

## **CALIFORNIA'S "USE IT AND LOSE IT" PROBLEM**

---

Written by Aaron Motschenbacher, Law Student at Santa Clara University, on October 23, 2007, for United Policyholders of San Francisco, under the guidance of Amy Bach, Executive Director; <http://www.unitedpolicyholders.org>.

## USE IT AND LOSE IT: THE PROBLEM

In 2003, John Garamendi, the former Insurance Commissioner (Commissioner) of the State of California, publicly addressed a crisis in the availability of homeowners insurance. Garamendi announced that the California Department of Insurance (CDI) began to receive, at an increasing rate, complaints from policyholders who were charged increased rates or had their insurance coverage nonrenewed because they made a claim or inquired about their coverage.<sup>1</sup> The crisis took on the name “use it and lose it,” reflecting the underlying idea that you will lose your insurance coverage if you use it.

The CDI attributes the “use it and lose it” problem to insurance carriers’ increasing use of loss reporting databases compiled by insurance-support organizations, such as Comprehensive Loss Underwriting Exchange (CLUE) and Automated Property Loss Underwriting System (A-PLUS).<sup>2</sup> Insurance carriers use the data from these databases, in conjunction with internally prepared loss reports, to assess the potential risk of future loss associated with insureds. Problems have resulted from the use of such reports because the insurance carriers are correlating a homeowner’s prior loss experience with an increased risk of loss in the future. In turn, insureds that have used their insurance coverage are not being extended renewal offers or are being charged increased rates because of their property’s alleged susceptibility to damage and the insured’s propensity to file claims. Subsequent legislation, which will be discussed in detail below, eliminated the problem of rate increases and nonrenewals due to coverage inquiries alone.

The central issue now is whether insurance carriers should be able to use prior loss data in underwriting decisions if the losses involved have been *fully* remedied.<sup>3</sup> Consumer advocates argue that once an insured fully remedies a loss, there has been no change in the risk of future loss, as the property, and conditions surrounding the property, have returned to their pre-loss status.

Insurance carriers’ use of prior loss data in coverage and pricing determinations severely impacts the rates and availability of homeowners insurance. A recent study shows such effects nationwide. In 2003, the Independent Insurance Agents & Brokers of America (IIABA) initiated an independent study that confirmed “non-renewals and premium increases are becoming more common in the current homeowners insurance market.”<sup>4</sup> According to the study, nearly 2.5 million households lost their homeowners insurance coverage within the 24 months leading up to the study.<sup>5</sup> Of the people who lost their coverage due to nonrenewals, only about 73 percent of them were able to obtain other coverage, leaving a staggering 27 percent of them uninsured.<sup>6</sup> IIABA’s survey also determined that “approximately 51 million households (about 42 percent of all American households) experienced a homeowners insurance rate increase” within the 24 months leading up to the study.<sup>7</sup> Of those households, the rate increases were as follows:

---

<sup>1</sup> See California Department of Insurance, *Consideration of Losses and Loss Exposure in Residential Property Insurance Rating and Underwriting* (File No. ER03030135), <http://www.insurance.ca.gov/0100-consumers/0060-information-guides/0040-residential/upload/Adoption-of-Regulation-on-an-Emergency-Basis.pdf> (last visited Oct. 24, 2007).

<sup>2</sup> According to NW Insurance Council, “CLUE reports include information from 600+ insurance companies (90% of homeowners insurance carriers) [and] A-PLUS includes data from 1200+ companies (90% of industry’s premium volume).” NW Insurance Council, Questions and Answers About, [http://www.wiconline.org/cm\\_CLUEQ&A.htm](http://www.wiconline.org/cm_CLUEQ&A.htm) (last visited on October 29, 2007).

<sup>3</sup> When damage to an insured premise is not fully remedied, arguably a *prima facie* case can be shown that there is an increased risk of future loss and exposure, as the related hazards persist.

<sup>4</sup> Independent Insurance Agents and Brokers of America, *Consumers Can Minimize Homeowners Insurance Non-renewals, Rate Increases*, [http://www.iiaba.net/na/02\\_News/02\\_PressRelease/NA20070711114437](http://www.iiaba.net/na/02_News/02_PressRelease/NA20070711114437) (last visited Oct. 24, 2007).

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

- Up to 10 percent rate increase 56.7 percent
- 11-25 percent rate increase 23.2 percent
- More than 25 percent rate increase 13.8 percent  
(6.3 percent were undetermined).<sup>8</sup>

Another study confirms similar trends are occurring right here in California. The CDI performed a study based on information supplied by insurance companies representing 96 percent of the California homeowners insurance market and confirmed insurance carriers commonly nonrenew because of an insured's prior loss history; the study states:

Filing a claim may result in the non-renewal of a homeowner's policy. Even after excluding water claims and limiting claims to those in the last three years, at least four percent of the companies nonrenewed applicants based on just one claim, 21 percent on two claims, 13 percent on three claims, and an additional four percent on four or more claims.<sup>9</sup>

All of these studies clearly support the proposition that immediate concern needs to be paid to the use of prior losses in underwriting decisions.

### **THE COMMISSIONER'S ATTEMPT TO CURE THE PROBLEM**

In April 2003, Garamendi, in an attempt to take the "use it and lose it" problem head on, issued an advisory notice to insurance carriers providing homeowners insurance in California. The advisory notice warned:

Not every loss is related to the current loss exposure. An insurer choosing to include losses as an eligibility criterion must be able to demonstrate that each loss utilized bears a substantial relationship to risk of future loss. A loss at a particular property, or by a particular consumer, must be evaluated to determine if the loss is evidence of increased risk of future loss. Losses that have been fully remedied or otherwise resolved so that they no longer present an increased risk of loss do not have a substantial relationship to the insured's loss exposure. Inquiries regarding coverage, coverage discussions, or hypothetical discussions between the insured and the insurer or its agents are not relevant for underwriting consideration, unless an actual loss or exposure to loss is identified and determined to have a substantial relationship to the consumer's loss exposure.<sup>10</sup>

Garamendi found primary support for his authority to issue the advisory notice in § 2360.2 of the California Code of Regulations, which states:

An insurer shall maintain *eligibility guidelines* for every line of insurance offered for sale to the public. The *eligibility Guidelines* shall be sufficiently detailed to determine the appropriate rating plan for the insured. An insured or applicant who meets the *eligibility guidelines* shall qualify to purchase the insurance.<sup>11</sup>

Section 2360.0(b) of the California Code of Regulations defines *eligibility guidelines* as "specific, objective factors" that "have a *substantial relationship* to an insured's loss exposure."<sup>12</sup> Garamendi took the position that an insured's prior loss history does not necessarily have a "substantial relationship" to the insured's future loss exposure, especially when the insured has fully remedied all prior losses.<sup>13</sup>

<sup>8</sup> *Id.*

<sup>9</sup> Don McNeill, Policy Research Division, California Department of Insurance, *Underwriting Guidelines and Access to Homeowners Insurance* (Aug. 12, 2004), <http://www.insurance.ca.gov/0100-consumers/0060-information-guides/0040-residential/upload/Underwriting-Guidelines-for-Homeowners-Insurance.pdf>.

<sup>10</sup> *American Insurance Association v. Garamendi*, 127 Cal.Rptr.4th 228 (Cal. Ct. App. 2005) (unpublished opinion).

<sup>11</sup> CAL. CODE REGS. tit. 10, § 2360.2 (2007)

<sup>12</sup> CAL. CODE REGS. tit. 10, § 2360.0(b) (2007) (emphasis added)

<sup>13</sup> *American Insurance Association v. Garamendi*, 127 Cal.Rptr.4th 228 (Cal. Ct. App. 2005) (unpublished opinion)

The American Insurance Association, Association of California Insurance Companies, and Personal Insurance Federation of California, all large trade groups representing insurance carriers, in *American Insurance Association v. Garamendi* (*Garamendi*), “petitioned for a peremptory writ of mandate to invalidate the advisory notice, arguing it was an illegal underground regulation and it conflicted with existing law.”<sup>14</sup> The trial court found the “advisory notice was likely a regulation and stayed enforcement of it” pending resolution of the case.<sup>15</sup> *Garamendi* fought back and adopted a new regulation, on an emergency basis, which, in pertinent part, stated “an insurer shall not base, in whole or in part, an adverse underwriting decision on losses or loss exposures that have been *fully* remedied or otherwise resolved.”<sup>16</sup> The insurance trade groups continued their challenge to such regulation. Again, the trial court found for the insurance carriers and found “the Commissioner exceeded his authority in promulgating this regulation because it is inconsistent with the governing statutes.”<sup>17</sup> The court issued a peremptory writ of mandate ordering *Garamendi* to “cease, desist, and decline from enforcing the regulation.”<sup>18</sup> *Garamendi* appealed to the Third District Court of Appeals.<sup>19</sup>

One of the central issues addressed in *Garamendi* is whether the Commissioner has the authority to curtail the use of prior loss data as an underwriting criterion. On appeal, *Garamendi* argued he had authority to issue the emergency regulation by the powers conferred upon him in Proposition 103, which added § 1861.05 to the Insurance Code. That section, entitled Approval of Insurance Rates, states:

(a) No rate shall be approved or remain in effect which is excessive, inadequate, unfairly discriminatory or otherwise in violation of this chapter. In considering whether a rate is excessive, inadequate or unfairly discriminatory, no consideration shall be given to the degree of competition and the commissioner shall consider whether the rate mathematically reflects the insurance company's investment income.<sup>20</sup>

*Garamendi* argued that the use of prior loss data in underwriting decisions would “impermissibly affect rates charged by insurers and lead to insurance that is unfair, unavailable, and unaffordable;” effects Proposition 103 expressly sought to curtail.<sup>21</sup> The Court clarified the purpose of Proposition 103: to “ensure that insurance is fair, available, and affordable for all Californians.”<sup>22</sup> *Garamendi* argued that since he had authority under § 1861.05 to regulate such rates, he had an implied authority to regulate the underwriting procedures that would lead to discriminatory and unfair rates and unavailable coverage.

The insurance trade groups’ argument was twofold: first, “loss history data [is] an objective factor related to the risk of future loss because statistical and actuarial analyzes using loss history indicated an applicant with prior losses presents an increased risk of loss, in terms of both frequency and size of loss” and second, the commissioner does not have the power to make regulations curtailing the use of prior loss data in underwriting decisions because such power was not conferred upon him by statute.<sup>23</sup>

<sup>14</sup> *Id.* at 908-09.

<sup>15</sup> *Id.* at 909.

<sup>16</sup> *Id.* (emphasis added).

<sup>17</sup> *Id.* at 910.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> CAL. INS. CODE § 1861.05(a) (Deering 2007)

<sup>21</sup> *American Insurance Association v. Garamendi*, 24 Cal.Rptr.3d 905, 913-14 (Cal. Ct. App. 2005) (unpublished opinion) (citing *State Farm Mutual Automobile Ins. Co. v. Garamendi*, 88 P.3d 71, 77 (Cal. Ct. App. 2004)).

<sup>22</sup> *Id.*

<sup>23</sup> *Id.* at 909, 14

The court clarified the role of the Commissioner in making regulations. The court stated the Commissioner does have “broad discretion to adopt regulation as necessary to promote the public welfare” to the degree that such powers are expressly conferred by statute, or to the degree that such power “may fairly be implied from the statutes.”<sup>24</sup> Accordingly, the Commissioner’s powers must be arise from a specific statute.

The court held that under enacted law, the Commissioner possesses broad power to regulate rates to ensure that they are fair and not discriminatory, but the determination of what factors make rates fair and not discriminatory is left to the Legislature.<sup>25</sup> The court clearly stated there are no Codes or Regulations enacted which limit insurance carriers’ ability to use prior loss data in underwriting decisions, and therefore, no authority is conferred upon the Commissioner to curtail such use.<sup>26</sup> In conclusion, the Commissioner, under the Insurance Codes enacted at the time, did not have the ability to enact his emergency regulation.

As far as nonrenewals are concerned, *Garamendi* pointedly states that the issue of “whether an insurer should be required to offer a particular class of insurance or insure particular risks are matters...entrusted to the Legislature.”<sup>27</sup> Generally speaking, California courts have held “an insurer does not have a duty to do business with or issue a policy of insurance to any applicant for insurance.”<sup>28</sup> However, courts have noted that the Legislature can enact laws determining what risks an insurer is required to insure. For instance, in *Quelimane Co. v. Stewart Title Guar. Co.*, the court stated, “[w]hether an insurer should be required to offer a particular class of insurance or insure particular risks are matters of complex economic policy entrusted to the Legislature.”<sup>29</sup> In *Garamendi*, the court stated that there was nothing under existing law showing the Legislature had determined what risks in the residential casualty market an insurer must insure when prior losses are involved.<sup>30</sup> Therefore, in order to curtail “use it and lose it” underwriting practices, the Legislature needs to act.

### **THE LEGISLATURE NEEDS TO ACT**

Prior to the “use it and lose it” problem surfacing in 2003, the Legislature had enacted very few regulations limiting insurance carriers’ ability to nonrenew homeowners insurance policies or charge surcharges on homeowners insurance policies. The court in *Garamendi* noted the laws that were enacted at the time:

“...an insurer may not refuse to renew a policy solely on the basis that a claim is pending. (§ 675, subd. (c).) An insurer may not refuse to renew, or accept an application, refuse to insure, cancel, restrict, terminate, or charge a different rate, on the basis the insured or applicant is, has been, or may be a victim of domestic violence. (§ 676.9.) An insurer may not refuse to renew a policy for a religious, educational, nonprofit, or reproductive health services facility due to a claim for loss due to a hate crime or an anti-reproductive-rights crime. (§ 676.10.) There are sanctions for the arbitrary cancellation of a homeowners policy where the insured has a day care license. (§ 676.1.)...Chapter 12 (§§ 679.70-679.73) prohibits certain discriminatory practices. Insurance cannot be denied or offered only on less favorable terms due solely to the applicant's marital status, sex, race, color, religion, national origin, or ancestry. (§ 679.71.) The birthplace of the applicant may be used only for identification, not to discriminate against the

---

<sup>24</sup> *Id.* at 916-17

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> *American Insurance Association v. Garamendi*, 24 Cal.Rptr.3d 905, 913-14 (Cal. Ct. App. 2005) (unpublished opinion).

<sup>28</sup> *Quelimane Co. v. Stewart Title Guar. Co.*, 19 Cal. 4th 26, 43 (Cal. 1998).

<sup>29</sup> *Id.* (citing *Wolfe v. State Farm Fire & Casualty Ins. Co.* 46 Cal. 554 (Cal. 1996)).

<sup>30</sup> *American Insurance Association v. Garamendi*, 24 Cal.Rptr.3d 905, 914 (Cal. Ct. App. 2005) (unpublished opinion).

applicant. (§ 679.3.) Prior claims experience is not cited as a prohibited basis for discrimination.<sup>31</sup>

Before the Third District Court of Appeals rendered its decision in *Garamendi*, some members of the California Legislature were already trying to curtail “use it and lose it” underwriting practices. One of the first Legislative acts put forth, in January of 2003, was a comprehensive cure for the “use it and lose it” problem: Senate Bill (SB) 64. The Bill, as proposed by the Senate Committee on Insurance, “would generally require insurers to offer homeowners insurance unless a home is uninsurable... would establish new requirements for recording claims, would make underwriting guidelines public, and would prohibit the use of credit scoring to price or to offer homeowners insurance.”<sup>32</sup> Insurance carriers, notably Liberty Mutual and Nationwide, expressed opposition to the Bill, stating:

While large companies are overexposed and creating problems in the marketplace by not writing new customers, smaller carriers are writing more policies than ever before. Thus, the bill interferes with a healthy market transition to smaller carriers.<sup>33</sup>

Their argument appears to have been grounded in the presumption that a *laizzes-faire* approach is best for the affordability and availability of insurance. As history notes, such an approach failed in California and was a primary purpose for Proposition 103’s enactment. Due to a great deal of opposition, after all said and done, SB 64, as adopted, left no authority for the Commissioner to regulate the use of loss history in the underwriting process, but rather addressed sections of the insurance code not pertinent to the issue at hand. SB 64 was passed prior to the *Garamendi* decision being rendered. Therefore, whether the Legislature would have made more headway on the issues involved in the initial Bill, had it known what the court was going to do in *Garamendi*, is unknown. Further, the question remains, was the initial language in SB 64 too comprehensive to get passed?

At the same time, several less comprehensive Bills were being sponsored to deal with the “use it and lose it” problem. For instance, Assembly Bill (AB) 1049, which was introduced in February of 2003 and passed in September of 2003,<sup>34</sup> amended Insurance Code § 791.12 to add subdivision (c):

791.12. No insurance institution or agent may base an adverse underwriting decision in whole or in part on the following:

(c) On the fact that an individual has previously inquired and received information about the scope or nature of coverage under a residential fire or property insurance policy, if the information is received from an insurance-support organization whose primary source of information is insurance institutions and the inquiry did not result in the filing of a claim.<sup>35</sup>

AB 1049, as passed, was much broader than it was when initially presented in committee.<sup>36</sup> In committee, the Bill only applied if there “was no damage to the insured property.”<sup>37</sup> As passed,

<sup>31</sup> *Id.*, at 915.

<sup>32</sup> Senate Committee on Insurance, Analysis of Senate Bill 64 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb\\_0051-0100/sb\\_64\\_cfa\\_20030401\\_121726\\_sen\\_comm.html](http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb_0051-0100/sb_64_cfa_20030401_121726_sen_comm.html).

<sup>33</sup> *Id.*

<sup>34</sup> Assembly Committee on Insurance, History of Assembly Bill 1049 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab\\_1001-1050/ab\\_1049\\_bill\\_20030922\\_history.html](http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab_1001-1050/ab_1049_bill_20030922_history.html).

<sup>35</sup> CAL. INS. CODE § 791.12(c) (Deering 2007)

<sup>36</sup> This Bill enacts a more comprehensive ban on coverage inquiries as a basis for an adverse underwriting decision and is similar to the language contained in Assembly Bill 81, which was subsequently amended on June 22, 2004 to deal with energy resources and not the insurance underwriting criterion. See Assembly Committee on Insurance, Amendment to Assembly Bill 81 of June 22, 2004 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab\\_0051-0100/ab\\_81\\_bill\\_20040622\\_amended\\_sen.html](http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab_0051-0100/ab_81_bill_20040622_amended_sen.html).

<sup>37</sup> Assembly Committee on Insurance, Introduction of Assembly Bill 64 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab\\_0051-0100/ab\\_64\\_bill\\_20030106\\_introduced.html](http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab_0051-0100/ab_64_bill_20030106_introduced.html).

the Bill expressly prohibits insurance carriers from using prior coverage inquiries as a basis for increased rates or non-renewals, regardless if there was damage to the insured property. The use of coverage inquiries was seen as part of the problem causing nonrenewals and increased rates. Loss reporting databases, such as CLUE and A-PLUS, did not distinguish between losses where payments were issued and coverage inquiries where no payments were issued. The amendment curtails the use of all coverage inquiries that do not result in a claim. Therefore, insurance carriers are now required to investigate and confirm the information contained in their loss reports.

In February of 2004, SB 1474 was introduced and sought to directly cure the “use it and lose it” problem by limiting an insurers ability to use prior loss data. The Bill sought to accomplish the following:

[This] bill would prohibit an insurer from refusing to issue or renew a homeowners' policy on the basis of claims made by the applicant or insured unless the applicant has made 3 or more claims, as specified, within the preceding 3-year period. It would prohibit an insurer from charging a surcharge to issue or renew a policy on the basis of claims unless this circumstance exists. The bill would provide that certain types of claims may not be considered in determining the number of claims filed for the purposes of these provisions.<sup>38</sup>

SB 1474 was passed by the Senate Committee and, subsequently, by the Senate, but failed in the Assembly Committee.<sup>39</sup> The Senate floor debates surrounding the Bill led to a change in the language, so as to allow insurers to use prior loss data if the insured had claimed “2 or more claims, as specified, within the preceding three year period.”<sup>40</sup> This change, from three to two losses, appears to have been a compromise between those concerned about the affects of such a law on insurance coverage availability and affordability in California. Opponents of the Bill argued its passage would lead to higher insurance rates for two reasons: first, “it would require insurers to accept and retain applicants and policyholders with high loss frequencies at the expense of other policyholders,” and second, it would reduce “the availability of homeowners' insurance by discouraging companies from entering or remaining in the homeowners' insurance market in California.”<sup>41</sup> These concerns did not appear to have an affect on a majority of the Assembly Committee, which broadened the terms of the Bill to the following:

An insurer shall not refuse to issue or renew a policy, charge a surcharge, or disallow a credit on the basis of any of the following claims: ...Claims for which the exposure to loss has been mitigated through the removal of the hazard, the repair of the damage or defect, or other changes to the property or the condition causing loss that eliminate the insurer's increased exposure to loss.<sup>42</sup>

The amended version of SB 1474 would have been a triumph for consumer advocates, as the use of an insured's prior loss record would have been severely limited, especially when the prior losses were fully remedied. As noted above, SB 1474 failed to pass in the Assembly Committee; possibly because of the amendments to the Bill, which may have been too broad in scope.

<sup>38</sup> Senate Committee on Insurance, Introduction of Senate Bill 64 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb\\_1451-1500/sb\\_1474\\_cfa\\_20040503\\_171625\\_sen\\_comm.html](http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb_1451-1500/sb_1474_cfa_20040503_171625_sen_comm.html).

<sup>39</sup> Senate Committee on Insurance, History of Senate Bill 64 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb\\_1451-1500/sb\\_1474\\_bill\\_20041130\\_history.html](http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb_1451-1500/sb_1474_bill_20041130_history.html).

<sup>40</sup> Senate Committee on Insurance, Amendment to Senate Bill 1474 of May 12, 2004 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb\\_1451-1500/sb\\_1474\\_bill\\_20040512\\_amended\\_sen.html](http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb_1451-1500/sb_1474_bill_20040512_amended_sen.html).

<sup>41</sup> Senate Committee on Insurance, Analysis to Senate Bill 1474 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb\\_1451-1500/sb\\_1474\\_cfa\\_20040503\\_171625\\_sen\\_comm.html](http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb_1451-1500/sb_1474_cfa_20040503_171625_sen_comm.html).

<sup>42</sup> Assembly Committee on Insurance, Amendment to Senate Bill 1474 of June 21, 2004 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb\\_1451-1500/sb\\_1474\\_bill\\_20040621\\_amended\\_sen.html](http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb_1451-1500/sb_1474_bill_20040621_amended_sen.html).

At about the same time that SB 1474 was introduced, SB 1323 was introduced and sought to similarly limit the use of prior loss data in underwriting decisions. The Bill had a similar purpose to that found in SB 1474:

This bill would prohibit an insurer from refusing to issue or renew a homeowners' policy based upon prior claims made by the applicant or insured under any homeowners' policy, unless the applicant or insured has made more than 2 of these claims in the previous 2 years, except as specified.<sup>43</sup>

SB 1323 met a great deal of opposition from insurers, trade groups and insurance-support organizations. They argued that “the bill creates a disincentive for insurers to do business in the state [and] makes it difficult for insurers to manage their risk.”<sup>44</sup> State Farm posited a strong argument against the Bill:

SB 1323 is, in effect, a "take all comers" rule and that it "virtually" treats all risks the same. Past claims are a valid predictor of future losses. "For example, the goal of insurance is for the average policy holder to have a relative loss ratio of 100%. Policy holders with two or more claims have a relative loss ratio of 156.4%. SB 1323 would require the policy holders with no or only one claim to pay higher rates to cover those policy holders with two claims in two years. This bill...ignore[s] the economic reality of insurance.<sup>45</sup>

The opposition prevailed and the Senate subsequently amended the Bill in May of 2004, so that the Bill only addressed the use of credit information in underwriting decisions.<sup>46</sup>

Subsequently, Senator Escutia, the author of SB 1474, amended SB 1564 in June of 2004, to add language that would limit an insurer's ability to nonrenew based on specified types of prior losses: those caused by either fire or natural disasters.<sup>47</sup> The opposition stated similar reasons to those proffered under SB 1474. After the amendment, the Assembly took no further action with respect to SB 1564, and the Bill died.<sup>48</sup>

In June of 2004, another Bill was amended to include language that would limit an insurer's ability to nonrenew a homeowners insurance policy: AB 2962. The Bill sought to add language to the Insurance Code that limited an insurer's ability nonrenew a policy because of damage caused by a disaster. The language to be added to the Insurance Code specifically stated that insurance carriers would be required to renew a policy at least once, “if the total loss to the primary insured structure was caused by a disaster... and the loss was not also due to the negligence of the insured.”<sup>49</sup> AB 2962 defined “disaster” to mean “an earthquake, flood, fire, hurricane, riot, storm, tidal wave, or other similar sudden or catastrophic occurrence for which a state of emergency has been declared....”<sup>50</sup> AB 2962 met little opposition from insurance carriers and trade groups, and was passed by both the Senate and Assembly, in August of 2004, and was subsequently approved by the Governor in September of 2004.<sup>51</sup>

<sup>43</sup> Senate Committee on Insurance, Analysis of Senate Bill 1323 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb\\_1301-1350/sb\\_1323\\_cfa\\_20040503\\_171144\\_sen\\_comm.html](http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb_1301-1350/sb_1323_cfa_20040503_171144_sen_comm.html).

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> Senate, Amendment of Senate Bill 1323 of June 23, 2004 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb\\_1301-1350/sb\\_1323\\_bill\\_20040512\\_amended\\_sen.html](http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb_1301-1350/sb_1323_bill_20040512_amended_sen.html).

<sup>47</sup> Assembly, Amendment of Senate Bill 1564 of August 23, 2004 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb\\_1551-1600/sb\\_1564\\_bill\\_20040823\\_amended\\_asm.html](http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb_1551-1600/sb_1564_bill_20040823_amended_asm.html).

<sup>48</sup> Assembly Committee on Insurance, History of Senate Bill 1564 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb\\_1551-1600/sb\\_1564\\_bill\\_20041130\\_history.html](http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb_1551-1600/sb_1564_bill_20041130_history.html).

<sup>49</sup> Senate, Amendment of Assembly Bill 2962 of June 22, 2004 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab\\_2951-3000/ab\\_2962\\_bill\\_20040622\\_amended\\_sen.html](http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab_2951-3000/ab_2962_bill_20040622_amended_sen.html).

<sup>50</sup> See CAL. CIV. CODE § 1689.14 (Deering 2007) (AB 2962 used § 1689.14 definition of “disaster”).

<sup>51</sup> Assembly, History of Assembly Bill 2962 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab\\_2951-3000/ab\\_2962\\_bill\\_20040823\\_history.html](http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab_2951-3000/ab_2962_bill_20040823_history.html).



Further attempts to curtail the “use it and lose it” problem fall way short of satisfying the desires of consumer advocates, but nevertheless offer some benefits to consumers. Primarily, these Bills deal with insurers’ responsibility to notify insureds or applicants of changes in rates or the use of certain information in underwriting decisions. AB 1191, as introduced in February of 2003, would require “an insurer under certain property insurance policies...to inform an insured in writing of (1) any increase or decrease in an annual premium as compared to the previous year, (2) the reasons for the change, and (3) specified telephone numbers and information regarding consumer complaints.”<sup>52</sup> AB 1191 was amended in April of 2003 to include a notification requirement when an insurer issues a nonrenewal notice; the language was amended so the Bill “would require an insurer under certain property insurance policies to inform an insured of (1) *the nonrenewal of a policy*... (2) the reasons for the *nonrenewal*, and (3) specified telephone numbers where the insured may register complaints.”<sup>53</sup> The Bill was amended back to its original language after several insurance carriers opposed it.<sup>54</sup> The Bill passed in the Assembly and Senate, and was approved by the Governor in September of 2003.<sup>55</sup> The bill does not provide any limitations on the use of prior losses, but allows insureds and consumer watch groups to get a better understanding of the reasons behind nonrenewals, and puts insureds on notice if a loss database contains incorrect information.

A subsequent Bill, SB 150, was introduced to further the same objectives of AB 1191. SB 150, as introduced, would require an “insurance institution or agent to provide the reasons for [an] adverse underwriting decision in all instances.”<sup>56</sup> One of the central purposes for the Bill was to provide insureds with the ability to ensure correct information is given by insurance-support organizations to insurance carriers. As the proponents of the Bill stated, “[t]he consumer may not know or take the time to determine if the information in an industry database is correct.”<sup>57</sup> If the consumer is provided with the reason for an adverse underwriting decision, which may have been caused in part by incorrect information provided by a CLUE or A-PLUS report, he or she will be able to address the problem and ensure correct information is provided to insurance carriers in the future. The Bill was subsequently amended to force CLUE and A-PLUS reports to include certain and specific information, which sought to further protect consumers, but was thereafter amended back to the less restrictive terms.<sup>58</sup> The Bill was passed by the Assembly and Senate, and subsequently approved by the Governor in September of 2005.<sup>59</sup>

A further legislative attempt to provide protection to consumers was found in AB 1640. AB 1640, as passed by the Senate and Assembly and approved by the Governor in September of 2005<sup>60</sup>, requires:

<sup>52</sup> Assembly Committee on Insurance, Introduction of Assembly Bill 1191 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab\\_1151-1200/ab\\_1191\\_bill\\_20030221\\_introduced.html](http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab_1151-1200/ab_1191_bill_20030221_introduced.html).

<sup>53</sup> Assembly Committee on Insurance, Amendment of Assembly Bill 1191 of April 03, 2004 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab\\_1151-1200/ab\\_1191\\_bill\\_20030403\\_amended\\_asm.html](http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab_1151-1200/ab_1191_bill_20030403_amended_asm.html).

<sup>54</sup> Assembly, Amendment of Assembly Bill 1191 of June 03, 2004 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab\\_1151-1200/ab\\_1191\\_bill\\_20030603\\_amended\\_asm.html](http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab_1151-1200/ab_1191_bill_20030603_amended_asm.html).

<sup>55</sup> Assembly, History of Assembly Bill 1191 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab\\_1151-1200/ab\\_1191\\_bill\\_20030929\\_history.html](http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab_1151-1200/ab_1191_bill_20030929_history.html).

<sup>56</sup> Senate Committee on Insurance, Introduction of Senate Bill 150 (2005-2006 Reg. Sess.): [http://www.leginfo.ca.gov/pub/05-06/bill/sen/sb\\_0101-0150/sb\\_150\\_bill\\_20050207\\_introduced.html](http://www.leginfo.ca.gov/pub/05-06/bill/sen/sb_0101-0150/sb_150_bill_20050207_introduced.html).

<sup>57</sup> Senate Committee on Insurance, Analysis of Senate Bill 150 (2005-2006 Reg. Sess.): [http://www.leginfo.ca.gov/pub/05-06/bill/sen/sb\\_0101-0150/sb\\_150\\_cfa\\_20050421\\_093151\\_sen\\_comm.html](http://www.leginfo.ca.gov/pub/05-06/bill/sen/sb_0101-0150/sb_150_cfa_20050421_093151_sen_comm.html).

<sup>58</sup> Senate Committee on Insurance, Amendments to Senate Bill 150 of April 4, 2005, May 4, 2005, and June 16, 2005 (2005-2006 Reg. Sess.): [http://www.leginfo.ca.gov/pub/05-06/bill/sen/sb\\_0101-0150/sb\\_150\\_bill\\_20050616\\_amended\\_asm.html](http://www.leginfo.ca.gov/pub/05-06/bill/sen/sb_0101-0150/sb_150_bill_20050616_amended_asm.html).

<sup>59</sup> Senate Committee on Insurance, History of Senate Bill 150 (2005-2006 Reg. Sess.): [http://www.leginfo.ca.gov/pub/05-06/bill/sen/sb\\_0101-0150/sb\\_150\\_bill\\_20050930\\_history.html](http://www.leginfo.ca.gov/pub/05-06/bill/sen/sb_0101-0150/sb_150_bill_20050930_history.html).

<sup>60</sup> Assembly Committee on Insurance, History of Assembly Bill 1640 (2005-2006 Reg. Sess.): [http://www.leginfo.ca.gov/pub/05-06/bill/asm/ab\\_1601-1650/ab\\_1640\\_bill\\_20050920\\_history.html](http://www.leginfo.ca.gov/pub/05-06/bill/asm/ab_1601-1650/ab_1640_bill_20050920_history.html).

Any insurer who issues a policy of insurance covering residential property, if it reports claims history or loss experience to an insurance-support organization, to provide the insured, within a certain period, with a specified disclosure regarding contacting the claims information database, and to include the disclosure in the California Residential Property Insurance Bill of Rights.<sup>61</sup>

The specific language added to the Insurance Code can be found in § 791.28.<sup>62</sup> This section of the Code provides additional protection to consumers, as they will be notified when their loss information is submitted to an insurance-support organization, so they can make any necessary corrections to the information before an adverse underwriting decision occurs.

### **NO CURE TO DATE**

As the holding in *Garamendi* and legislative bills enacted to date show, insurers still retain the ability to use prior loss history in underwriting decisions, with some limited exceptions. The DOI and consumer advocates argue that such use of prior loss data poses a serious threat to the “availability” and “affordability” of homeowners insurance in California. The legislative bills that have been enacted to date do little to solve the problem. At most, they provide insurers with notice of reports sent to insurance-support organizations and, more significantly, prevent insurers from using coverage inquiries alone as a basis for adverse underwriting decisions and require renewal offers to be offered after destruction of an insured premise caused by a disaster. The question becomes, what limitations should be placed on insurance carriers’ ability to use prior loss data in the future, especially when the prior losses have been fully remedied?

### **AVAILABLE CURES**

Two states have taken the lead on regulating the use of prior loss data in underwriting decisions: Louisiana and Texas. The Louisiana Legislature enacted § 635.3(C) and § 636.2(D) of its Insurance Code to limit insurance carriers’ ability to use prior loss data in renewal and deductible determinations. The sections state, in pertinent part:

§ 635.3(C): No insurer providing property, casualty, or liability insurance shall cancel or fail to renew a homeowner's policy of insurance or to increase the policy deductible that has been in effect and renewed for more than three years unless based on nonpayment of premium, fraud of the insured, a material change in the risk being insured, two or more claims within a period of three years, or if continuation of such policy endangers the solvency of the insurer. This Subsection shall not apply to an insurer that ceases writing homeowner's insurance or to policy deductibles increased for all homeowners policies in the state.<sup>63</sup>

§ 636.2(D): No insurer providing property, casualty, or liability insurance shall cancel or fail to renew a homeowner's policy of insurance or to increase the policy deductible that has been in effect and renewed for more than three years unless based on nonpayment of premium, fraud of the insured, a material change in the risk being insured, two or more claims within a period of three years, or if continuation of such policy endangers the solvency of the insurer. This Subsection shall not apply to an insurer that ceases writing homeowner's insurance or to policy deductibles increased for all homeowners' policies in the state. For the purposes of this Subsection, an incident shall be deemed a claim only when there is a demand for payment by the insured or the insured's representative under the terms of the policy. A report of a loss or a question relating to coverage shall not independently establish a claim.<sup>64</sup>

These statutes limit insurers’ ability to use an insured’s prior loss history in nonrenewal and deductible determinations, when the insured has been insured with the carrier for more than three

<sup>61</sup> Assembly Committee on Insurance, Enrollment of Assembly Bill 1640 (2005-2006 Reg. Sess.): [http://www.leginfo.ca.gov/pub/05-06/bill/asm/ab\\_1601-1650/ab\\_1640\\_bill\\_20050831\\_enrolled.html](http://www.leginfo.ca.gov/pub/05-06/bill/asm/ab_1601-1650/ab_1640_bill_20050831_enrolled.html)

<sup>62</sup> CAL. INS. CODE § 791.28 (Deering 2007).

<sup>63</sup> LA. REV. STAT. ANN. 22:635.3(C) (2007).

<sup>64</sup> LA. REV. STAT. ANN. 22:636.2(D) (2007).

years. Insurance carriers can use the prior loss data only in those situations where the insured has filed two or more claims within a three year period. The language found in these statutes is very similar to that found in SB 1474, which, as notated above, failed to pass in the Assembly, and SB 1323, also notated above, which was amended to take out the language pertinent to the issues at hand. Further, § 636.2(D) limits the use of coverage inquiries and certain uncovered claims, as underwriting criterion, which is similar to § 719.12 of the California Insurance Code, which was enacted by AB 1049.

The notable language of these statutes pertains to their limitations, especially the language stating they do not apply to situations where the insurers' solvency is threatened, where the insurers cease to write homeowners policies in the state, or where the deductible increases apply to all homeowners insurance policies in the state. These exceptions, in conjunction with the fact that insurers are not prohibited from increasing rates, appear to undermine the arguments against such legislation. As noted above, opponents to SB 1474 and SB 1323, argued that the acceptance of such law would lead to higher insurance rates for two reasons: first, "it would require insurers to accept and retain applicants and policyholders with high loss frequencies at the expense of other policyholders," and second, it would reduce "the availability of homeowners' insurance by discouraging companies from entering or remaining in the homeowners' insurance market in California."<sup>65</sup> Further, opponents to SB 1323 argued "the bill creates a disincentive for insurers to do business in the state [and] makes it difficult for insurers to manage their risk."<sup>66</sup> State Farm posited a strong argument against the Bill:

SB 1323 is, in effect, a "take all comers" rule and that it "virtually" treats all risks the same. Past claims are a valid predictor of future losses. "For example, the goal of insurance is for the average policy holder to have a relative loss ratio of 100%. Policy holders with two or more claims have a relative loss ratio of 156.4%. SB 1323 would require the policy holders with no or only one claim to pay higher rates to cover those policy holders with two claims in two years. This bill...ignore[s] the economic reality of insurance."<sup>67</sup>

If the California Legislature proposed a Bill that includes language similar to that found in the Louisiana statutes, the opponents' arguments would be invalidated for two reasons: first, insurers could not argue that "it would require insurers to accept and retain applicants and policyholders with high loss frequencies at the expense of other policyholders" because rates could be adjusted for the increased risks. Second, insurers could not argue that such legislation would reduce "the availability of homeowners' insurance by discouraging companies from entering or remaining in the homeowners' insurance market in California" because they would be protected from having to "take all comers" in situations where acceptance would threaten the insurers' solvency or where the insurers stopped writing such policies throughout the state. Further, insurers would retain the right to charge appropriate premiums for the underlying risks. If the insured can not afford the premiums, then they, in effect, must choose to nonrenew.

Louisiana's statutes do not provide the level of consumer protection most consumer advocates would like, but they do strike a balance between the insureds and insurers. The balance appears to be between "availability" and "affordability" of homeowners insurance. Under Louisiana's statutes, consumers are afforded more protection in the "availability" of insurance, if they have been insured with the same insurer for more than three years, but very little protection in the "affordability" of insurance. If this compromise is something attainable in California, should it be pursued? Or, should consumers continue to advocate for greater

<sup>65</sup> Senate Committee on Insurance, Analysis to Senate Bill 1474 (2003-2004 Reg. Sess.): [http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb\\_1451-1500/sb\\_1474\\_cfa\\_20040503\\_171625\\_sen\\_comm.html](http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb_1451-1500/sb_1474_cfa_20040503_171625_sen_comm.html).

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

protection in both “affordability” and “availability?” Based on the legislative history of Bills introduced in California on the subject, it appears there just is not enough support in the Legislature to pass a comprehensive cure to the “use it and lose it” problem. Therefore, maybe a compromise is necessary in order to offer consumers *more* protection than they currently have.

Texas also took steps to cure the “use it and lose it” problem. Texas enacted a statute similar to Louisiana’s in 2005: § 551.107 of the Texas Insurance Code. Section 551.107 states:

551.107. RENEWAL OF CERTAIN POLICIES; PREMIUM SURCHARGE AUTHORIZED; NOTICE.

- (a) This section applies only to a standard fire, homeowners, or farm or ranch owners insurance policy.
- (b) A claim under this section does not include a claim:
  - (1) resulting from a loss caused by natural causes;
  - (2) that is filed but is not paid or payable under the policy; or
  - (3) that an insurer is prohibited from using under Section 3, Article 5.35-4.
- (c) An insurer may assess a premium surcharge at the time an insurance policy is renewed if the insured has filed one or more claims in the preceding three policy years. The amount of the surcharge must be based on sound actuarial principles.
- (d) Subject to Subsection (e), an insurer may refuse to renew an insurance policy if the insured has filed three or more claims under the policy in any three-year period.
- (e) An insurer may notify an insured who has filed two claims in a period of less than three years that the insurer may refuse to renew the policy if the insured files a third claim during the three-year period. If the insurer does not notify the insured in accordance with this subsection, the insurer may not refuse to renew the policy because of claims. The notice form must:
  - (1) list the policyholder's claims; and
  - (2) contain the sentence: "The filing by you of another claim, except for a claim resulting from a loss caused by natural causes, a claim filed but not paid or payable under the policy under which it was filed, or an appliance-related claim that we are prohibited from using under Section 3, Article 5.35-4, Texas Insurance Code, could cause us to refuse to renew your policy."
- (f) In this section, "premium surcharge" means an additional amount that is added to the base rate. the term does not include a reduction or elimination of a discount previously received by an insured, reassignment of an insured from one rating tier to another, re-rating an insured, or re-underwriting an insured by using multiple affiliates.
- (g) The commissioner shall adopt rules as necessary to implement this section.<sup>68</sup>

Section 551.107 exhibits a similar, but distinct, compromise between insurers and insureds. The statute offers more comprehensive protection for insureds compared to the Louisiana statutes. The statute prohibits insurers from nonrenewing based on prior losses, unless there have been three in the past three years; more than Louisiana’s statutes require. If the California Legislature proposed a bill with language similar to that found in the Texas statutes, the opponents of such legislation would have little to argue about. First, insurers could not argue that “it would require insurers to accept and retain applicants and policyholders with high loss frequencies at the expense of other policyholders” because rates could be adjusted for the increased risk, so long as the claim or claims were filed within the preceding three years. Second, insurers could not argue that such legislation would reduce “the availability of homeowners’ insurance by discouraging companies from entering or remaining in the homeowners’ insurance market in California” because they would be able to charge appropriate premiums for the underlying risks. Further, such a statute allows insurers to nonrenew if the insured has filed three or more claims in the past three years, protecting the insurers’ arguable interest in maintaining profitable policies. The Texas statute, like the Louisiana statutes, expressly limits the definition of “claim,” affording more protection for insureds. However, the Texas statute provides an insurer “may” provide notice to the insured after the insured files two claims in less than a three year duration, so as to advise them that the insurer may refuse to renew the policy if the insured files a third claim in

<sup>68</sup> TEX. INS. CODE ANN. § 551.107 (Version 2006)

less than a three year period. The greatest difference between the two states' statutes is that the Texas statute does not require the insured to have been insured with the insurer for more than three years to be offered the protections. Therefore, all insureds are protected from the unfair and discriminatory use of prior loss data.

The Texas statute appears to have stricken a balance between the insureds and insurers in both the "availability" and "affordability" of homeowners insurance. On the one hand, insurers are offered greater protection in having available insurance, as their policies must be renewed unless they have filed three or more claims in three years. The insurers, on the other hand, can assess a premium surcharge if the insured has filed one or more claims in the preceding three year period. The surcharge cannot be based on inquiries and certain losses that do not fit within the narrow definition of "claim" under the statute, providing insureds more protection in the "affordability" of homeowners insurance.

The Louisiana statutes and the Texas statute provide more protection for consumers than California statutes provide Californians. As discussed above, the Texas statute appears to offer more protection to insureds in both the "availability" and "affordability" of insurance, as compared to Louisiana. However, both provide models of how compromises can be made in California between insureds and insurers on proposed legislation. As noted above, it appears that such a compromise may be necessary to afford California consumers greater protection in the "affordability" and "availability" of homeowners insurance.

### CONCLUSION

One thing is certain: insurance regulation is needed to help stabilize the market conditions causing problems in the "availability" and "affordability" of homeowners insurance coverage. The market has become "hard," or in other words, premiums for insurance have risen and insurers have tightened their underwriting guidelines.<sup>69</sup> A "soft" market is identified by "an increased capacity to underwrite insurance business resulting in increased availability and affordability of insurance."<sup>70</sup> What is needed is regulation that will smooth the overall market so there is neither too "hard" nor too "soft" of a market. "Successful insurance regulation helps stabilize the underwriting cycle so there are less hills and valleys. However, since the insurance industry is not immune to the market forces of the state, national, or world economies, *this is a very difficult challenge and oftentimes a very precarious balancing act.*"<sup>71</sup> The question remains, how do we balance the interests of insureds and insurers in California?

---

<sup>69</sup> California Department of Insurance, Consumer Communications Bureau, "Homeowner's Insurance Market," pamphlet (2003).

<sup>70</sup> *Id.*

<sup>71</sup> *Id.* (emphasis added).