Los Angeles Fires Become Existential Test for California’s Stopgap Insurer

Bloomberg

The conflagrations tearing across Los Angeles are on track to be among the most expensive wildfire disasters in US history, draining insurance coffers and threatening California’s massive state-sponsored insurance program.

Losses from the fires “could push insurance markets over the brink in California,” said Michael Wara, a senior researcher for climate and energy at Stanford University and a wildfire expert.

It’s an unprecedented test of the FAIR plan, the state-sponsored insurer of last resort. Pacific Palisades is the high-cost neighborhood at the center of the Palisades Fire. The FAIR plan has seen its exposure there skyrocket to $5.89 billion. Its policies in one ZIP code central to Pacific Palisades grew 85% between 2023 and 2024.

At least three fires continued to spread rapidly on Wednesday, more than a day after the initial fire outbreak. The Palisades Fire destroyed 300 structures and 13,306 remain threatened. The Hurst Fire, burning northwest of Los Angeles and Burbank, has threatened another 40,000 buildings, while the Eaton Fire burning near Pasadena has endangered more than 28,000 structures.

“It is plausible that the Palisades Fire in particular will become the costliest fire on record, period. Not just in California, but in general,” said Daniel Swain, a University of California Los Angeles climatologist, in a briefing on Wednesday.

Long before the Palisades erupted in flames, the multimillion dollar homes in the area had become a concern to major insurers. That’s because the homes are both extremely expensive and tightly packed together, which makes it easy for fires to jump from one property to another. The neighborhood is also located along steep canyons, which makes it less accessible for firefighters.

The rise of massive wildfires in the state over the last several years has been exacerbated by climate change. Droughts have become more frequent as temperatures rise. The Los Angeles area has had no meaningful rain for many months, despite the fact that winter is usually the rainy season. The enormous volumes of claims following recent fires has taken a toll on insurers. Seven out of the 12 biggest home insurers have limited their coverage in California over the past two years, driven in part by increased fire risk.

State Farm General Insurance Co., California's largest property insurer, announced in March that it would not renew 72,000 home and apartment policies statewide. Pacific Palisades was hit particularly hard. The agency canceled 69% of its policies in the neighborhood's 90272 ZIP code.

In a statement, State Farm said: "Our number one priority right now is the safety of our customers, agents and employees impacted by the fires and assisting our customers in the midst of this tragedy."

When Californians can't find a traditional insurer to sell them a policy, they can turn to the FAIR Plan. In September, FAIR listed its exposure as $458 billion, up 61% from the previous year.

Wara at Stanford warned that the state-run insurer does not have the basic infrastructure of assessors and personnel to handle claims. But the bigger question is whether the state can pay for resulting claims.

Reinsurance — or the insurance policies purchased by insurers to backstop claims — is in short supply. In testimony last year, the FAIR plan reported it had only about $2.5 billion in reinsurance and $200 million in surplus cash. If the fires continue to expand and destroy buildings, the damage could top the amount of resources the state-run plan has to pay claims.

Recently, however, California Insurance Commissioner Ricardo Lara outlined a plan for such an emergency. At first, uncovered costs would be split between insurers and policy holders through additional assessments. Such assessments would have to be approved first by the commissioner, but they could be on any property or casualty policy, including auto.

In a statement, the FAIR plan said it's prepared to help its customers. "It is too early to provide loss estimates as claims are just beginning to be submitted and processed," it said. "The FAIR Plan has payment mechanisms in place, including reinsurance, to ensure all covered claims are paid."

Lara didn’t respond to requests for comment on Wednesday.

“We are concerned,” said Amy Bach, the executive director of United Policyholders, a consumer group. “We think the FAIR plan will have adequate funds to cover the claims unless the number of claims really jumps. We are watching very nervously.”

Wara predicted the fires are “going to trigger further escalation in insurance costs in California.” The reinsurers that back the major insurers will likely have to pay large sums to cover claims from this catastrophe. That means next year they will raise costs. Many reinsurers are located overseas, meaning they are not regulated by the US and there are no caps on how much they can charge insurers.

Last month, Lara issued two regulations that aim to ease Californians’ access to home insurance. The first change allows insurers to use catastrophe models when setting rates instead of relying solely on historical data, while the other one lets them pass along rises in reinsurance costs in their pricing. That could keep the insurers from canceling policies altogether, but prices will almost certainly rise for consumers.

“Without question” policy holders will pay more because of this, Bach said. “It will give insurers a very strong argument to support additional rate increases.”

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