March 20, 2024

The Honorable Ricardo Lara
Commissioner of Insurance
California Department of Insurance
300 Capitol Mall, 17th Floor
Sacramento, CA 95814
via email: commissionerlara@insurance.ca.gov

Re: Restoring the financial condition of State Farm General Insurance Company

Dear Commissioner Lara,

Thank you for your recent meeting with us and the candid conversation. On behalf of State Farm General Insurance Company (SFG)[1], we write to reinforce our need, and express hope and appreciation, for the role the Department of Insurance must play in our financial recovery, to the benefit of California consumers.

As we discussed, SFG's capital position has severely deteriorated, and we are increasingly concerned about its financial well-being. SFG's policyholder surplus was $2.2 billion and $1.3 billion at year-end 2022 and 2023 respectively, in contrast to $4.1 billion at year-end 2016. Although there haven't been significant wildfire losses for several years, windstorm catastrophes in early 2023 and increasing trends in non-catastrophe water losses and liability claims (especially commercial lines and personal umbrella policies), without the additional premium needed to support those cost increases, have generated large underwriting losses. SFG has managed its policy growth by limiting writing in high-risk areas for many years, and more recently by ending all new policy sales. However, SFG's risk exposure grew tremendously in the last few years, with construction cost inflation being a major driver. Taken together, these trends have resulted in surplus of less than 50 cents for every dollar of risk (as measured by net written premium) we face today, which makes SFG's financial strength less than a quarter of what it was at year-end 2016. With that drop in surplus and increase in exposure, the company necessarily has to rely increasingly on reinsurance cover, the cost of which puts further downward pressure on surplus without the needed additional premium to support this cost.

As also noted, external measures of SFG's financial strength are also becoming increasingly concerning. AM Best already had a negative ratings outlook for SFG and continues to review the financial condition of SFG to determine if additional action is needed. At certain financial strength rating levels, acceptance of SFG policies as appropriate insurance cover for mortgage collateral may diminish. This has the potential to affect existing SFG policyholders across California. Additionally, to comply with solvency regulations, SFG is required to file a Company Action Plan by April 15th with the Illinois Department of Insurance (SFG's solvency regulator) to explain the company's plan to restore its financial condition.

[1] As a reminder, SFG is almost exclusively a California-only insurer.

As we look to continue to serve the insurance needs of Californians, we seek the Department's assistance in helping to rebuild the company's financial strength. We recognize and appreciate the positive impact of the Department's recent homeowners rate approval. Of course, the full effect of that new rate on SFG's surplus position won't begin until March 2025, since the rate is applied to policies as they renew on a rolling 12-month basis. And it's clear more rate is still needed, as market conditions have not remained static since we made our last filing supporting the recently approved increase in February of 2023. Insurance is not insulated from inflationary trends affecting goods across the entire economy. In fact, construction cost increases have been among the highest inflationary categories over the last five years. Short of emergency rate regulations being issued very soon, the limitations of CDI's current rate template may necessitate the next homeowners rate filing to rely on one or more variances. While there will undoubtedly be novel issues to work through, rapid review and approval of a new rate appropriate to the circumstances – along with all other upcoming and pending SFG rate filings – will be critical to SFG's survival, especially in light of potential intervenor delays.

As shared with the Department prior to the February 2023 filing, rate increases alone would likely be insufficient to restore SFG's financial strength. We must now take action to reduce our overall exposure to be more commensurate with the capital on hand to cover such exposure, as most insurers in California have already done. We have been reluctant to take this step, recognizing how difficult it will be for impacted policyholders, in addition to our independent contractor agents who are small business owners and employers in their local California communities. Rebuilding capital, even with higher rates, will take some time. We are striving to minimize the impact of the necessary actions that must be taken. We will continue to be transparent with you and your staff regarding these actions.

You and your Department are an indispensable part of broader market reforms that could eventually allow SFG to resume its normal place in that market. As you have pointed out, California residents are best served in the long run by a fair and well-functioning insurance market, a key component of which is that consumers bear the economic reality of the true costs to insure their property. California homeowners insurance premiums are still below the national average, and far below other disaster-prone states. We understand the impact of higher prices on consumers. At the same time, we are even more concerned with availability of insurance.

We recognize the Department's ongoing efforts to pursue implementation of your Sustainable Insurance Strategy, including the allowance for catastrophe modeling and reinsurance costs in ratemaking and improving rate filing procedures and timelines. Along with addressing the uncapped financial exposure of FAIR Plan assessments, such reforms could materially improve the health of the market, particularly if they allow for more nimble insurer pricing in response to sudden changes in market conditions. We are acutely aware of the political challenges that the actions needed to improve SFG's financial position pose to broader reform efforts. Please know that we have an ongoing desire and commitment to collaborate with you and your staff, as well as the Governor's office, to achieve these reforms as quickly as possible. We cannot overstate, and we agree with your public plea for, the need for regulatory modernization.

The swift capital depletion of SFG is an alarm signaling the grave need for rapid and transformational action, including the critical need for rapid review and approval of currently pending and future rate filings. We take very seriously our responsibility to be there for customers who experience a claim and our actions are with that goal at the fore. A financial failure of SFG will detrimentally impact the entire market, an outcome we are all trying to avoid. We look forward to working with you and your staff to rebuild the financial health of SFG and to create a firmer foundation on which this market can thrive.

Sincerely,

Denise Hardin
President and Chief Executive Officer
State Farm General Insurance Company

Mark Schwamberger
Vice President and Treasurer
State Farm General Insurance Company

Keesha-Lu Mitra
General Counsel
State Farm General Insurance Company

CC: Michael Martinez, Chief Deputy Commissioner