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Informational Hearing

**UPDATE ON
WILDFIRES AND HOMEOWNERS INSURANCE:
ACCESS AND AFFORDABILITY**

Wednesday, May 8, 2019
State Capitol, Room 113

Summary

The Senate Committee on Insurance has been monitoring the homeowners insurance market and whether homeowners have access to affordable coverage. Testimony provided during informational hearings held in 2016 and 2018 indicated that despite anecdotal evidence that some consumers were having difficulty finding coverage, consumers still had access. Since then, several events have raised further concerns, including record-breaking fires that burned more acres, destroyed more buildings, and took more lives than any before. Last year, California saw its first recorded “fire tornado,” the second documented anywhere, and its first property insurer insolvency arising out of a wildfire in decades. This hearing follows the Committee’s prior efforts and is intended to provide an update on those factors that make homeowners insurance more expensive and harder to get.

I. HOMEOWNERS INSURANCE IN THE ERA OF THE NEW NORMAL

California policyholders have enjoyed a long spell of low insurance rates. Unlike other states that regularly see hurricanes and tornados, California has not seen a major natural disaster of similar magnitude since the Northridge Earthquake in 1994. But climate change, drought, population movement, and other factors may be changing the fundamental nature of the homeowners insurance market.



The 2017 fires resulted in 67,757 claims valued at about \$13.9 billion (\$11.7 billion in residential losses). The 2018 fires gave rise to 56,648 total claims valued at \$12.4 billion (\$10.9 billion in residential losses). Last year, the Department of Insurance (“Department”) sounded the alarm that global climate change is driving losses and that some insurers are withdrawing from certain markets and significantly increasing premiums in high-risk areas. This concern is reinforced by frequent media reports about homeowners who have been nonrenewed or face dramatic rate increases. Cited examples of increases range from \$600 to \$4,000 per year.

The Basics

According to 2017 Market Share Reports, 108 individual admitted insurers offered homeowners multi-peril insurance policies (the most common form) in California, down from 163 in 1999. In 2017, they wrote \$7.7 billion dollars in premium in the homeowners market. Just 10 insurance groups account for 75% of homeowners premium written in this state; the largest, State Farm, holds about 18% of the market, followed by Farmers Insurance Group at 16%, and the Auto Clubs of Northern and Southern California together represent just over 13%. Only 20 insurers wrote more than \$100 million in coverage.

Larger insurers have increased access to resources and data, and are able to provide a stable source of coverage for most consumers. Smaller insurers play a different role. These insurers typically work through independent agents who act on behalf of multiple insurers and brokers who work for the consumer. They might not even advertise. Because they offer far fewer policies, they have a much smaller presence in each community and less concentrated risk (with some exceptions). Smaller insurers may offer coverage when their larger counterparts refuse to issue new policies or renew some existing ones in high-risk areas.

Affordability & Access

Insurance rates are highly regulated. Any rate increase is carefully scrutinized and approved by the Department. Rates must be actuarially sound, adequate to support potential claims, and may not be excessive or unfairly discriminatory. They are expected to reflect the risk, ensure the solvency of the insurer, and be justified through past experience data.

California’s current ratemaking system was established by Proposition 103 in 1988. The Department approves a property insurer’s rate schedule before it can sell insurance. Rate filings may be subject to an administrative hearing if required by the Insurance Commissioner, but hearings occur automatically if the filing involves a 7% increase or more. Some industry representatives suggest that many insurers file for increases up to 6.9% in order to avoid an automatic hearing. Third-party representatives of the public, known as “intervenor” may challenge the filing and, if they make a substantial contribution to the proceeding, may recover advocacy and witness fees paid by the insurer. An administrative law judge oversees the hearing and proposes a decision to the Insurance Commissioner who makes the final decision on whether to order a rate increase, a decrease, or no rate change, as well as related decisions like whether to grant intervenor fees. Proposition 103 requires any statutory changes to further its purpose and meet a two-thirds vote threshold. California’s ratemaking system has not undergone some of the radical changes that have occurred in other areas of the country.

This hearing is only one of many discussions addressing wildfire risk. The Department released its own report in December 2017 (“Department Report”).¹ In August 2018, the RAND Corporation and GreenwareTech released a study as part of California’s Fourth Climate Change Assessment; that report raised several issues that directly relate to insurance access and affordability (“RAND Climate Change Study”).² In January of this year, Governor Gavin Newsom called for the creation of a strike force to develop a comprehensive strategy to address the destabilizing effect of catastrophic wildfires on the state’s electric utilities. That Strike Force released its report on April 12, 2019, including some discussion of insurance-related issues (“Strike Force Report”).³ On March 13, 2019, the Senate Governance and Finance and the Natural Resources Committees held a joint hearing that took an in-depth look at the need for fire prevention, resilience, and mitigation efforts. On May 8, the Senate Select Committee on the Governor's 2019 Report: Wildfires and Climate Change - California's Energy Future will meet to consider the Strike Force report.

To further this larger discussion, the May 8, 2019 hearing of the Senate Insurance Committee will consider issues related to insurance affordability and access in high fire-risk areas. Subjects include the ratemaking process and underlying issues related to access, such as concentration of risk level, as well as consumer options when homeowners insurance becomes hard to get.

II. AFFORDABILITY IN THE FACE OF INCREASING WILDFIRE RISK

Insurance is a community effort to even out the costs of unpredictable and uncontrollable drastic events; participants chip in a little so that an unfortunate few are not stuck bearing large losses. In order to keep premium affordable, high-value losses must be infrequent and spread across a large pool of contributors. Where losses are high and frequent, insurance becomes less efficient and leaves policyholders paying more for less. Wildfire risk is not the only factor that drives up potential losses; as building costs increase and more people move into riskier areas, or the risk creeps into areas previously thought safe, the risk of loss grows as well.

To motivate homeowners to prevent losses, as well as fairly allocate costs, insurance rates are designed so that insureds pay premium proportionate to the risk. Insurers are wary of creating a “moral hazard” that encourages a person to engage in risky behavior by protecting them from the consequences. For example, some argue that the highly subsidized federal National Flood Insurance Program encourages building in flood prone areas, resulting in a repeated and predictable cycle of building and destruction. One way insurers avoid the moral hazard is to make sure that the insured has “skin in the game” by limiting coverage or requiring a deductible.

¹ California Department of Insurance, *The Availability and Affordability of Coverage for Wildfire Loss in Residential Property Insurance in the Wildland-Urban Interface and Other High-Risk Areas of California: Department Summary and Proposed Solutions* (2017), <http://www.insurance.ca.gov/0400-news/0100-press-releases/2018/upload/nr002-2018AvailabilityandAffordabilityofWildfireCoverage.pdf>.

² Dixon, Lloyd, Flavia Tsang, Gary Fitts, *The Impact of Changing Wildfire Risk on California’s Residential Insurance Market*, GreenwareTech and RAND Corporation (2018). California’s Fourth Climate Change Assessment, California Natural Resources Agency, Publication number: CCCA4-CNRA-2018-008, p. 70, http://www.climateassessment.ca.gov/techreports/docs/20180827-Forests_CCCA4-CNRA-2018-008.pdf.

³ Governor Newsome’s Strike Force, *Wildfires and Climate Change: California’s Energy Future* (2019), <https://www.gov.ca.gov/wp-content/uploads/2019/04/Wildfires-and-Climate-Change-California%E2%80%99s-Energy-Future.pdf>.

Rethinking Wildfire Risk. While California has a long history of wildfires, the insurance industry has not historically viewed them as equivalent to other types of major disasters. The National Association of Insurance Commissioners (NAIC) publishes a list of the 10 most costly insured property catastrophes in the U.S. through 2017.⁴ Hurricanes dominate the list. In 2017 dollars, Hurricane Katrina caused \$50.8 billion in insured losses, followed by Harvey, Maria, Sandy, and Irma, all causing over \$20 billion in losses. The only California event to reach the list is the Northridge Earthquake, ranked 7th, at \$19 billion in insured losses.

The last two years of accumulating wildfire losses, however, are causing insurers to take another look. Areas once considered safe, such as Coffey Park in Santa Rosa, are now viewed with concern. The 2018 Camp Fire revealed a new type of potential threat—the loss of an entire community—after it almost entirely destroyed the city of Paradise. Some industry experts explain that prior to these events, wildfires would be considered an “attritional,” rather than catastrophic, risk. Insurers and reinsurers that view wildfire risk as catastrophic, similar to hurricanes, will be more careful about writing coverage in wildfire prone areas.

The NAIC data also suggests that California homeowners insurance premiums fall well below the national average and far below those states with a high propensity for natural disasters. The table below compares California’s average rates with the U.S. average and with high premium states for the most common form of homeowners insurance (HO-3 form, 2016 rates).

Average Premium by Coverage Amount			
Jurisdiction	\$300,000-\$399,999	\$400,000-\$499,999	\$500,000 and over
National	\$1,242	\$1,466	\$2,164
Texas	\$2,164	\$2,519	\$3,612
Florida	\$2,354	\$2,970	\$4,634
Louisiana	\$2,502	\$3,165	\$4,686
California	\$856	\$1,032	\$1,662

This data is consistent with other research published in 2018 by Insurance.com that indicates that California homeowners insurance rates are about 35% below the national average. As wildfires look more like traditional catastrophes, so might insurance rates.

Ratemaking

The Strike Force Report notes that carriers have submitted applications for over 100 rate increases in the last two years, more than double the filings from the prior two years. It also notes that homeowners with heightened fire risk are looking at double-digit rate increases. These rate filings, however, will not include losses related to the November 2018 fires. The following describes aspects of the catastrophic ratemaking process that could have an impact on whether insurers will see the approved rates as adequate to justify covering properties in high-risk areas.

⁴ *Dwelling Fire, Homeowners Owner-Occupied, and Homeowners Tenant and Condominium/Cooperative Unit Owner’s Insurance Report: Data for 2016*, National Association of Insurance Commissioners (2018), https://www.naic.org/prod_serv/HMR-ZU-18.pdf

Insurers do not have crystal balls; they have actuaries who use mathematics, statistics, and financial theory to provide carefully reasoned guesses of how likely an event will happen and how much it will cost. Those guesses are used to establish rates. If they guess correctly, the insurer enjoys a profit; if not, the insurer suffers unexpected losses. Generally, the occurrence of standard losses such as homes lost to a kitchen fire are fairly predictable and consistent. When developing insurance rates, the insurer will compile recent data (typically 1 to 3 years) in order to estimate the amount needed to pay anticipated losses. Those losses combined with other expenses, such as operational costs, regulatory costs, and taxes, make up the expected losses and expenses that serves as the basis for the rate. However, not all losses end up costing the insurer. Under some circumstances, the insurer may recover the loss from a third party.

Subrogation. By paying a claim, insurers assume the legal right to recover from an at-fault party; this is known as “subrogation.” By reducing insurers’ net losses, subrogation recoveries should lead to lower average rates. For example, insurers are currently seeking reimbursement from Pacific Gas and Electric (PG&E) for losses related to the Tubbs Fire in 2017 and the Camp Fire in 2018. However, any recovery may be impeded by PG&E’s related bankruptcy proceedings and a determination by CAL FIRE that something other than PG&E equipment caused the Tubbs Fire. The Strike Force Report suggests altering the liability standard applicable to utilities; if enacted, that proposal might make it more difficult to pursue future subrogation claims. Subrogation recoveries typically occur over many years after the date of loss and so the losses are part of the rate calculation in the intervening years. To the extent that insurers will be able to collect less from utilities for wildfires losses, they have greater justification for higher rates.

Reinsurance. Reinsurance arrangements bring in other insurers to help carry the risk load. Reinsurance is a form of “insurance for insurers.” It is a contract between two insurers where, for a price, one insurer agrees to cover the losses incurred by another insurer. The agreement can be highly customized, but often involves a payment by the reinsurer once losses reach a certain threshold, like a deductible. In return, the reinsurer takes a portion of the premium, but may pay the insurer a “commission” to reimburse it for administrative and marketing costs.

Any insurer may act as a reinsurer, but there are many specialized reinsurers, and several very large reinsurers that operate internationally. Reinsurers create a web of support that dissipate and distribute catastrophic losses across international boundaries and types of catastrophes.

Unlike most states, California does not permit property insurers to pass along the net cost of reinsurance through their rates (except for earthquake as provided), and accordingly, does not deduct reinsured losses from the value of claims paid when calculating rates. Insurers have raised concerns that they must absorb the difference between the cost of reinsurance and the approved expenses built into their rate even though they see reinsurance as a contributing factor to the actual cost of offering coverage.

The Department Report suggests that including net reinsurance costs do not guarantee that insurers will be more open to writing in high-risk areas, but would significantly complicate the ratemaking process. For example, the complexity of reinsurance contracts makes it difficult to judge the reasonableness of the charge, i.e. whether the insurer paid a fair price.

The RAND Climate Change Study also addresses this issue, but presumes that including the net cost of reinsurance would increase insurers' willingness to write in risk areas and better allow admitted insurers to compete with surplus lines carriers. However, the practice would likely lead to higher rates and cause affordability problems, because increases could be concentrated in risky areas. The study suggests that further work is needed to understand the full implications.

Because of recent catastrophes, including the California wildfires, reinsurance rates are expected to climb. If insurers' concerns are valid, they may experience increasing unrecouped cost that may create an additional pressure to avoid high-risk areas.

Saving for that "Very Rainy Day"

Unlike standard, non-catastrophic losses, which are calculated according to recent loss experience, catastrophes are accounted for differently. California uses the traditional approach to rate infrequent and severe events; "catastrophic loading" is a process that allows insurers to charge extra to compensate for extraordinary losses. The share of premium for catastrophic losses builds up over time in order to save for a "rainy day." For this reason, catastrophic losses are separated from the regular experience data and the catastrophic premium component is calculated based on average losses over a period of at least 20 years.

Charging a little extra each year for extraordinary losses allows the insurer to spread the risk over time. Although the excess charge is considered income to the insurer in the form of "underwriting profit," it is not really profit if it is used to pay claims arising from a catastrophe. At this Committee's October 2018 hearing, insurers noted that 17 years of underwriting profit went to pay claims for wildfires.

The RAND Climate Change Study raises concerns about the catastrophic load approach. It notes that relying on past loss history could result in overall average rates that do not accurately reflect expected loss. Particularly given the assumption that climate change is augmenting weather patterns, the current ratemaking approach of relying on historic losses will tend to result in rates that do not keep up with actual wildfire risk. The study further explains that, conversely, a large event, like the 2017 fires, could also inflate the rate beyond appropriate levels.

Probabilistic Modeling. In lieu of catastrophic loading, most states allow insurers to use probabilistic modeling when estimating potential catastrophic losses. Reinsurers use it as well. Where catastrophic loading uses past experience data, modeling estimates probable losses based on multiple factors, including past data and by creating thousands of possible scenarios.

The unexpected extent of the damages caused by Hurricane Andrew in 1992 (over \$24.5 billion in 2017 dollars) triggered major changes in the insurance industry, including a significantly increased reliance on catastrophic modeling. The extent of the unexpected losses proved to be a shock as the older method did not account for population movements and fluctuations in construction and other costs. (Population movement will not impact the probability of a hurricane, but it will impact the value of probable losses; it will also impact the likelihood of human ignited fires.) The technology behind probabilistic modeling has continually evolved to become more sophisticated since Andrew.

Since historical data, rather than modeling, is used for establishing expected losses in California, there is some concern that rates will not reflect climate change-driven losses, population movement into high-risk areas, or unanticipated increases in building costs. Some industry representatives suggest that California has not caught up to the Gulf States that have already experienced climate-driven increases in rates, and who now allow the use of modeling and inclusion of net reinsurance costs.

Underwriting Profits. Ratemaking allows insurers to charge extra, through catastrophic loading and other techniques, so that they can enjoy a moderate feast one year and weather a famine the next. The built up savings (not including investment income) is considered underwriting profits. (Outside of the U.S., insurers set aside the extra revenue as dedicated “catastrophic reserves” but U.S. tax law discourages that approach.)

The RAND Climate Change Study explains that the 2017 fires almost completely wiped out the underwriting profits in the Homeowners Multiple Peril and Fire lines from 2001 through 2016, a total of \$12.1 billion. More specifically, 45% of insurance companies and 43% of insurance groups that wrote at least \$10 million in direct written premium over this period lost as much as they made in underwriting profit or more. Nevertheless, when taking into account investment income, the industry remained profitable up to that point.

The study did not include the costs of the November 2018 fires and that data has not yet been published by the Department. The Committee has requested the Legislative Analyst’s Office to provide some updated analysis when that data becomes available.

III. ACCESS IN HIGH FIRE-RISK AREAS

If the losses of the last few years represent “a new normal,” insurers will increasingly see themselves overexposed in many geographic areas recently thought to be a lower risk. In order to avoid an overconcentration of risk in newly recognized high-risk areas, and to protect its financial solvency, an insurer may adjust its risk exposure in any one area by raising its eligibility criteria, refusing to write new or to renew policies, or charging a higher rate.

When an insurer restricts its underwriting, it raises the eligibility criteria to make it harder for consumers to qualify. Whether this is an inconvenience to an individual or a community-wide problem depends on the size of the insurer and number of other willing insurers in that region. When decisions to restrict underwriting are made by larger insurers with thousands of policies in one area, it will have a major impact on consumers in that region.

Underwriting and Risk Concentration

During the underwriting process, insurers assess eligibility by evaluating the property against underwriting guidelines. Common factors include roof type, protection class (scoring the availability of fire suppression services), wildfire risk model score, and brush clearance. As an insurer takes on more risk, it becomes more vulnerable to loss. Aggregate risk in an area is not a simple function of the number of policies written, but a combination of many factors, including the probability of losses, the severity of a probable event, and the value and quality of the homes insured.

For example, the RAND Climate Change Study estimates that the average number of acres that will burn annually in areas of the Sierra Foothills will double by midcentury and, absent aggressive improvements in carbon emissions, will double again by the end of the 21st century. An insurer that issues coverage in a moderate risk area may find over time that the fire risk in those areas has increased significantly.

Increases in coverage limits also place more risk on the insurer. Based on repeated reports that fire victims lack adequate insurance coverage, AB 1797 (Levine), Chapter 205, Statutes of 2018, was enacted to encourage more appropriate insurance limits by requiring insurers to provide a new replacement cost estimate every other year or provide built-in inflation protection. If that works and limits rise accordingly, so will an insurer's aggregate risk.

The insurer's risk tolerance will determine if it loosens or tightens its underwriting standards. Refusing to issue new policies or renew existing ones is one way insurers can adapt to changes in risk without a rate increase. Some advocates argue that this amounts to "cherry picking" so that the insurer can make profit off of lower risk policies without offering coverage in higher risk areas. On the other hand, the insurer may argue that its ability to manage its own risk is necessary to protect its ability to pay claims. The threat of a catastrophe and massive simultaneous losses forces the insurer to carefully consider insuring properties in catastrophe-prone areas. If the perceived risk grows, but the rates are perceived as inadequate, insurers may restrict their underwriting.

The Department does not have the authority to dictate insurers' underwriting standards as insurers are free to determine the level of risk. Underwriting must be applied consistently and not be unfairly discriminatory; decisions must be based on risk characteristics and not other biases.

Wildfires victims and those living in areas impacted by wildfires have some temporary protections. SB 824 (Lara), Chapter 616, Statutes of 2018, requires insurers to renew policies in areas impacted by a disaster for at least one year, as specified. SB 894 (Dodd), Chapter 618, Statutes of 2018, requires insurers to renew policies for at least 24 months, if the property suffered a total loss in a declared disaster. However, once those periods expire, insurers are not required to issue policies or maintain any particular level of coverage in an area. Existing law, in part, leaves this discretion in place because devastating losses can put the insurer out of business.

Merced. The importance of risk management is illustrated by the recent insolvency of the Merced Property and Casualty Co. arising from the Camp Fire. Merced was a small insurer founded in 1906. In 2017, it represented 0.06% of the homeowners multi-peril market, saw only \$74,526 in losses, and collected \$4.4 million in premium. While other insurers were either refusing to issue new policies or renew existing policies in Paradise, Merced expanded in that area. After the Camp Fire, Merced claims exceeded \$64 million, more than double the \$23 million it had to pay them (not including reinsurance).

The California Insurance Guarantee Association (CIGA) covers claims up to \$500,000, which should cover most homeowners from that area. That limit might be combined with other coverages under the policy, so that the dwelling coverage, "other structures" coverage, personal contents coverage, etc. would all be subject to a separate \$500,000 cap subject to the policy

limits. For example, CIGA might cover \$500,000 for dwelling, \$50,000 for other structures, \$200,000 for personal contents, etc.

Still, there is a serious question as to whether those limits are enough. The CIGA limit of \$500,000 has been in statute since 1978 and has not been modified since. That cap might not be adequate to cover claims against an insolvent insurer for losses with a higher replacement value, such as homes burned by the Woolsey Fire.

Fire Risk Scores. Although modeling is not used for establishing catastrophic risk, it is used for underwriting purposes and rate differentials (charging some consumers more than others). This is often referred to as fire risk scoring. Two frequently cited examples of rate segmentation tools are the Public Protection Classification and FireLine (both produced by the same company). The Public Protection Classification scores a community's fire prevention and suppression system (such as the location and number of fire stations and fire hydrants). Newer products, such as FireLine or CoreLogic, measure individual properties for wildfire risk by weighing factors such as topography, vegetation, wind patterns and accessibility. An insurer might refuse to insure a property with a high score or charge significantly higher premium.

Some consumer advocates and the Department Report raise several concerns about the use of wildfire models that score a property according to available fuel, property geography, distance to high risk areas, and access to firefighting services. Although not used for loss development, modeling can be used for rate segmentation and to determine whether the insurer will issue or renew a policy. The Department argues that these models may not be accurate. Many of these models rely on satellite imagery that may not be sharp or clear enough to make an individualized assessment. The Department also points out that these models do not take into account the homeowners' efforts to fortify the home or create defensible space, or community mitigation efforts such as stringent building codes or fire breaks.

Current Market Indicators

There is no centralized, real-time, tracking system that will red flag areas where insurance is hard to get. Antitrust laws discourage insurers from sharing that information. What measurements we have only track a part of the overall question of availability.

One measurement is based on the number of policies that the insurer or the homeowner has refused to renew. The Department Report states that more than 10,000 homeowners in high-risk counties were non-renewed by their insurer in 2016 and more than 36,000 homeowners in those counties chose not to renew, presumably because of steep premium increases or lower coverage reasons. The Department also reports that it has increasingly received complaints about renewal and premium increases between 2010 and 2016, and that about 60% come from very high fire-risk areas.

Without centralized tracking, changes in accessibility can be inferred by looking at the number of homeowners who rely on "last resort" options, such as the California FAIR Plan and the surplus lines insurers. Because these options are usually more expensive, growth suggests homeowners did not have other viable choices.

The California Fair Access to Insurance Requirements Plan. The California Fair Access to Insurance Requirements (“FAIR”) Plan was created by state legislation in 1968 following brush fires and riots in the 1960s that led many insurers to exit urban areas or neighborhoods, primarily in Los Angeles. Organized as a private association, the FAIR Plan is comprised of all insurers admitted to write property insurance in California. FAIR Plan policies must be actuarially sound, can be pricey, and only offer limited coverage up to \$1.5 million. They do not cover liability, theft, or water damage. FAIR plan policyholders who want broader coverage must find excess or supplemental coverage called “differences-in-conditions” policies.

About 66% of FAIR Plan policies cover homes in Los Angeles County and 10% are located in San Bernardino County. FAIR Plan market share declined slightly from 127,000 in February 2014 to 123,000 in February 2018, but market share is now increasing. The FAIR Plan grew by 2,784 policies between August 2018 and February 2019, and there were 125,000 FAIR Plan policies in force in February of this year. Growth data alone does not reveal the FAIR Plan’s shifting portfolio from urban to wildfire risk. While 72% of FAIR Plan policies still cover urban risks, this is down from 75% last year. FAIR Plan enrollment still only represents a mere fraction of the 2 million policies issued to homes in areas with high or very high fire risk.

The FAIR Plan recently implemented a 20% rate increase due to the 2017 fires, and an additional increase is expected next year. Also, as building costs increase, more homes will exceed the \$1.5 million cap and force insureds to retain the excess risk or obtain an excess insurance policy covering the difference. Some may be forced into the surplus lines market.

Surplus Lines. Surplus lines insurers, such as the underwriters that transact insurance through Lloyds of London, are not “admitted” to sell insurance in California but are regulated by another jurisdiction. These carriers are like free agents and are able to respond to changing market conditions and special insurance needs. Because they are subject to less regulation, they have more flexibility to meet fast-changing consumer demand.

Still, that flexibility comes at a cost. Policies are not protected by CIGA if the insurer becomes insolvent. Moreover, they are not required to get their rates approved before selling in California, and premiums can vary widely. One expert suggests that recent surplus lines premiums ranged between 20% of, and up to four times more than, the cost of a FAIR Plan policy.

Surplus lines policies are placed by surplus line brokers who must follow special procedures. This helps to protect consumers from taking unnecessary risks and also prevents surplus lines insurers from unfairly competing with the admitted market. Usually, a broker must first attempt to place the insurance with admitted insurers who decline to issue a policy. The Department also keeps a list of pre-approved surplus lines insurers that qualify for a streamlined process.

Consumers should only purchase surplus lines insurance when absolutely necessary and when admitted insurance is unavailable. Because of this, the number of policies placed with surplus lines is seen as an indicator, albeit a crude one, of coverage availability in the standard market.

Last year, surplus lines brokers placed 49,370 homeowners policies, up from a 10-year low of 13,517 in 2011. This year, they placed almost 20,000 by March 31, about twice the rate at that point in 2018. Although this represents a 60% increase from 2016, it remains a small portion of the homeowners market. The association estimates approximately only 1% of all homeowners premiums in the state go into the surplus lines marketplace.⁵

Improved Monitoring

Unfortunately, there is no centralized means of measuring consumer access to insurance coverage and no system for aggregating insurers' willingness to offer coverage in any one area. Available indicators do not show a widespread problem. FAIR Plan and surplus lines policies represent a small fraction of the overall market. Although non-renewals and complaints have been on the rise, they do not tell whether consumers were able to replace their policies.

Surges or shifts in the FAIR Plan or surplus lines do not take into account other critical factors. There may be many untracked uninsured homeowners in high-risk areas who are unaware of, or cannot afford, coverage options. Perhaps last resort placements may be viewed as a "miner's canary." If existing policyholders are having trouble getting coverage, it would be reasonable to expect that other high-risk homes may have similar problems.

The Senate Insurance Committee held a March 2018 informational hearing on the impact of drought, climate change and wildfires on the homeowners' insurance market. One of the key findings was the lack of data needed to understand the impact of climate change and the growing wildfire risk on both the availability and affordability of homeowners insurance in high and extreme fire risk areas. SB 824 (Lara), Chapter 616, Statutes of 2018, was intended to address that data gap by authorizing the Department to conduct a biennial data call on insurer losses related to fires and wildfires, including data on issues such as premiums in high-risk areas, the use of fire risk scores, losses by zip code, and other important information. The Department is required to issue a report based on the data collected that summarizes the findings both to help insurer assessment of risk and guide policymakers in determining what additional steps might need to be taken. However, the first round of data is not due until April 2020.

Based on the available indicators, the California insurance market is still functioning well for an overwhelming number of consumers. Nevertheless, some indicators outline a trend of increasing difficulty for these consumers, especially those who might live in older homes that do not meet modern standards, such as those with wood shake roofs. At some point, they might not be able to find coverage for themselves or sell their home at market rates if potential buyers cannot find coverage. A crisis in the insurance market can quickly become a crisis in the real estate market.

IV. BUILDING FOR SURVIVAL (& AFFORDABLE INSURANCE COVERAGE)

California has an ongoing housing supply problem in many urban areas that continues to push more people into sparsely occupied areas. When those areas are also prone to wildfires, the

⁵ Kathleen Pender, *Wildfires make it harder for California homeowners to get insurance*, San Francisco Chronicle (April 20, 2019) <https://www.sfchronicle.com/business/networth/article/Wildfires-make-it-harder-for-California-13781879.php>

mixture of more structures to burn and more people to start fires creates potential insurance problems. The Department report describes the extent of the potential fire risk; about 3.6 million homes are located within the Wildland Urban Interface (WUI) and more than one million are in high or very high fire-risk areas.

Some experts argue that fire losses are not a forest fire problem, but one of community planning. Wildfire risk may be tempered by forest management practices, local planning practices, and the availability of fire suppression systems in the area, but location is still the most important factor. For example, Fountaingrove is positioned along a ridge where steep slopes and canyons direct wind driven fires. In 1964, less than 100 homes burned in the Hanley Fire along almost the same route where the 2017 Tubbs Fire burned 1,500 homes in 2017. Similar observations have been made about the Camp Fire and Paradise. Since 1914, 42 fires larger than 300 acres burned within the Camp Fire area.⁶

Building Toward Resilience

Unlike hurricanes and earthquakes, a wildfire itself is preventable, but it is also contagious. Fire mitigation helps protect the homeowner and the neighbor; it is a way of preventing the peril itself. While simply not building in these areas is the safest option, building new homes, and retrofitting older homes, to meet current standards could help a great deal. “Hardening” a home refers to making structural changes to the home and other techniques that mitigate or prevent fire damage. Homeowners in high-risk areas should clear brush, screens on vents to block embers, install sprinklers and fire alarms, and use fire-resistant roofing and siding. In fact, state laws now require new homes in the WUI be built with fire resistant materials.

However, even hardening the home does not necessarily save it. In the 1990s, Santa Rosa planners approved construction in Fountaingrove over some residents’ objections based on the Hanley blaze. Some of the newer homes were subject to stricter fire safety standards and the homeowners association assessed a monthly fee for fire mitigation services such as clearing weeds and brush, maintaining firebreaks, and promoting fire-resistant native plants. But those efforts did not stop the destruction. While each individual home should be hardened, communities must also be planned carefully.

Some experts warn against placing houses too close together, which is a common practice designed to make housing more affordable. Fire is contagious; homes that are not hardened might serve as kindling and threaten even the most up-to-date homes that are nearby. Even a fire-resistant home remains vulnerable if they are set too close together or next to vulnerable homes. Community fire prevention strategies require a “herd immunity” and too many individual vulnerabilities can weaken the community.

The Camp Fire offers an illustration of the importance of housing in high fire-risk areas complying with modern codes. In Paradise, most homes were built between the 1940s and 1970s. Older homes are particularly vulnerable. According to an analysis by McLatchy, “about

⁶ Matthias Gafni, *Rebuild Paradise? Since 1999, 13 large wildfires burned in the footprint of the Camp Fire*, The Mercury News (Dec. 3, 2018), <https://www.mercurynews.com/2018/12/02/rebuild-paradise-since-1999-13-large-wildfires-burned-in-the-footprint-of-the-camp-fire/>.

51 percent of the 350 single-family homes built after 2008 in the path of the Camp Fire were undamaged,” but “only 18 percent of the 12,100 homes built prior to 2008 escaped damage.”⁷

Fortunately, local mitigation and prevention efforts to are ongoing. Boulder County, Colorado, began looking at fire-mitigation back in the late 1980s. The county developed its own program called Wildfire Partners to ensure homeowners have access to insurance if their homes meet certain home hardening guidelines. That program has grown to include several other counties. The Firewise USA program also offers a framework to reduce wildfire risks at the local level by certifying sites that comply with fire prevention and mitigation standards.

However, insurers are likely to point out that programs that are successful in other areas of the country have not been tested against the unprecedented 2017 and 2018 fires. While there is some evidence that hardening and planning help avoid losses, they have only been narrowly tested against California’s new normal.

V. WHAT’S NEXT?

Some see insurance discounts as a way to incentivize prevention and mitigation efforts. Some consumer advocates have suggested, and the Strike Force Reports asks, whether insurers should be required to give discounts for those efforts.

Insurers argue that rates for homeowners in high-risk areas are already subsidized by those living in low-risk areas; they feel rates are already discounted notwithstanding mitigation efforts. The Department Report responds that insurers lack sufficient data to justify rate differentials. The RAND Climate Change Study suggests that there is insufficient evidence to determine whether rate differentials are suppressed, but notes that cross-subsidies reduce insurer’s incentives to write in high-risk areas and their ability to offer mitigation discounts.

Until all the factors are laid out and enough data is compiled, insurers may balk at required discounts. (AB 2229 (Wood), Chapter 75, Statutes of 2018, will require insurers to notify consumers of potential discounts starting January 1, 2020.) Further, if the idea is to incentivize home-hardening upgrades, it may be more effective to assist homeowners who lack the resources to harden their homes than to provide insurance discounts for completed work. Given the desperate need to upgrade these older homes in order to protect them and the homes surrounding them, potential insurance market problems might be better addressed through proactive mitigation and prevention efforts while simultaneously collecting the data necessary to properly allocate the cost to provide the insurance coverage. Regardless, insurance rates will continue to reflect the new normal even as insurers and regulators debate how best to build in those costs.

⁷ Dale Kasler and Phillip Reese, *Millions bracing for wildfire season wonder if their homes are safe* (April 11, 2019), <https://www.redding.com/in-depth/news/2019/04/11/california-wildfire-prevention-protection-home/3412609002/>

APPENDIX – A DECADE OF WILDFIRES

Fire Name	Counties	Acres	Structures	Deaths	Ranks
Camp (2018)	Butte	153,336	18,804	86	Most Destructive, Deadliest, 16th Largest
Woolsey (2018)	Ventura	96,949	1,643	3	7 th Destructive
Carr (2018)	Shasta County, Trinity County	229,651	1,604	7	8 th Destructive, 7 th Largest, 14 th Deadliest
Mendocino Complex (2018)	Mendocino, Lake, Colusa, Glenn	459,123	280	1	Largest
Thomas (2017)	Ventura & Santa Barbara	281,893	1,063	2	10 th Destructive, 2 nd Largest
Tubbs (2017)	Napa & Sonoma	36,807	5,636	22	2 nd Destructive, 4 th Deadliest
Nuns (2017)	Sonoma	54,382	1,355	3	9 th Destructive
Atlas (2017)	Napa & Solano	51,624	783	6	14 th Destructive, 15 th Deadliest
Redwood Valley (2017)	Mendocino	36,523	546	9	20 th Destructive, 11 th Deadliest
Cascade (2017)	Yuba	9,989	266	4	20 th Largest
Valley (2015)	Lake, Napa & Sonoma	76,067	1,955	4	5 th Destructive
Butte (2015)	Amador & Calaveras	70,868	921	2	13 th Destructive
Rough (2015)	Fresno	151,623	4	0	17 th Largest
Happy Camp Complex (2014)	Siskiyou	134,056	6	0	20 th Largest
Rim (2013)	Tuolumne	257,314	112	0	5 th Largest
Rush (2012)	Lassen	271,911	0	0	4 th Largest
Station (2009)	Los Angeles	160,557	209	2	15 th Largest
Sayre (2008)	Los Angeles	11,262	604	0	15 th Destructive
Iron Alps Complex (2008)	Trinity	105,855	10	10	10 th Deadliest
Basin Complex (2008)	Monterey	162,818	58	0	13 th Largest
Klamath Theater Complex (2008)	Siskiyou	192,038	0	2	10 th Largest