HOME INSURANCE EXODUS

State’s backup plan struggles

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As home insurers flee California, the state’s last-resort insurance plan is warning that it’s being pushed toward insolvency, forced to cover a rapidly growing number of properties that have lost traditional coverage and unable to collect enough in premiums to cover potential losses.

The number of homes and commercial properties in high-risk wildfire areas covered by the California FAIR Plan has more than doubled, from 154,000 in 2019 to 375,000, and liability exposure has ballooned from $50 billion in 2018 to $336 billion in February, its president told lawmakers at an insurance committee hearing recently.

“These are huge numbers,” California FAIR Plan President Victoria Roach told the committee. “And they continue to grow. … As those numbers climb, our financial stability comes more into question.”

Roach added that one bad wildfire or even a series of smaller fires could overwhelm the plan’s resources, forcing it to bill all the state’s insurers for liabilities it cannot cover, which they in turn would pass on to all their insured home and business customers as higher premiums.

“It’s a gamble,” Roach said. “We are one event away from a large assessment, there’s no other way to say it, because we don’t have a lot of money on hand, and we have a lot of exposure out there.”

The FAIR Plan’s financial instability has emerged as collateral damage from the state’s insurance market meltdown. Major carriers have discontinued or restricted coverage in recent years following a series of costly wildfires — 14 of California’s 20 most destructive wildfires burned the state in the last 10 years. That’s forced property owners who’ve lost coverage onto the FAIR Plan in rapidly growing numbers — with 1,000 applications now every work day.

Elected Insurance Commissioner Ricardo Lara last fall announced plans for a major overhaul of the state’s home insurance regulations and already has rolled out proposed new rules to speed approval of rate increases and allow computer catastrophe modeling to factor into them. Those changes are on track by the end of the year, Lara said.

But it isn't coming fast enough for both consumers and insurers. State Farm, the state's largest insurer, last year rocked the market by declaring it wouldn't issue new policies in California. The company dropped another bomb when it announced last week it will begin shedding coverage of 72,000 California homes and apartment buildings over the next year. Those customers are expected to end up on the FAIR Plan as well.

The state created the California FAIR Plan in the 1960s in response to insurers refusing to cover inner-city businesses following riots in Los Angeles' Watts neighborhood. It's a nonprofit association of all the state's authorized property insurance providers, chartered to provide temporary basic insurance for properties deemed so high risk that companies refused coverage.

The FAIR plan isn't tax supported, and its bare-bones coverage — just fire and smoke damage — is paid from policy premiums that can be much more expensive than regular insurance because the risk pool is much higher.

The plan also isn't subject to the insurance regulation under Proposition 103, the check on rates voters approved in 1988. But it is regulated by the state legislature and its rates approved by the elected insurance commissioner, though not under the review of consumer groups, which can intervene on regular policies.

Roach said that the FAIR Plan has encountered the same problems as regular insurance providers in getting policy rate increases approved to provide enough revenue to cover its risk exposure. Approvals take too long and don't allow the plan to include the cost of reinsurance — which helps insurers absorb losses — or to factor in catastrophe risk models.

"Our rates are never actuarially sound because not all of our expenses are included in that ratemaking," Roach told lawmakers. The plan must file for rate adjustments every two years, and she said its last increase requested in 2021 should have been "around 70%" but the plan asked for 48.8%. The insurance department approved only a 15.7% increase, she testified.

At the same time, the huge increase in properties needing last-resort coverage has greatly inflated the plan's risk liability.

Much of the growth in Fair Plan policies has been in inland areas, such as at Lake Arrowhead, surrounded by the San Bernardino National Forest, with $8.4 billion in risk exposure. Other high risk concentrations include Big Bear City, also in San Bernardino County, with $6.3 billion in risk exposure, Truckee, with $4.1 billion in risk exposure, Grass Valley and Sonora, each with $2.1 billion in risk exposure.

Roach said the FAIR Plan has cash on hand “somewhere in the neighborhood of $700 million.”

Michael D’Arelli, executive director of the American Agents Alliance, representing insurance agents, told the committee that the state needs to lean on the insurance commissioner to move quickly and allow traditional insurers and the FAIR Plan adequate rates.

“It’s a ticking time bomb,” D’Arelli said. “It’s worse than I think you know. You’re going to hear from a lot of angry consumers and insurance agents.”

Kim Stone, representing Consumer Watchdog, whose founder authored Proposition 103, warned that “a complete loss for FAIR Plan policies in Lake Arrowhead could amount to a $975 surcharge on every other insurance policy.” Should all the top five FAIR Plan cities suffer a catastrophic wildfire at the same time, the bill would be $3,700.

But Stone said the answer to the insurance industry’s coverage withdrawals shouldn’t be to force other policy holders to pay more, too. She suggested the state require insurers to provide coverage to homeowners who meet “home hardening” guidelines to make their properties more wildfire resistant.

“Renters and lower- and middle-income home owners with comparatively low fire risk should not be on the hook for (the costs of) rebuilding more expensive homes or even second homes in high fire-risk areas like Lake Arrowhead or Truckee,” Stone said. “We urge the committee not to force struggling families with little to no wildfire risk to pay billions to bail out the insurance company for abandoning California neighborhoods.”