PROANALYSIS

WHAT YOU NEED TO KNOW ABOUT

The FAIR Plan and Wildfire Insurance

BY CAMILLE VON KAENEL AND JESSIE BLAESER | 08/02/2023 08:00:00 AM EDT

PRO POINTS

- **Insurers have been increasingly retreating from fire-prone areas in California over the past five** years after suffering billions of dollars in losses from catastrophic wildfires. Allstate and State Farm have stopped writing new policies in the state.
- **Out of options, more home and business owners are paying more for insurance. Homeowners are** increasingly signing up with a basic last-resort insurer that's become so exposed that it has warned it may not be able to cover potential losses.
- **California's voter-imposed rules have kept premiums among the lowest in the nation so far — but** insurers have also blamed those rules for adding strain to their industry.

HOW WE GOT HERE

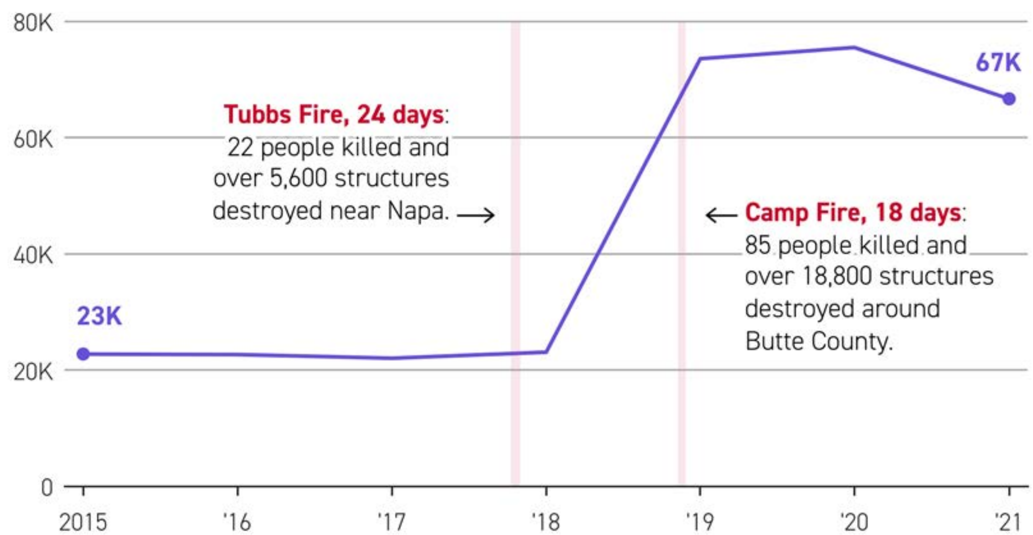
Wildfires are common nearly everywhere in California, from the Sierra Nevada foothills to the North Bay wine country to the canyons of Southern California. With new housing developments spilling over from cities into open spaces, rising temperatures from climate change and overgrown forests, the risk a spark will burn down homes has only grown. The devastating economic effects became clear in 2017 and 2018, when massive wildfires in Northern California wiped out nearly two times the combined underwriting profits for insurers in the state for the prior 26 years.

Spooked, insurers began withdrawing. They've declined to renew 40% more policies in 2021 than in 2018, according to the latest data from the California Department of Insurance. Allstate decided last year to stop writing new homeowners or commercial insurance policies in California, in part due to the wildfire risk. State Farm made a similar decision this year, attributing the decision to factors that included increases risk and higher building costs.

With fewer or no options for insurance, homeowners in fire-prone areas have had to shell out much more money for coverage, sometimes from unregulated companies. Some bills have gone up tenfold, reaching the tens of thousands a year. Some have had no choice but to sign up with the more expensive FAIR Plan, a pool of insurers required by state law to provide basic insurance as a last resort. Statewide, the total number of FAIR plan policies nearly doubled between 2018 and 2021, and new FAIR plan policies more than tripled between 2018 and 2019. The shift is concentrated in the highest risk areas. For example, the FAIR Plan's exposure in Lake Arrowhead, a mountain resort community in Southern California, went from $768 million in 2018 to $7.44 billion in 2022.

New FAIR Plan insurance policies more than tripled between 2018 and 2019

Annual new FAIR Plan insurance policies



Source: California Department of Insurance, Cal Fire

Concerns about insurance affordability and availability, heightened by the state's difficult housing market, have gained political traction and fueled campaign races. But insurers have said they must be allowed to raise their rates to avoid going out of business. They point to rising global reinsurance rates because of climate change. They also point to a 1988 law passed by the state's voters requiring any rate hikes to get approval from the elected insurance commissioner. The process has kept rates in California among the lowest in the U.S. but insurers say it makes it harder to operate.

WHAT'S NEXT

Lawmakers and regulators are trying to attract insurers back into the market and expand options for consumers to avoid spiraling rates as has happened in Florida.

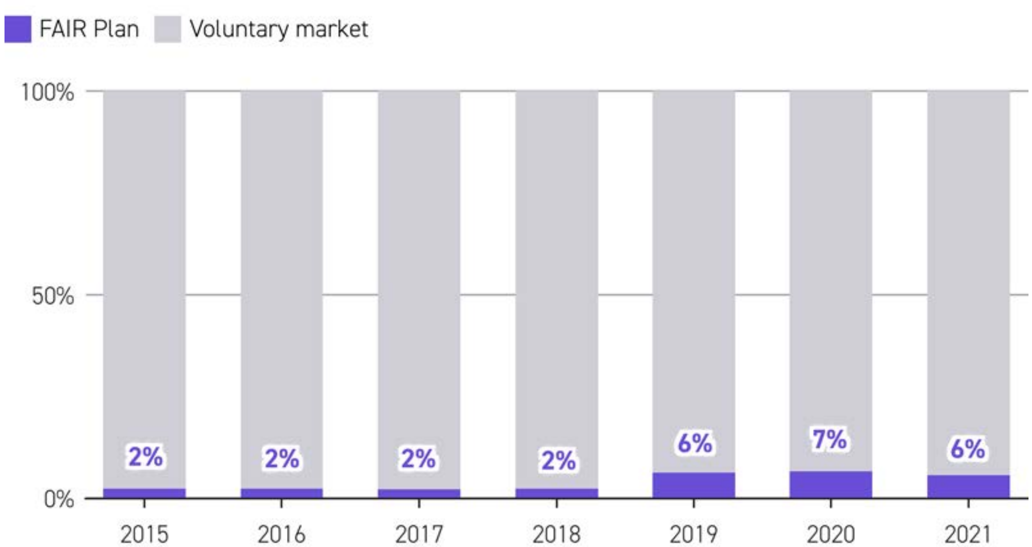
Insurance Commissioner Ricardo Lara announced he will consider letting insurers change the models they use to set rates to account for the increased danger to homes and people from climate change. Using "catastrophe models" is a long-time ask of the industry frustrated by current rules that require rate-setting based on historical data. Changing the models will likely lead to higher rates.

The department is also rolling out a new requirement for insurers to provide discounts to people who take steps to limit the risk from wildfire, such as using fire resistant building materials or clearing vegetation.

Meanwhile, lawmakers continue to pressure the insurance commissioner to require the FAIR Plan to expand its coverage. Already, the FAIR Plan has had to increase its limits to cover condominiums and homeowner associations and offer policies to farms.

By 2019, new FAIR Plan policies made up 6 percent of all new California insurance policies

New FAIR Plan and voluntary market insurance policies, shown as a percent



Source: California Department of Insurance

POWER PLAYERS

- **Ricardo Lara:** California voters elected Lara to his second four-year term as Insurance Commissioner in 2022. The job gives him discretion over insurers' request for rate hikes, as well as to adjust regulations. As a longtime Democratic official who has served in both the Assembly and Senate, Lara also holds sway with lawmakers.

- **Trade groups:** The Personal Insurance Federation of California and the American Property Casualty Insurance Association are the voices for insurers who do business in California. Representatives work closely with the Insurance Department and have spent heavily on lobbying.

- **State Sen. Susan Rubio**: As chair of the Senate Insurance Committee, she holds power over legislation and a growing crop of lawmakers interested in but new to the issue because of constituent concerns.

- **Consumer groups**: Consumer Watchdog wants Lara to do more to protect insurance policyholders and has grown increasingly at odds with the regulator. United Policyholders, a non-profit helping people recover from wildfires, has helped craft some regulations.