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Informational Hearing

Is the California Insurance Market Flexible Enough to Respond To Climate Change?

Wednesday, May 10, 2023, 10am-noon
1021 O Street, Room 2100

Summary

For 35 years, California’s insurance market has been governed by Proposition 103. This groundbreaking piece of legislation has been lauded and criticized since then. As climate change worsens, the question of whether Proposition 103 is capable of responding to the climate crisis and the pressures this crisis has put on the insurance market has become apparent. This hearing is intended to explore that question.

Proposition 103

California's Proposition 103 was a ballot initiative passed by California voters in 1988. It was championed by consumer activist Ralph Nader and led by Harvey Rosenfield. Proposition 103 was designed to regulate insurance rates in California by requiring that automobile, homeowner, and other property and casualty insurers get approval from the state insurance commissioner before raising or lowering rates. It also required insurers to base rates on a driver's safety record, number of years of driving experience, and miles driven annually, rather than using factors like ZIP code and occupation as the primary rate-setting factors.

The initiative was driven by concerns over skyrocketing insurance rates in California at the time, which many believed were due to unfair and discriminatory rate-setting practices by insurance companies. Proposition 103 was seen as a way to give consumers more power and protect them from unfair rate hikes. Despite fierce opposition from the insurance industry, Proposition 103 passed with 51% of the vote in November 1988 and became law in California.

Today, Proposition 103 remains in effect in California and continues to provide protections for consumers. Insurance companies must still receive prior approval from the California Department of Insurance before they can raise rates, and policyholders are still entitled to the various discounts and protections outlined in the law.

Climate Change in California

This is Much More Than a Property Loss Issue

The insurance crisis is making California a test case for the financial dangers of climate change nationwide, as wildfires, floods, and other disasters create economic shocks well beyond the physical damage of the disasters themselves.[1] Those changes have already started to affect home prices, the mortgage industry, and the bond market. There is also a growing human toll in the wildland firefighting workforce. The workforce is being asked to fight more intense wildfires, for longer wildfire seasons. Maintaining force readiness in the face of 21st Century wildfires is likely going to require fundamental structural change in wildland firefighting that will increase costs at the state and federal levels even beyond where they are now."[2]

The case can be made for the "danger of unchecked climate change blowing the debt through the roof, in the same way that both the mortgage meltdown and the pandemic together added $10 trillion to the deficit," Dr. Michael Wara said in an interview with the New York Times.[3] These comments from Wara and other speakers at a recent Congressional hearing emphasized the fiscal costs from wildfire extend far beyond property loss. A "status-quo" approach to suppression-based fire management policy has dire implications for housing in areas already stressed by rising home costs and shortages.

Collaborative Innovation at the Department of Insurance

With California communities increasingly exposed to climate change-related threats, Commissioner Ricardo Lara wrote the nation's first climate insurance law (SB 30) to explore innovative strategies that reduce the risk. He has appointed a working group of environmental advocates, researchers, and insurance experts that will make recommendations to reduce the threat from wildfires, floods, mudflows, urban high heat, sea-level rise and other issues facing our state. While other nations have used

[1] Wildfires Hasten Another Climate Crisis: Homeowners Who Can't Get Insurance - The New York Times (nytimes.com) https://www.nytimes.com/2020/09/02/climate/wildfires-insurance.html

[2] A Burning Issue: Stanford scholar testifies on rising costs of wildfire | Stanford Woods Institute for the Environment. https://woods.stanford.edu/news/burning-issue-stanford-scholar-testifies-rising-costs-wildfire

[3] New York Times https://www.nytimes.com/2023/03/07/climate/sheldon-whitehouse-climate-senator.html

insurance markets to address climate impacts, California is the first U.S. state to consider innovative ideas, insurance policies, and risk transfer mechanisms.

This working group, through examination and discussion of recent climate events and their impacts to vulnerable communities, has identified four key elements of resilience – risk assessment, risk communication, risk reduction, and risk transfer. Risk assessment and risk communication support community preparation and enable public policies to anticipate events. Early investment in risk reduction reduces future losses, and the expansion of risk transfer options could lead to more affordable and effective insurance concepts. The working group applies these key elements of risk to three specific perils – fire, flood, and extreme heat – and provides specific recommendations for preventing and managing the risks associated with these perils, including closing coverage gaps, and strengthening the role of mitigation investments in reducing mounting climate risks to communities

Climate Change is Changing the Insurance Markets

Climate change is impacting homeowners insurance in three ways:

1) Climate change is not a problem of the distant future; it's already here. Across the country, we have insurance protection gaps and crises exacerbated by climate change. For example, unprecedented wildfires have driven insurers to shed high-risk policies in Western states like California, Oregon, and Colorado. In California, homeowners' insurers lost $20 billion in 2017 and 2018 due to wildfire, wiping out two times the cumulative profits earned over the prior 26 years.

2) A broken insurance market is not *the* problem; it's a *symptom* of a larger problem which is there is simply too much risk for the market to bear. The risks associated with climate change and catastrophes are owned by homeowners and the community, not the insurance industry. Much of that risk can potentially be transferred to insurers if there is a sustainable private market, which rests on three pillars: availability, affordability and reliability. Climate change is interacting in new ways with other inherent risks, causing cracks in all three of those pillars. The policy actions intended to help can actually backfire and accelerate the collapse of the insurance market. This generally happens because these actions don't address the underlying problem – that the risk is too high.

3) The cost of driving down climate risk is much lower than the cost of inaction. The choice to ignore climate risk and manage from crisis to crisis puts more families in harm's way, with low-income communities likely to be hit the hardest and suffer the most. Failure to act early reduces the number of options available and drives up the costs of reaction at various government levels. To avoid this we need to work collectively to bend down the risk curve. We need better data, better modeling, higher prioritization of mitigation vs. disaster response, better stakeholder coordination, and resource assistance to those areas most in need. The sooner our society chooses to face the risks associated with climate change, the more options we will have to drive down these risks, and the lower the cost will be.

Tangible Impacts of Climate Change: The Consumer Perspective

Though Proposition 103 was intended to protect consumers, many have found it has fallen short of its intended goals. Homebuyers and homeowners associations have found their insurance rates in the wildland-urban interface area (WUI) increase exponentially over the course of only a few years due to limits on the ability to effectively use available technology in calculating rates, delays and roadblocks in the rate making process, and hardening efforts that are not being accounted for in the insurance rate setting process.

Conclusion

The impact of Proposition 103 is undeniable. Even after 35 years it continues to shape the insurance marketplace. But 35 years ago, climate change was something in the distant future. Now that future crisis is here and we are living with unprecedented wildfires, extreme heat, and unpredictable weather patterns and the costs of these events caused by these climate changes. That's why if we continue to work around the edges and don't start to think outside the box, there will be calamitous implications for housing in areas already stressed by rising home costs and shortages. We need better data, better modeling, higher prioritization of mitigation vs. disaster response, better stakeholder coordination, and resource assistance to those areas most in need. The homeowners, community members, and firefighting workforce are bearing the brunt of the crisis. Is Proposition 103 flexible enough to respond to these changes?