United Policyholders
Empowering the Insured

California overhauled its insurance system. Then Los Angeles caught fire.

Grist

On Tuesday, after a ferocious Santa Ana windstorm blew through Southern California, a severe brush fire broke out in the wealthy Pacific Palisades neighborhood of Los Angeles, burning at least 1,000 structures and forcing hundreds of thousands of residents to evacuate as of Thursday morning. Another large brush fire broke out near Pasadena around the same time, killing at least two people. Together the two blazes threatened some of the most valuable homes and businesses in the United States. The damage from the Palisades Fire alone could exceed $10 billion, according to a preliminary estimate from JP Morgan.

RelatedThe unusually strong force behind the apocalyptic fires in Los Angeles
If this estimate holds true, it will test insurers' commitment to a market that has been teetering on the verge of collapse for the better part of a decade now. Over the past five years, California has become a poster child for what climate-fueled weather disasters can do to a state's home insurance market. Following a rash of historic wildfires in 2017 and 2018, insurance companies have fled the state, dropped tens of thousands of customers in flammable areas, and raised prices by double-digit percentages.

Until recently, elected officials have taken few major steps to address the crisis. But late last month, after more than a year of drafting, California's insurance commissioner unveiled a set of reforms that he claimed will bring companies back into the fold as they take effect this year.

"This is a historic moment for California," said Ricardo Lara, the state's insurance commissioner, when he revealed the rules in December. "With input from thousands of residents throughout California, this reform balances protecting consumers with the need to strengthen our market against climate risks."

The rules come after months of debate among state insurance officials, lawmakers, insurance companies, and consumer advocates. The biggest change is that California will now require many insurance companies to do more business in what the state calls "distressed areas," the fire-prone scrubland and mountain regions where insurers are now hiking prices and dropping customers. Companies will soon have to ensure that their market share in these areas is at least 85 percent of their total statewide market share — in other words, if a company controls 10 percent of the state's insurance market, it must control at least 8.5 percent of the market in fire-prone areas.

This mandate should push big companies like State Farm and Allstate to pick up customers they've dropped in flammable regions like the mountainous north of the state. Some companies have already begun to offer new policies in burned areas in anticipation of the state's new rules: the insurance company Mercury announced last week that it will be the first insurance company in the state to offer new policies in Paradise, California, which was destroyed in the catastrophic 2018 Camp Fire. The move recognizes the town's work to mitigate future fires by clearing trees and hardening homes.

The requirement to expand coverage, coupled with recent announcements from companies like Mercury, "should give consumers hope that competition and options will be returning," said Amy Bach, the head of insurance customer advocacy group United Policyholders, in a statement.

In return for this added coverage, the state is making a few big tweaks that will allow insurers to pass on the price of fire risk to their customers. California is the only state in the country that doesn't allow insurance companies to use forward-looking "catastrophe models" when they set prices. It also prohibits companies from factoring in the rising costs of reinsurance, the insurance purchased by insurance companies to ensure they're able to pay out big claims.

These two restrictions have kept prices artificially low for years, and also prevented insurers from planning for climate change impacts, creating a de facto subsidy for homeowners in risky areas.

"This addresses the major stumbling blocks that companies have been identifying for a decade, so that's a positive," said Rex Frazier, the president of the Personal Insurance Federation of California, the state's leading insurance trade group.

This trade-off has some residents in fire-prone areas worried. Insurance companies might now have to offer more policies in flammable zones, but they also have more latitude to increase prices.

"I'm not optimistic that it will improve the experience of the consumer, as the insurers can now pass certain costs onto consumers, which I'm expecting will result in higher premiums," said Jason Lloyd, who moved to mountainous Lake County last spring. He and his wife came to the area because they wanted to be closer to his wife's family, but when they made an offer on a home, they learned that they would have to pay more than $8,000 a year for insurance, or else go to the California FAIR Plan, a state-run insurance program that offers minimal coverage.

Lloyd and his wife later bought another home in Hidden Valley Lake, a town that has taken ambitious steps to reduce flammable vegetation, but their insurance premium is still more than $4,500 a year, more than triple what it was on their last home in Kansas. Lloyd is worried that his insurance company will hike his price further under the new rules.

Other states across the West, such as Colorado and Oregon, are also seeing insurance coverage gaps emerge after big wildfires, though their problems are less acute than those in the Golden State. In Colorado, for instance, officials just recently established a state fire insurance backstop like California's FAIR Plan, since it's only in the past few years that customers there have been dropped en masse. California's grand bargain with the insurance industry provides a blueprint for those other states: If you want to address coverage gaps, you need to give insurers broader authority to set prices.

Even this might not be enough. The past few years have seen a reprieve from major wildfires like the ones that struck in 2017 and 2018, but this week's blazes in the Los Angeles area could cause billions of dollars of damage, on par with an event like the Camp Fire.

Joel Laucher, a former regulator and fire insurance expert at the consumer advocacy organization United Policyholders, said the damage from the Los Angeles blazes could lead to further price hikes and more availability gaps.

"These are going to be major losses, certainly," he told Grist. "Certain areas are definitely going to have new challenges, to the degree that insurers are going to be able to charge to the rate they believe those areas deserve to pay." Laucher said insurance companies may not decline to renew as many policies as they might have under previous state rules, but they could still avoid selling policies in some of the affected areas.

Frazier, of the insurance trade group, voiced similar concerns. He said another round of monster blazes on the scale of 2017 and 2018 could drive the insurance industry away from the state once again, despite the commissioners' reforms.

"If we were to have a couple more unprecedented years, all bets are off," he told Grist.