated with this report.

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Attachment: Draft Resolution