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[Four things California can do as home insurers retreat](https://uphelp.org/four-things-california-can-do-as-home-insurers-retreat/)

CAL Matters

After State Farm declared in late May that it wouldn't sell any new home insurance policies in California, people shopping around for new insurance had one fewer option. When days later it was revealed that Allstate had quietly made the same decision last year, Californians are now left wondering: How bad is this? And how should the state respond?

The "crisis" in California's insurance market was caused by "a laser focus only on affordability," said Nancy Watkins, a principal at Milliman, an actuarial firm, at a legislative hearing on Wednesday. The companies are operating with "very crude tools" at the expense of availability and reliability, she said.

She said the current regulatory system is too rigid. "It's like you've got your steering wheel locked straight ahead, you've got your speed set on cruise control, and now you find yourself on the Pacific Coast Highway," she said. "What insurance company would agree to that?"

Home insurance premiums in California are a little cheaper than the national average — and much lower than premiums in other disaster-prone states like Florida and Louisiana. That's without accounting for the fact that California has some of the most expensive housing in the country.

California still has about 115 companies offering home insurance, said Michael Soller, a deputy commissioner for the state's insurance department. As for whether more companies are likely to follow State Farm and Allstate, "we don't think that will happen," he said.

California home insurance premiums in the middle of the pack nationally
California ranks 24th out of the 50 states and the District of Columbia with an $1,241 average premium for homeowners in 2020. Nationwide, the average was $1,311.

Consumer and insurance industry groups and other experts have ideas for what they'd like to see California do in the wake of the news — few of which they agree upon. Here's the debate over four of those ideas.

Require State Farm to keep issuing new policies
There's disagreement whether this idea, backed by the group Consumer Watchdog, is legal.

The idea hinges on how insurance prices are regulated in California. Under current laws, insurance companies can't just charge whatever they want: They have to submit their proposed rates to the insurance department, which they back up by explaining their projected costs, losses, revenue and more. State regulators can approve a company's proposed rates, or deny them, if they think, for example, the rates are unjustifiably high, or so low that they could put the company's finances at risk.

Harvey Rosenfield, founder of Consumer Watchdog, said if a company suddenly says that it's not going to take the same number of customers that it had projected when it got the department's approval, then it has changed the assumptions on which the approval was based.

"They granted themselves a de facto rate increase by reducing the risk" in a state where that's illegal, said Rosenfield. The department could issue a notice to State Farm, he said, and tell the company it needs to keep selling new home insurance policies until it submits new rates and those rates are approved.

The insurance department disputes that it has the power to do this. "Their claims are not supported by law," said Soller, the deputy commissioner. "There's a reason why it hasn't been done by any insurance commissioner before."

Let insurance companies use forward-looking catastrophe models
The kinds of data and statistical models insurance companies can use to set prices may sound like a nighttime sleep aid, but it's a matter of lively discussion in insurance circles.

When a company tries to justify rate changes, it is required to rely on past losses to project future losses. It can't use factors like the locations of new homes it is covering — whether they're in downtown San Francisco or rural wine country — or the increased risk of wildfires due to climate change.

“We do it in a very old-fashioned way, and it needs to be updated,” said Rex Frazier, president of the Personal Insurance Federation of California, an insurance industry group that counts State Farm as a member. He supports the use of forward-looking models, which are generally provided by other private companies. California already permits insurers to use models for earthquake insurance.

If a company is trying to figure out how much it should charge for earthquake coverage, it would look at proximity to fault lines, Frazier said, but for wildfire insurance, California doesn’t do that.

“For wildfire it just says ‘Well, looking backward, what have you paid over the last 20 years for wildfire clients?’” he said.

Consumer groups generally oppose letting insurance companies use models, fearing that companies will use them to justify extreme price hikes, and that complex math will make scrutiny a challenge.

“They’re just very sophisticated crystal balls,” said Amy Bach, executive director for United Policyholders, a consumer group. Modeling companies generally see their models as intellectual property, which can pose a challenge for transparency. “Our fear is that they overstate risk,” said Bach.

About a week and a half after State Farm’s announcement, the insurance department said it would host a public workshop on use of models in insurance pricing, ahead of considering regulations. The workshop will take place on July 13.

On Wednesday, the Assembly’s insurance committee held a hearing on models. When asked by a legislator whether the department was moving toward incorporating catastrophe models, a department representative confirmed that it was.

“Historic losses do not fully account for growing wildfire risks, or risk mitigation measures taken by communities,” said Michael Peterson, a deputy commissioner at the insurance department, during the hearing.

Address the increasing cost of insurance — for insurance companies
Insurance companies are just like us: They buy insurance! When insurance companies buy it, it’s called “reinsurance.”

The cost of reinsurance has risen dramatically, and State Farm cited “a challenging reinsurance market” as one of the reasons it decided to stop selling new home insurance policies in California.

When insurance companies explain their costs to the insurance department as part of the process for justifying their prices, they aren’t allowed to include the cost of reinsurance. The department hasn’t historically permitted it, Soller said, because it doesn’t regulate reinsurance.

“What are insurers supposed to do when, on the one hand, the Department of Insurance is telling them ‘maintain your solvency’ and then, on the other hand, when their costs go up, you can’t charge for it,” said Frazier.

Insurance industry groups say it would help if they could incorporate the cost of reinsurance into their prices. But consumer groups say that the move would cause premiums to spike.

“Californians would see immediate massive rate hikes — both as soon as that went into effect and ongoing,” said Carmen Balber executive director of Consumer Watchdog. A reinsurance provider regulated by California would address problems she sees with the reinsurance market, Balber said, but that doesn’t exist currently.

Reduce the risk of disasters
The underlying problem is that disasters happen in California — at an increasing rate thanks to climate change — and that homes are at risk. They’re in the middle of the woods, or surrounded by flammable grasslands, or on the edge of bluffs that are expected to erode. Making homes less likely to burn, flood or collapse would be good for homeowners and would also make California feel less risky to insurers.

There’s no shortage of ideas for how to reduce risk, and there’s been action on this front in recent years. The insurance department, for example, has required insurance companies to consider whether homeowners take certain steps to protect their homes — like installing fire-resistant vents and clearing out vegetation under decks — in their prices.

California has set aside $2.7 billion for wildfire resilience over the past three years, according to the insurance department. When the department convened a group of environmental advocates, researchers, and public policy and insurance experts to make recommendations on how to reduce the risks of climate change, they came up with a long list. Among the recommendations:

Create statewide hazard maps so that future risks are more clear to the public
Increase funding to retrofit homes
And apply fire-resistant building codes in areas with moderate to higher fire risk.
Cutting greenhouse gas emissions would ultimately be the best way to reduce the risk, said Alice Hill, chair of the group convened by the department and a senior fellow for energy and the environment at the Council on Foreign Relations. But the world will get warmer even if we reduce emissions, she said, so focusing on where and how homes are built remains important.

“That could mean not building in areas that are just becoming too risky,” Hill said.