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REPORT OF THE MARKET CONDUCT EXAMINATION OF THE RATING AND UNDERWRITING PRACTICES, AS THEY RELATE TO LAWS OTHER THAN CIC § 790.03, OF THE

CALIFORNIA FAIR PLAN ASSOCIATION

AS OF JANUARY 30, 2020

ADOPTED ON APRIL 27, 2021

STATE OF CALIFORNIA



**CALIFORNIA DEPARTMENT OF INSURANCE
MARKET CONDUCT DIVISION
FIELD RATING AND UNDERWRITING BUREAU**

NOTICE REGARDING CONFIDENTIALITY

The provisions of Section 735.5(a), (b), and (c) of the California Insurance Code describe the Commissioner's authority and exercise of discretion in the use and/or publication of any final or preliminary examination report or other associated documents. Section 12938(b)(1) of the California Insurance Code requires the publication of certain legal documents and examination reports.

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FOREWORD

This report is written in a “report by exception” format. This report does not present a comprehensive overview of the Association’s practices. The report contains only a summary of pertinent information about the lines of business examined and of the non-compliant or problematic activities or results that were discovered during the course of the examination, along with the Association’s proposals for correcting the deficiencies.

This report contains only alleged violations of laws other than CIC § 790.03 that were alleged during the examination. While this report contains alleged violations of law that were cited by the examiner, violations of CIC § 790.03 or other laws not cited in this report may also apply to any or all of the non-compliant or problematic activities that are described herein.

All unacceptable or non-compliant activities may not have been discovered. Failure to identify, comment on, or criticize non-compliant activities in this state or other jurisdictions does not constitute acceptance of such practices.

Alleged violations identified in this report, any criticisms of practices, and the Association’s responses, if any, have not undergone a formal administrative or judicial process.

SCOPE OF THE EXAMINATION

Under the authority granted under the California Insurance Code (CIC) Part 2, Chapter 1, Article 4, Sections 730, a targeted examination was made of the rating and underwriting practices and procedures in California of the **CALIFORNIA FAIR PLAN ASSOCIATION**, hereinafter also referred to as either the FAIR Plan, CFPA or the Association. The California Department of Insurance will be referred to as the Department.

This targeted examination covered the CFPA's practices and procedures related to its non-renewal, cancellation and declination practices for its dwelling fire book of business, and its application of brush rates on commercial policies. The examination was made to determine, in general, if these and other operating procedures of the Companies conform to provisions of the California Insurance Code (CIC), the California Code of Regulations (CCR), and other applicable insurance law. This exam did not include a review of any of CFPA's claim files or cover CFPA's claims handling practices and/or procedures.

The examination was conducted in-house at the Department's Sacramento office.

EXECUTIVE SUMMARY

Due to the high number of non-renewals initiated by the FAIR Plan in recent years, a targeted examination of the Association's termination and declination practices in the dwelling fire line of business was performed. The examination also sought to verify whether the Association was using unfiled brush rates in its commercial fire program. The examination included a review of dwelling fire policies that were cancelled, non-renewed, or declined during the period of January 1, 2016 and June 30, 2019. In the commercial fire program, the Department targeted brush rates that had been used between January 25, 2012 and January 30, 2020. The examiner reviewed 203 dwelling fire policies and 70 commercial fire policies. Within the scope of this report, five general practices were alleged as being in violation of California law. To date, a total of \$5,332 in premium has been returned to consumers as a result of this examination.

The areas of non-compliance identified in this examination included the use of unfiled brush rates in the commercial fire program. In the dwelling fire program, the use of vague and non-specific underwriting guidelines, inconsistency in the processing of rescissions and basing eligibility decisions on non-risk-based criteria in terms of unrelated prior property damage were identified as areas of non-compliance. Details regarding the examination results are provided in the final section of this report.

METHOD OF DOING BUSINESS

The California FAIR Plan Association operates as a joint reinsurance association issuing commercial and personal property policies on behalf of its member insurers. FAIR is an acronym for Fair Access to Insurance Requirements. The purpose of the CFPA is to provide specified property insurance coverages to individuals and businesses in areas where insurance traditionally has been hard to obtain in the voluntary market. The FAIR Plan does not have any appointed agents and accepts business from licensed insurance brokers or directly from consumers. Underwriting and processing occur at the FAIR Plan's facility located in Los Angeles, California.

DESCRIPTIONS OF DWELLING AND COMMERCIAL FIRE
UNDERWRITING PROCESSES

The California FAIR Plan Association examination was limited to a review of Dwelling Fire and Commercial Fire business.

Dwelling Fire

The dwelling fire program administered by the FAIR Plan offers one policy that provides coverage on a named peril basis. Consumers can also purchase extended coverage, such as windstorm or hail and vandalism, as optional coverages. A policy can be written on an actual cash value basis or a replacement cost basis for those properties (excluding trailer/mobile homes) with an eligible roof and the purchase of the inflation guard endorsement. The FAIR Plan does not offer extended replacement cost or guaranteed replacement cost. The dwelling fire policy insures any building with four or fewer units used exclusively for dwelling purposes including trailers, mobile homes and floating homes. Eligible properties are defined as those properties which meet the eligibility guidelines and that are deemed insurable subject to either an exterior or interior inspection to ensure that the condition of the property meets reasonable underwriting standards.

The CFPA maintains inspection guidelines for its Dwelling Fire new business policies which determine whether an observational (exterior only) or a complete interior/exterior (habitational) inspection is required. The guidelines are based on whether the dwelling is owner occupied or tenancy/seasonal occupied, the age of the dwelling, whether the policy is written on an actual cash value basis or replacement cost basis. Other criteria used to evaluate inspection necessity is whether the dwelling is vacant, prior losses or loss frequency, content only policy and renovation status.

Currently insured properties that are identified to be in substandard condition are given the opportunity to have any deficiencies noted on the inspection report remedied prior to the end of the policy period. If proof of needed repairs is not received by CFPA within the requested time period, a notice of non-renewal is sent to the policyholder. Properties that are found to have prior damage or are not in good condition, when stated to the contrary on the application, are cancelled for material misrepresentation.

Commercial Fire

The commercial fire program administered by the FAIR Plan offers one commercial fire policy. Eligible risks include buildings with five or more habitational units, commercial properties, and residential and commercial buildings under Course of Construction. All commercially rated properties are inspected. A brush survey report is ordered as well if the risk is located in an ISO designated brush area to determine fuel proximity from the insured structure and to verify Public Protection Class, a ranking of a community's fire protection system, and roofing material type. Risks that are in brush areas are required to have a brush survey redone every five years.

DETAILS OF THE CURRENT EXAMINATION

The following sections of the report provide summary information regarding the policy file review, and regarding the statutes and regulations that were cited during the examination.

SAMPLE FILES REVIEWED

A sample of 203 files was selected from the CFPA's listing of 29,785 non-renewed, canceled or declined dwelling fire policies. In addition, a sample of 70 policies was selected from a listing of 259 commercial fire policies which included brush endorsements. The terminated and declined dwelling fire sample was reviewed to determine if the Association was properly and consistently applying its eligibility determination and underwriting procedures. The commercial fire sample was reviewed to determine if the Association was properly adhering to the rating plans, forms, and underwriting rules filed with the Department.

CFPA SAMPLE FILE REVIEW		
LINE OF BUSINESS / CATEGORY	NUMBER OF FILES IN POLICY RUN	NUMBER OF FILES REVIEWED IN POLICY SAMPLE
Dwelling Fire		
Non-renewals	16,439	68
Cancellations	4,721	67
Declinations	8,625	68
TOTALS	29,785	203
Commercial Fire		
Brush & Building	259	70
TOTALS	259	70
<u>TOTALS</u>	30,044	273

SUMMARY OF RELEVANT LAWS

The table below identifies the provisions of the California Insurance Code (CIC), the California Code of Regulations (CCR), or other pertinent law for which violations were alleged or to which reference was made during the examination. A total of two laws were cited based on the Association's practices as observed during the examination. Each law listed on the following table may be due to a general practice which affects many policyholders. One practice can also violate multiple laws.

	Code Citation	Description of Law
1.	CIC Section 10094	The program administered by the California FAIR Plan Association may also provide, with the approval of the commissioner, for assessment of all members in amounts sufficient to operate the facility, and may establish maximum limits of liability to be placed through the program, reasonable underwriting standards for determining insurability of a risk, and commission to be paid to the licensed producer designated by the applicant.
2.	CIC Section 10100.2(a)(1)	Rates for the FAIR Plan shall not be excessive, inadequate, or unfairly discriminatory, and shall be actuarially sound so that premiums are adequate to cover expected losses, expenses and taxes, and shall reflect investment income of the plan. If the plan returns premiums to members annually, the rates shall not include any component relating to surplus enhancements.

SUMMARY OF EXAMINATION RESULTS

During the CFPA examination, five general practices were alleged to be in violation of California law within the scope of this report. In response to each of the Department's allegations of non-compliance, the Association was required to identify remedial or corrective action that was or will be taken to correct the deficiency.

Regardless of actions taken or proposed by the CFPA in this report, it is the CFPA's obligation to ensure that compliance with California law is maintained continuously.

To date, a total of \$5,332 in premium has been returned to consumers as a result of this examination. CFPA's implementation of corrective actions based on this examination will continue to be reviewed by the Field Rating and Underwriting Bureau.

Dwelling Fire

1. The review of policies that were terminated for cause found that CFPA was non-renewing policies for deficient property conditions. The Association's underwriting guidelines did not contain specific criteria as to what was considered acceptable vs unacceptable property condition. Properties determined by CFPA to have sub-standard conditions at the time of inspection were subject to termination unless all of the deficiencies had been corrected prior to renewal. CFPA's underwriting guidelines, Edition August 1, 2017, list broad categories of items which may make the condition of the property ineligible. Those conditions include the "physical condition of the property, its present use or housekeeping or other characteristics of ownership, condition, occupancy or maintenance which are in violation of public policy and result in unreasonable exposure to loss". CIC Section 10094 provides that the Association's underwriting standards must be reasonable.

In reviewing the policies that were terminated or declined due to substandard property conditions, it appears that the manner in which CFPA is applying its underwriting guidelines with respect to property conditions may not be related to the risk of loss exposure presented under the coverage provided. Additionally, the underwriting guidelines are overly broad and not specific enough to objectively describe which property conditions or housekeeping deficiencies are sufficiently material to warrant termination of coverage. The over-breadth of the underwriting guidelines allows for differing interpretations and underwriter subjectivity, which may result in inconsistency in the underwriting process and unfair discrimination, in violation of California law. Deficiencies used to justify non-renewals, as communicated in letters to insured, included, but were not limited to, requirement to

paint fascia boards, address peeling paint, yard trimming, cracked shower door, worn floor in laundry room, excessive yard clutter and rubbish, and a single broken tile on roof.

These examples of deficiencies used to justify nonrenewals do not appear to present an unreasonable increase to exposure to loss as would be expected under “reasonable underwriting guidelines”. While many of the unacceptable conditions noted from inspection reports were related to fire exposure such as the requirement for trees or shrubbery to be located 10 feet away from the dwelling, and items concerning fire safety such as gas stove ventilation requirements, other property conditions cited as unacceptable by the CFPA have not been shown to present an unreasonable loss exposure and appear to be outside the coverage provided by the current CFPA policy. The CFPA, in responding to examiner questions, has not provided any support for its argument that these items create an unreasonable exposure to loss.

As an example, eight non-renewals were due in part or completely to excess clutter, litter or rubbish in the yard. Yard clutter is an ambiguous definition as some underwriters could determine that old patio furniture, barbecue grills and children’s toys can be construed as clutter. However, allowing such items to be used as a justification for non-renewal is not a reasonable underwriting guideline as these items do not necessarily present any additional fire exposure than newer outdoor furniture and toys which would be routinely found in everyday backyards.

Additionally, CFPA’s response to this scenario in one of the non-renewals was that it considered properties in areas with a higher risk of wildfire to also have a higher risk of loss for personal property left out in the open. However, this approach does not address the fact that the items are similar to other backyard items in terms of exposure and no data was provided to support the claim that the exposure is increased. Finally, it appears that the CFPA is placing a higher burden on insureds whose dwellings are located in areas with a higher risk of wildfire. The CFPA underwriting guidelines provide, however, the location of insured property is to have no bearing upon its insurability, as it is beyond the control of the insured. Although the review noted that excessive rubbish and debris was a common deficiency noted in inspections and was not limited to properties in high wildfire areas, CFPA’s justification that outdoor items located adjacent to a property in a high wildfire area, whether clutter or patio furniture, created a higher fire exposure to the insured property is tantamount to using location for eligibility.

CIC Sections 10094 and 10100.2(a)(1)

Summary of Association Response: CFPA responded that it has minimal underwriting standards and does not take the location or the property’s exposure to wildfire into consideration. However, it does maintain reasonable underwriting standards with respect to property insurability. The CFPA disagrees that there needs to be a relationship between substandard property conditions and the perils covered under the CFPA policy. If a property is not adequately maintained, then it presents a greater exposure to loss than a property that is well maintained.

As to the Department's contention that the underwriting guidelines are overly broad and allow for the possibility of underwriter subjectivity and interpretation, CFPA stated its intention is to allow its underwriters broad flexibility in using their judgment to determine whether a property's condition is acceptable enough to be insurable. CFPA stated that the lack of concrete guidelines enables the CFPA to minimize the number of non-renewals by allowing underwriters the discretion to determine eligibility.

The CFPA agrees with the Department's concerns that missing or peeling paint, unmaintained yards, broken shower doors and worn flooring are not justifications for non-renewal and will train its underwriters on these issues. However, CFPA maintains that excessive clutter or rubbish in the yard presents a higher risk of fire loss, which is within the insured's control to mitigate. However, to address the Department's concerns, CFPA agrees to revise its underwriting guidelines to be more specific and objective to ensure consistency in the eligibility determination process. CFPA maintains that the new guidelines will continue to allow for underwriting judgment in the establishment of insurable property conditions. CFPA will conduct regular reviews and periodic training to ensure that its underwriters are making consistent eligibility decisions based upon individual judgment.

Summary of Department's Evaluation of Association Response: Although CFPA agreed to revise its guidelines to be more specific and objective, the Association has not provided the Department with a copy of the revised guidelines or examples of property conditions where individual judgment would need to be utilized. At the time of this report, this issue was unresolved and may be referred for administrative action.

2. CFPA guidelines state that dwellings with unrepaired damage are not insurable. Any application submitted which states there is unrepaired damage is automatically declined. There is no distinction made between damage that would be covered under CFPA's current policy and damage caused by water, theft or liability which are not covered under CFPA's current policy. The applicant/insured must provide proof that any dwelling with unrepaired damage has been completely repaired in order for a dwelling policy to be written/renewed. All damaged items (even if the repair is covered under the CFPA policy) must be repaired within a 90-day window or have a signed and executed repair order on file.

The review found four applications that were declined due to the property having unrepaired damage as stated on the application. An additional two policies had been non-renewed due to unrepaired damage. There was no further assessment into what type of damage existed, its cause and whether it was covered under CFPA's current policy. For instance, one of the non-renewals was due to water damage which is not covered by CFPA. If for instance, there was damage due to a leaking toilet, the resulting interior damage would likely have no impact on the fire exposure to the property. Pursuant to current law, the CFPA's underwriting standards must be reasonable and used only for the purpose of determining the insurability of risks.

CIC Section 10094

Summary of Association Response: CFPA stated that it believes it is a reasonable underwriting guideline to decline risks with any unrepaired damage, whether or not the damage would be covered by the CFPA. Since maintenance of the property is within the control of the property owner/insured, a property in poor condition poses a greater risk of loss for a number of reasons, including providing an incentive for the insured not to protect the property from any future loss. The Association maintains that property with unrepaired damage that has not been repaired reflects unacceptable care and maintenance of the property regardless of the peril causing the damage. Properties with unrepaired damage are insurable as long as the insured is in the process of repairing the damage and a signed repair contract is in place. The Association believes it would be unfairly discriminatory to subject policyholders with well-maintained homes to higher premiums because of the additional risks presented by policyholders who have not repaired their homes.

Summary of Department's Evaluation of Association Response: CFPA has not provided any proof that providing coverage for dwellings with unrepaired damage not covered by the CFPA's policy form creates a higher exposure to property loss and incentivizes insureds to neglect protecting their property from further damage. At the time of this report, this issue was unresolved and may be referred for administrative action.

3. The examination found that the CFPA is inconsistent in its handling of dwellings whose inspections have revealed serious property deficiencies. In 90% of the policies reviewed, after the inspections revealed unacceptable property conditions, the policyholders were allotted time to make the needed corrections and provide CFPA with photos showing the repairs made to the property prior to the renewal date. If CFPA did not receive documentation establishing that the repairs had been made by the time the renewal was to be generated, a non-renewal notice would be sent to the insured. However, in three other circumstances, the policy was rescinded immediately after the inspection revealed deficiencies and the insured was not provided the same opportunity to make needed repairs. CFPA stated that the rescission was due to the homeowner stating on the application that there was either no unrepaired damage or that the property was in good condition. While the CFPA application does contain a box to indicate whether or not the property was in "good condition," the application does not define what constitutes "good condition" under the underwriting standards utilized by CFPA. CFPA's practice of rescinding a policy for material misrepresentation due to its assessment that the property was not in good condition as opposed to the homeowner's assessment of condition, without detailing what CFPA's expectations are for insurability, does not meet the reasonableness standard set by CIC Section 10094. Automatically rescinding some policies for unacceptable property conditions while allowing other insureds with a similar level of property defects the opportunity to repair is unreasonable and may be unfairly discriminatory pursuant to CIC Section 10100.2(a)(1).
CIC Sections 10094 and 10100.2(a)(1)

Summary of Association Response: CFPA stated that rescissions for material misrepresentation typically take place after an inspection revealed property conditions which would have rendered the risk ineligible had the property conditions been known prior to the issuance of a policy. Unrepaired damage that was not

disclosed on the CFPA dwelling application but later found at inspection would be considered a material misrepresentation. CFPA states that it believes that policyholders know the difference between a property in good condition and one that is not in good condition. CFPA is aware of circumstances where policies were non-renewed at the end of the policy term although they should have been rescinded for material misrepresentation according to CFPA's guidelines. CFPA is implementing additional training to its underwriters to ensure consistency in its rescission policies and procedures.

Summary of Department's Evaluation of Association Response: Although CFPA states that it will be providing additional training to its underwriting staff to ensure consistency in the processing of rescissions to ensure that only risks which meet eligibility standards are insured, it has not addressed what changes will be made to make the dwelling application self-disclosure of property condition more transparent and to provide specific objective characteristics that determine whether a property is in "good" vs "non-good" condition. At the time of this report, this issue was unresolved and may be referred for administrative action.

Commercial Fire

4. The examination sought to verify whether CFPA was using brush rates which had been filed with the Department in its commercial fire program. The most recent commercial fire filing containing brush rates submitted by CFPA was CDI Filing #11-10258, a form filing which was approved on February 8, 2012. The examination found that all 70 policies in the commercial sample had been rated with brush rates higher than those contained in CDI Filing #11-10258. The commercial brush rates published on CFPA's website, and in use since at least April 15, 2012, were 50% to 60% higher on average than the rates filed. The examination confirmed that CFPA was not using brush rates and rating factors contained in the CDI Filing #11-10258 correctly in rating the commercial building portion of the files sampled.

Based on review of CFPA's filings with the Department, CDI Filing #03-2172, a proposed rate filing was withdrawn on February 10, 2004. In withdrawing the filing, CFPA notified the Rate Regulation Branch that it would "continue to monitor its rate levels and experience and would make a further filing in the future should its indications warrant it." A review of CDI Filing #11-10258 indicates that it was intended to be a Form filing revising the CFPA Loss Payable Provisions form. CFPA confirmed that the Commercial Lines manual provided to the Department in conjunction with CDI form Filing #11-10258 was the rating manual in use at the time of the filing. CFPA has made consistent rate and form filings with the Department for its personal dwelling fire product, including filing rates which incorporate a risk's wildfire score into the rating plan. California law requires that the CFPA's rates not be excessive, inadequate or unfairly discriminatory, and be actuarially sound. CFPA has not yet proposed a plan of remediation for those policyholders affected over the time period the excessive rates were in use.

CIC Section 10100.2(a)(1)

Summary of Association Response: CFPA stated that it has never been subject to Proposition 103 and the requirement to have its rates filed and approved by the Commissioner. CFPA adheres to the rate setting statutes in CIC Section 10100.2. CFPA was not required to file its rates or have its rates approved until the most recent amendments to the FAIR Plan's Plan of Operation in May 2019. While the FAIR Plan frequently filed its rates, it was not required to do so. Accordingly, CFPA respectfully disagrees that its use of unfiled brush rates was improper. CFPA also disagrees that the use of these rates is a violation of CIC Section 10100.2(a)(1), which requires that the FAIR Plan's rates not be excessive, inadequate or unfairly discriminatory, and be actuarially sound. CFPA maintains that the brush rates used, whether filed or not, were not excessive, inadequate or unfairly discriminatory, and were actuarially sound. As such, CFPA disagrees that any premium refunds are due to policyholders. However, CFPA has submitted its revised brush rates to the Department for review and agrees to use filed and approved rates in the future as stipulated in the current Plan of Operation.

Summary of Department's Evaluation Association Response: Based upon CFPA's history of making required rate and form filings with the Department for both its commercial and dwelling fire programs, along with its stated commitment on February 10, 2004 to file its commercial rates with the Department if a rate increase was needed, the Association was well aware of the requirement to file the revisions to its commercial brush rates so that the Commissioner can ensure CFPA's rates do not violate CIC 10100.2(c). Accordingly, the examination confirmed that since at least January 25, 2012, CFPA has been using unfiled rates which are approximately 50% higher than those previously filed with the Department. Such action is in violation of CIC Section 10100.2(a)(1) which requires rates used by CFPA to not be excessive, inadequate, or unfairly discriminatory and to be actuarially sound. CFPA's prior history of rate filing communications with the Department contradicts its claims that it does not believe it was required to file its rates with the Commissioner. At the time of this report, CFPA has not offered a remediation plan for policyholders who were overcharged, therefore this issue was unconsidered unresolved and may be referred for administrative action.

5. The examination found three instances where incorrect brush surcharges were applied to policies. The amount of return premium generated by the three policies was \$5,332. Brush rates are determined based upon the commercial brush survey which outlines brush proximity from the insured building, protection class, and type of roof covering. Risks must be re-evaluated for brush proximity every five years. In the three policies identified, the brush survey confirmed a different brush proximity which warranted a brush rate change or the removal of the brush surcharge altogether. CFPA staff, however, did not review and update the policy rating with the necessary brush rate revisions which led to the application of excessive rates. CIC Section 10100.2(a)(1)

Summary of Association Response: CFPA corrected and re-rated the three policies identified by the examiner. Additionally, CFPA agrees to review the relevant commercial book of business at each policy renewal to ensure that the correct brush rates are being charged. The review will also include any policies that have

canceled or non-renewed in the last three years. If any policies are determined to be rated inaccurately, CFPA will issue retroactive refunds to the policyholder going back to the date any incorrect charge was applied to the policy, as confirmed by policy documents, for all affected policy terms. The refunds will include interest at 10%. CFPA will provide the Department with a list of policies identified along with the total amount of return premium refunded on a quarterly basis until the project is completed on June 30, 2022. CFPA will also provide additional training to its staff on the careful review of inspection reports to prevent the application of improper brush rates in the future. CFPA will continue to conduct periodic audits of inspection reports to ensure that any changes noted are acted upon promptly by CFPA staff.