California finalized its plan to ease home insurance crisis. Here's what it means for rates

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When a major wildfire hits, insurance companies call on insurance of their own — and starting next year, they'll be able to charge consumers for part of the millions of dollars they spend on it.

Insurance companies purchase reinsurance for the same reasons homeowners purchase home insurance: to have a backup pool of money to tap into in case of an overwhelming catastrophic loss. Insurers have always paid for reinsurance, but in California, they haven't been able to directly pass along that cost to their customers.

That's set to change in 2025, according to a new regulation released Monday by the California Department of Insurance. It's the final step in Insurance Commissioner Ricardo Lara's Sustainable Insurance Strategy, his plan to end California's insurance crisis.

Consumer advocates say the reinsurance reform will likely lead to immediately higher prices for consumers. But regulators have attached a condition that they believe will make the reform worthwhile for consumers. Insurance companies who pass on their reinsurance costs must also commit to writing more policies in wildfire-prone parts of the state or maintaining their current presence there.

As climate change-driven natural disasters drive up home insurance costs, reinsurance costs have risen too. Those increasing costs, and the inability to pass them on to consumers, has been a common factor cited by insurance companies leaving the state.

Some of the largest reinsurance companies are global firms subject to much less regulation than U.S.

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companies. Hurricanes in Florida or floods in Spain could cause them to raise the price of reinsurance, and therefore increase the costs to California consumers.

At a public workshop on the regulation held earlier this month, Doug Heller, director of insurance for the Consumer Federation of America, speculated that consumers could see price increases of 30%-40%.

But regulators will cap the amount of reinsurance able to be passed on at an industry standard. Companies who pay more for reinsurance than their peers will be limited in how much of that cost they can pass along.

The standard limits how much cost can be passed through and incentivizes insurance companies to focus on getting a good deal on reinsurance, according to Joel Laucher, former chief deputy insurance commissioner for the Department of Insurance and current program specialist with the consumer advocacy group United Policyholders.

The regulation only impacts rate making for residential and commercial property insurance, according to Department of Insurance Deputy Commissioner Michael Soller.

Insurance companies will be able to decide how they split up their reinsurance costs among customers with different types of risk, and regulators will review those decisions, Soller said.

Allowing insurers to pass on reinsurance costs is a concession to insurers' desires, Laucher said, but it's also a recognized cost of doing business in the marketplace. Every other state in the U.S. allows insurers to pass on the cost of reinsurance in some way.

Laura Curtis, assistant vice president of state government relations for the American Property Casualty Insurance Association, an industry group, said in a statement that the reform was critical to solving California's insurance crisis and would improve access and availability of insurance across California.

The regulation has both a stick and a carrot for insurance companies to increase the number of policies they write. Allowing insurers to pass along the cost of reinsurance will make it easier for them to write more policies in risk-prone areas, Victor Joseph, president and chief operating officer of Mercury Insurance, previously told the Chronicle.

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If insurance companies can recoup some or all of the cost of purchasing reinsurance, then they can afford to purchase more reinsurance, Joseph said. And having more reinsurance means they can safely take on more exposure without increasing their risk of running out of money should a major wildfire happen.

The regulation also has a hard requirement for insurers to write more policies. Insurers who already write a significant amount of business in wildfire-prone areas would have to maintain that presence, while those who don't would be required to write at least 5% more policies over a two-year period. Those who don't comply won't be allowed to pass on their reinsurance costs.

The reinsurance reform is set to go into effect in January 2025 alongside a separate reform that will allow insurance companies to use wildfire catastrophe models to set their prices. Lara has publicly promised consumers will see insurance become easier to find by mid-2025.

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