[California fires show states' 'last resort' insurance plans could be overwhelmed]

The Oregonian

In the months before thousands of Los Angeles homes went up in flames, property insurance companies dropped coverage in many neighborhoods of the city, citing the growing wildfire risks caused by climate change.

As a result, a fast-growing number of California residents have switched to a state-backed "last resort" insurance plan. That plan has taken on policies covering billions of dollars in some of the neighborhoods hardest hit by the fires, which have engulfed more than 12,000 structures and prompted staggering loss projections. Some experts think the plan's reserves won't be enough to cover the damage.

"They're not going to have enough money to pay these claims," said Amy Bach, executive director of United Policyholders, a nonprofit that advocates for insurance customers.

If that happens, it will trigger an assessment on every home insurance policyholder in the state to cover the outstanding claims. It's a mechanism available under some state-backed insurance plans — one that's known in Florida as the "hurricane tax." Now, for the first time, Californians may be hit with the "wildfire tax."

A single wildfire disaster could impose a surcharge of close to $1,000 on every Californian with home insurance coverage, Consumer Watchdog, a nonprofit advocacy group, told state lawmakers in March.

Some experts fear it's just the beginning of a vicious cycle in states across the country. As climate change increases the frequency and severity of disasters, experts predict, insurance companies will stop offering coverage to vast swaths of the country. State-backed "last resort" plans will take on an ever-growing number of the highest risk properties. And homeowners everywhere will get stuck with the bill when disaster strikes.

“We’re all going to be paying for the insurance industry’s unwillingness to serve in those communities,” said Doug Heller, director of insurance with the Consumer Federation of America, a research and advocacy nonprofit. “The private companies are getting all the best risk [policies] and the public holds the bag for the worst risk.”

Insurance companies have lobbied state regulators for more flexibility in setting rates and faster approvals of rate hikes. They say the market needs to keep up with the ever-growing risks caused by climate change for their business to be viable. The American Property Casualty Insurance Association did not grant an interview request by publication time.

FAIR Plans

State-backed insurance plans, known as FAIR Plans or Citizens Plans, were set up starting in the 1960s to provide coverage for homeowners who couldn’t find policies on the private market. The plans are managed by state governments, but backed financially by a pool of the private insurers doing business in that state.

Today, 35 states and the District of Columbia offer FAIR Plan policies to high-risk property owners. In many cases, those plans — often designed to cover a handful of outlier properties — are insuring hundreds of thousands of homes valued at billions of dollars. California, Florida, Louisiana, Massachusetts and North Carolina all have more than 100,000 policies insured by their state plans.

Nationwide, these state-backed plans cover nearly 3 million properties — California’s alone provides nearly half a million policies — with an exposure exceeding $1 trillion. Those numbers are only likely to grow.

“[The Los Angeles fires] will be a giant ‘I told you so’ from insurers,” Bach said. “‘This proves our point, and we just can’t continue to do business in this market.’ That’s going to be a big blow to the FAIR Plan.”

State Farm, California’s largest insurer, said last year that it could drop more than 1 million policies in the state over the next five years — a signal that private insurers’ retreat from the market could accelerate.

This month’s wildfires are likely to hasten that exit.

Because the FAIR Plan pools the private insurers doing business in California, any companies withdrawing from the market also weaken the safety net that’s meant to cover the absence of private plans.

The plan’s first big stress test is likely to be in the Pacific Palisades neighborhood of Los Angeles, which was devastated by the fires. The FAIR Plan provides nearly $6 billion of wildfire coverage in that area, among the highest totals in the state.

At present, the California plan has about $377 million available to pay claims, with another $5.75 billion in reinsurance, The New York Times reported. In a news release, FAIR Plan officials said it was too early to calculate loss estimates from the Los Angeles fires and whether the plan would have to use “payment mechanisms” to cover its claims.

Until last year, the plan’s pool of insurance companies would have been required to cover the balance of outstanding claims, based on their market share in the state. But a policy announced last July by Insurance Commissioner Ricardo Lara, a Democrat, allows insurers to surcharge their policyholders directly to cover losses over $1 billion in an “extreme worst case scenario.”

Consumer advocates say that policy was among a series of concessions made by Lara’s office, meant to induce insurance companies to continue providing policies in the state.

“That was supposed to be in return for a guarantee that insurers come back to the market, but that guarantee has not played out,” said Carmen Balber, executive director of Consumer Watchdog, a nonprofit advocacy group. “If the insurance industry has their way, one half of California will no longer be covered, and we will get to that point quickly.”

Balber noted that FAIR Plan policies still have expensive premiums and provide minimal coverage compared with private plans.

Lara’s office did not grant an interview by publication time.

Insurance company concerns

While advocates lament the increased risk borne by the public, insurance industry leaders say they can't continue to cover disaster-prone areas without damaging their companies.

"[In 2023], insurers paid $1.11 in claims and expenses for every dollar in premiums collected," Mark Friedlander, director of corporate communications with the Insurance Information Institute, said in an interview with Stateline last year. "If insurers continue to see significant underwriting losses year after year, that's going to be a determining factor in where they want to write policies."

Meanwhile, two California lawmakers have introduced a bill that would allow the state to issue catastrophe bonds to help the FAIR Plan cover shortfalls to its reserves.

Insurance experts agree that the industry is grappling with the failure of public officials to stop the worst effects of climate change and limit development in areas prone to disasters.

"Land use decision-making has been outsourced to the insurance industry," said Heller, of the Consumer Federation of America.

Private insurers are likely to continue pulling back as climate change worsens, and state-backed plans are not equipped to handle the extra risk, said Dave Jones, a former California insurance commissioner who is now director of the Climate Risk Initiative at the University of California, Berkeley's Center for Law, Energy & the Environment.

He is advocating for a federal program to provide reinsurance — a type of insurance purchased by insurers themselves to hedge against large claim payouts — for state FAIR Plans, which would provide an important backstop as private reinsurance becomes more expensive.

"We're marching steadily toward an uninsurable future, because we're not dealing with the root cause of climate change," Jones said. "Private insurers are going to act economically rationally in the face of these losses."

A 'vicious cycle'

California isn't the only state facing pressure on its "last resort" insurance plan. Florida covers nearly 1 million households on its Citizens Plan, making it the largest property insurer in the state. The state was hit by hurricanes Helene and Milton last year, which caused billions of dollars in damage across the southeastern U.S.

Lori Medders, a professor at Appalachian State University and a longtime expert on Florida insurance, said it’s unclear whether the claims paid out to hurricane survivors will require Citizens Plan to issue a “hurricane tax” on the state’s policyholders. This assessment was previously triggered after the hurricane seasons of 2004 and 2005. She said state-backed plans — even those charging massive rates — rarely collect premiums matching their exposure.

“It’s incomprehensible to charge those people the rates you need from them to cover their risk,” she said. “The more insurance [state plans] have and value at risk they have, the more exposure they have to losses. If you exacerbate that with climate change, you are putting a market problem on top of a market problem.”

Medders said increasing disasters could create a “vicious cycle” where private insurers cover fewer and fewer homes, forcing state plans to step in and hit residents with “assessment on top of assessment on top of assessment” to cover their losses.Heller said governments may need to rethink insurance as a system akin to a utility, if the market approach can no longer sustain an industry.

“The private sector approach to property insurance is starting to crack under the weight of climate change and the public can’t fill in the gaps under the existing structure,” he said.