How Your Insurance Rates are Set in California

The following was written by Joel Laucher, a former regulator and United Policyholders' staff member whose work is focused on wildfire risk reduction and appropriate insurance rewards for mitigation. Prior to joining Team UP, Joel rose through the ranks at the California Department of Insurance (CDI) to become a Chief Deputy Commissioner after serving for many years in various supervisory roles related to insurance rate setting and consumer services. Prior to joining the CDI Joel was a Commercial Insurance Underwriter.

Warning: Potential Boredom Alert! The following information is about homeowners insurance premiums and coverage in California. Unless this something you really want to know, turn back and complete your Wordle!

Homeowners Insurance Rates in California…or "Why am I paying so much and how are these big premium hikes justified?? I've never made a claim."

Here is a basic summary of how insurers' rates for property policies, including homeowners, condominium, and renters, are set in California:

Home insurance is also known as "Property-Casualty" (or "P & C") coverage because it includes protection against casualties (events that cause property damage and losses).

Insurers track their losses and expenses for each coverage form. When an insurer's loss experience is trending toward unprofitable for a particular coverage, the insurer will compile its loss experience, typically for the previous 3 years (the "experience period"), determine the percentage of rate increase it needs and can justify, and submits a request in a "rate filing" for that increase to the California Department of Insurance (CDI).

Any change in property-casualty rates must be approved by the CDI.

One major focus of the evaluation of the loss data by the CDI will be to calculate its own determination of the year-to-year loss trend indicated by those 3 years of losses. In other words, does the loss experience credibly support a determination that losses are increasing by at least as much as the insurer is requesting for this rate increase? Or maybe something less? That determination is essential in justifying the amount of rate increase that will be approved.

Just as important, the rate filing will also include a level of detail from the insurer breaking that loss data down to indicate the ore specific loss experience for each factor in the insurer's rating plan. In other words, the insurer will show not only it overall loss experience but will also break down that loss experience to show its losses by territory, by protection class, and for each category of roof type, age of home, claim history, wildfire score, etc. This is called "class rating" – every home has a multifaceted general profile that is based on each characteristic the insurer uses in its rating plan.

So, assuming the insurer is requesting a 7% overall increase, and the CDI agrees that amount of increase and how that increase will be distributed across the policyholder population is justified by the data and approves the filing, the insurer will implement that increase for all new business and renewals on a specified date.

The actual amount of increase each policyholder will experience will depend on how that overall 7% increase is distributed across the insurer's policyholders.

If the majority of the increasing losses were generated by older homes in protection classes 5-10, those policyholders may receive a 15% rate increase while policyholders in newer homes and protection classes 1-5 receive only 5% increases. If homes with higher wildfire scores experienced major losses – which has unfortunately been the reality in recent years- then all homes with high wildfire risk scores will receive significantly higher rate increases. (Again this "rate distribution" must also be supported by the loss data and approved by the CDI.)

In other words, the rate increase is not distributed equally across all insureds but is distributed "equitably" (though you may not like it or believe it fair) based on the loss experience for each insured's composite/categorical "risk profile" as compared to other insureds.

That is why so many insureds in wildland urban interface (WUI) locations are experiencing such major rate increases even if they have individually had no losses and have significantly mitigated their homes – it is insureds with the WUI profile of zip code groups, protection classes, and, most importantly, high wildfire risk scores, that are suffering the most losses while urban-situated homes have experienced much lower losses.

The only way to bring those rates down again is reduce the losses across all those impacted risk profiles. That effort is underway in many communities and deserves its own narrative…

Further Reading: About the United Policyholders' Wildfire Risk Reduction and Asset Protection Initiative https://uphelp.org/advocacy/wrap-initiative/
