



**United Policyholders testimony: CDI Hearing re: California Fair Plan, Santa Barbara, CA. Tuesday, August 25, 2009, 6:30 p.m., County Administration Building, Board of Supervisors Hearing Room**

We thank the CDI for initiating this important fact-gathering process and we appreciate this opportunity to provide input on improving our state's homeowners' insurer of last resort.

United Policyholders is a non-profit consumer organization that helps solve insurance problems and that advocates for fairness in insurance transactions. We offer resources to the public through our three programs: Roadmap to Recovery; Roadmap to Preparedness; and Advocacy and Action. For more information, please visit our website at [www.uphelp.org](http://www.uphelp.org).

**The Fair Plan is a critically important safety net for California homeowners**

United Policyholders has had eighteen years of direct contact and experience with policyholders, regulators and the insurance industry with regard to property/casualty coverage, claim and marketplace issues. The majority of California homeowners can comparison shop among competing insurance companies to find the one that offers the best coverage for the lowest price. However, there a substantial number of homeowners whose risk factors are not sufficiently attractive to private insurers or who for various reasons *beyond their control* cannot find a company willing to insure them. For this group, the California Fair Plan is a critically important safety net.

**The Fair Plan has changed little since 1968 yet much has changed in our state**

The California Fair Plan has changed very little since it was established in 1968. Yet there have been huge changes in real estate values, construction costs and where people live. I doubt the phrase "Wildland Urban Interface zone" existed when the California Fair Plan was created. Obviously, in 1968, insurance agents and brokers weren't competing with the Internet for customers. We believe this competition is helping fuel the underinsurance crisis for consumers. There's so much pressure on agents and brokers to make the sale—less attention is being paid to the adequacy of the coverage being sold.

**Inherent conflicts exist when private insurers are forced to participate in a quasi-public entity like the Fair Plan, so extra care is required in governing the entity and crafting the products it sells.**

Through our work in hurricane and earthquake regions, United Policyholders is aware of the political and economic dynamics relating to “quasi-public” insurance entities including pools like the California Fair Plan. Most quasi-public insurance entities, such as the California Fair Plan, are created in response to an availability and/or affordability crisis created by private insurers. Insurance lobbyists generally have a heavy hand in designing the entity when the legislature creates it; and insurance company representatives generally populate the governing boards. Most quasi-public insurance entities sell policies that are intentionally designed *not* to compete with privately issued policies. Inherent conflicts arise in part because the insurers that are forced to participate in the entity and that help govern the entity don’t want its products to be attractive to consumers. Agents and brokers tend to be ill-informed about Fair Plan policies, extended coverages and the guidelines relating to these “last resort” products.

**The public generally understands Fair Plan policies are expensive. The public does not generally understand that Fair Plan coverage is less than basic**

It is generally understood that the coverage a consumer can buy from the California Fair Plan is relatively expensive. It is not generally understood that the policies have significant gaps in coverage. As with private market homeowners insurance, sellers of the California Fair Plan set the policy limits at the point of sale. Agents and brokers selling the California Fair Plan fill out a standard form application (that you can read on the Internet) which indicates the replacement value of the structure per square foot. When that calculation turns out to be wrong after a loss—it is likely that sellers of the California Fair Plan—much like agents and brokers who sold private policies—may attempt to shift blame onto the policyholder. The key issue here is at the point of sale, how a real replacement cost for one’s property is likely never calculated properly in the first place, and at each subsequent renewal, policy limits are not adjusted properly to keep pace with real replacement cost, and thus, underinsurance becomes endemic in the industry regardless of which company or quasi-public entity sold the policy. But that’s a topic for another hearing.

The essential problem with the California Fair Plan policies being sold today is that the policies provide less than the “basic” coverage a homeowner expects to receive in an insurance policy.

The “Definitions” section of the California Fair Plan, in the California Insurance Code, section 10091, plainly states the plan would provide “basic property insurance”—meaning “insurance against direct loss to real or tangible personal property...from perils insured under the standard fire policy and extended coverage endorsement” and other coverages as the Plan decided to add with approval from the Commissioner. In analyzing how adjustments are made to the California Fair Plan through the governing board, it becomes

clear that adequate changes, historically, have not been made to have the California Fair Plan keep up with the “basic” needs of consumers in protecting their property, and giving policyholders a “fair” opportunity to rebuild their property when they have suffered catastrophic and total losses. Perhaps, the California Fair Plan is adequate in partial losses, but we have yet to see, at United Policyholders, the California Fair Plan be adequate when policyholders suffer total losses, such as the ones recently suffered in Santa Barbara County where policyholders need “Additional Living Expenses,” “Debris removal,” “Code Upgrade,” and policy limits high enough on “Dwelling,” “Other Structures,” and “Personal Property” to be able to rebuild their homes.

Obviously, the California Fair Plan needs to be overhauled, and it would be of great benefit to add consumer-advocacy “seats” to the governing board which is now filled by insurance industry members almost exclusively.

**The revised rating plan that is currently being reviewed is a step in the right direction but not far enough**

This hearing is particularly timely. The California Department of Insurance is aware of the struggles that 2008 and 2009 Santa Barbara wildfire survivors are grappling with as we speak. And, it is reasonable to assume that private insurers will be increasingly selective in light of economic conditions, climate change and the current drought in Southern California. It is likely that more people will end up in the California Fair Plan in the near future. That said, the Fair Plan’s policy count is lower than most people would expect, and its recent rate filing with the CDI is very promising.

We believe the California Department of Insurance, the legislature, and California Fair Plan management have an obligation to the citizens of our state to make sure the California Fair Plan policies aren’t a rip off or a bleak surprise after a tragic loss. Homeowners pay dearly for the Plan’s coverage, and they deserve good advice from agents and brokers, basic coverage that is adequate, and to receive good claim service after a loss.

**Revising its rating plan to sell higher contents percentage and stand-alone coverages will help remedy chronic inadequate coverage for dwellings, contents, debris removal, code upgrades, ALE, trees, shrubs and other structures:**

Most of the California Fair Plan insureds who come to United Policyholders for claim assistance are *underinsured* on their dwelling and even more so as to contents. Usually, they have far too little or no coverage at all for debris removal, additional living expenses, trees and shrubs, and other structures.

By revising its rating plans and selling adequate limits for these important items, the California Fair Plan can fix several of the fundamental flaws in the products it is currently selling.

**It is important to provide incentives to agents and brokers so they will not improperly place customers in the California Fair Plan because it is easier to stick them in the Plan than to notify and/or help policyholders get out of the California Fair Plan when private coverage is available.**

Many of the California Fair Plan insureds who come to United Policyholders for help have neighbors with similar properties that are insured in the private market. Many are in the Plan because they got bad advice, or were placed into the California Fair Plan by an agent or broker, and were never told they could get out when marketplace conditions improved. It is imperative that agents and brokers annually review their California Fair Plan customers and assist them in getting adequate private insurance with provides more coverages wherever possible.

It is equally important that the California Department of Insurance examine the current California Fair Plan commission structure to ensure it provides the appropriate incentives for agents and brokers to be diligent in advising applicants on proper limits, the extended coverages that are available through the Plan, and supplement/wrap around/excess options.

The California Department of Insurance must also examine the voluntary brush writing credit system to see how it can be adjusted to better achieve the goal of creating the necessary incentives for private companies to accept applications from rural homeowners.

**California Fair Plan insureds are not second class citizens; they are entitled to fair rates, basic coverage, and good claim service**

Many California Fair Plan insureds tell us they are deeply grateful that they were able to buy insurance at all, but are frustrated by gaps in coverage and poor claim service. Let me give you one example:

Timothy “Dusty” Rhodes reported the following to United Policyholders this week:

Mr. Rhodes is a 62 year old disabled veteran. He lost his home in the 2007 Poomacha wildfire on the La Jolla Indian Reservation. Because his contents coverage was set at only 20% of his dwelling coverage, he is grossly underinsured.

Despite being grossly underinsured, his California Fair Plan adjuster continues to insist that no monies will be paid until he submits a complete and meticulously detailed inventory of every destroyed item.

Mr. Rhodes had thousands of books and is struggling to list each one, as well as the many other items he and his wife accumulated during their 38 years of marriage. The adjuster assigned to his claim

has been extremely difficult to work with, but Mr. Rhodes' request for a substitute adjuster was denied.

Mr. Rhodes had no coverage for debris removal, trees, shrubs or code upgrades, and is 50% underinsured on his other structures. As the two-year anniversary of the destruction of his home approaches, the California Fair Plan has yet to advance Mr. Rhodes a dime for his destroyed contents, unlike many private insurers who advance between 25-30% of policy limits after a total loss, with some insurers paying full policy limits while waiving the requirement of an inventory list.

'Call it anything you want' Mr. Rhodes said, "I appreciate the insurance and I appreciate an insurer of last resort, but the name is so misleading it's almost a joke".

If the California Fair Plan needs more staffing resources, it should ask for them. California Fair Plan rates by law must not be excessive, inadequate or unfairly discriminatory. (Ins. Code section 10100.2 (a)(1)).

#### **Necessary improvements:**

We understand the California Fair Plan management has submitted a proposed revised rating plan to the California Department of Insurance. We have not reviewed the filing, but the reported portions sound like important steps in the right direction. This series of hearings will give the California Fair Plan and the California Department of Insurance the information that is needed to evaluate the filing and undertake more extensive reforms including, but not limited to:

#### **#1: Creating true "Basic" coverage:**

- Automatic inclusion of debris removal coverage
- Higher policy limits on "Dwelling" and "Other Structures" and replacement coverage for personal property
- Adding an automatic inflation guard provision, to adjust their policy limits at a reasonable rate each year, so in catastrophic losses such as those suffered in the recent wildfires, there is not total devastation for homeowners who do not have enough coverage to rebuild their homes

#### **#2: Allowing the purchase of optional extended coverages:**

- Allowing a homeowner to buy stand-alone coverage for "Additional Living Expenses" up to 50% of their dwelling limit
- Allowing homeowners to purchase Building Code Upgrade/Ordinance compliance coverage at 10% of dwelling limit instead of the current ten thousand dollar (\$10,000) flat amount
- Allowing homeowners to purchase landscaping, trees and shrub coverage

**#3 Additional measures:**

- Mitigation assistance and premium reductions based on satisfactory completion of risk reduction/brush clearance/mitigation measures
- Penalties for agents and brokers who fail to use reasonable diligence in establishing adequate policy limits and procuring appropriate coverages
- Adding at least one qualified homeowner (e.g. one who's experienced a catastrophic loss) as a public member of the Fair Plan Governing Board
- Enforcing the Fair Claims Practices regulations with regard to California Fair Plan claims.
- **Maintain but enforce the current system whereby California Fair Plan agents and brokers are legally obligated to calculate reasonable replacement costs at the point of sale:**

The application form for replacement coverage which agents and brokers currently submit to the California Fair Plan is clear evidence that the agents and brokers—not homeowners—are calculating (obviously inadequate) replacement costs and setting policy limits as the form has blank spaces for calculating the replacement cost of the dwelling:

REPLACEMENT  
COST/SQ. FT. \$ \_\_\_\_\_

BUILDING AREA  
(MAIN STRUCTURE) \_\_\_\_\_ SQ.FT.

ESTIMATED REPLACEMENT COST:  
DWELLING \$ \_\_\_\_\_

OTHER STRUCTURES \$ \_\_\_\_\_

The form then asks the question:

HOW WAS THE VALUE DETERMINED?

PROFESSIONAL APPRAISAL (ATTACH A COPY)  
COMPANY APPRAISAL GUIDE. NAME OF COMPANY \_\_\_\_\_  
OTHER (DESCRIBE) \_\_\_\_\_  
(REAL ESTATE APPRAISER, CONTRACTOR OR OTHER KNOWLEDGEABLE PROFESSIONAL)

**In Conclusion:**

While we recognize that the California Fair Plan has many positive features, it is clear that substantial improvements are long overdue. We urge the California Department of Insurance to expeditiously analyze the data gathered at these hearings and the revised rating plan the California Fair Plan has submitted and move as quickly as possible to take all steps necessary to fix this untenable situation through administrative and legislative actions.

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