Solving California's Insurance Crisis The California Wildfire Plan

For the thousands of California residents who either own a home or commercial property in California, the news from the insurance industry has been frightening and anxiety provoking with dire financial consequences for many. Currently, California's insurance market is in a free fall with insurers either leaving the state or limiting their footprint to specific geographic areas. As a professional insurance broker, I hear the concerns from clients daily on whether they can insure their property, whether the policy will satisfy their lender or whether insurance costs will exceed their income. These changes are having major negative consequences for both residential and commercial owners. What happened? There are two key issues causing this disruption.

- Insurers no longer writing policies because of wildfire
- Personal injury lawsuits

For this perspective on the California insurance market, I will only focus on wildfire coverage. However, I will say that high payout personal injury claims are causing insurers to reduce coverage, significantly increase premiums and, in many cases, decline to offer policies. Ultimately, the high payouts for insurance-related lawsuits needs to be addressed to ensure an affordable and sustainable insurance market in California.

The Impact of Wildfires in California's Insurance Marketplace

A few examples of how wildfires have impacted California include the 2017 Tubbs Fire, which destroyed 2,800 homes in Santa Rosa according to the San Francisco Chronicle. In 2002, according to the California Department of Forestry and Fire Protection, California had 7,477 wildfires, 363,939 acres burned and 1,279 structures damaged or destroyed. These examples show the severity and unpredictable nature of wildfires which is why many insurers have decided to either reduce their exposure to specific geographic areas or to just simply vacate the state.

The California Fair Plan

In 1968, California created the California Fair Plan which was created to provide property insurance coverage when no other options are available. The Fair Plan was a good start to help solve this problem. However, this plan is falling short due to the many limitations explored below. At its base level, the California Fair Plan has a use, but it does not solve the problem of insurers reducing their footprint or leaving this state because of wildfires.

The Wildfire Solution

To remedy insurers leaving, I recommend creating the California Wildfire Plan

The California Wildfire Plan will only insure structures against wildfire losses and nothing else. By covering only wildfires, traditional insurers can then focus on losses they can model against such as kitchen fires, fallen trees or broken water pipes. By having a separate insurance policy specific to wildfires, companies like State Farm and others would not have to cover the heavy losses associated with California wildfires.

This concept is not new. A standard homeowner or commercial insurance policy for Gulf Coast states such as Texas typically covers wind and hail, but these policies do not automatically include insurance for “Named Storm”. A Named Storm is a hurricane with a name associated with it, such as Hurricane Irene. Named Storm covers damage specific to a named hurricane. Otherwise, the baseline policy covers wind/hail damage along with fire. Another example in California is that a traditional insurance policy excludes earthquakes and flood and so these are optional policies to purchase.

The Wildfire Plan would operate in a comparable manner but specifically to wildfires which allows the traditional insurer to cover other fire related losses. To make the program work, we need to define what qualifies as a wildfire. The least complicated way is to have the policy respond to named wildfires. The state today already names certain wildfires, but the state doesn’t name every wildfire. Because of this, the wildfire definition could be expanded to also include any single wildfire that has burned at least 500 acres under the same wildfire. Ultimately, traditional insurers and the Wildfire Plan would need to agree on the framework that would trigger the Wildfire Plan.

How the Wildfire Plan Would Work

Insurers have already created a fire rating map of California delineating areas that have low to high probability of wildfire exposure. Traditional insurers would then dictate when a Wildfire Plan policy is required based on the geographic location. For example, because homes in San Francsico have a very low score, an insurer would not require the Wildfire Plan. But a homeowner in Lake Tahoe would need the Wildfire Plan. The Wildfire Plan would apply to both residential and commercial buildings. So, in the event of a kitchen fire, a traditional insurer would respond. However, if a named wildfire damages the property, then the Wildfire Plan would respond. This way a company like State Farm can insure against the more standard losses and the Wildfire Plan covers the wildfire loss.

The Wildfire Plan is Sustainable

A few factors would make the plan sustainable. The biggest sustainability contributor will be the premiums paid into the Wildfire Plan because a traditional insurer will require a Wildfire policy if that insurer is to write a policy for the same property.

Another big factor is that insurers have included thousands of structures within cities as being in a high-risk fire zone because they are within a mile of hills or areas of grassland. Examples of these structures exist in downtown Berkeley, parts of San Rafael and outer parts of Los Angeles. The reality is these areas have a very low probability of being consumed by wildfire resulting in these owners’ paying premiums into the wildfire program with almost no chance of their buildings incurring a wildfire loss. This means more premium to pay for other wildfire losses.

Lastly, unlike a hurricane that can literally batter the same area annually, a wildfire has a low probability of returning to the same area for years because the vegetation is depleted. When structures are rebuilt, premiums paid moving forward would, in most scenarios, go towards paying for losses in other areas.

The Wildfire Plan would collect premiums from both residential and commercial property owners. In mild summers, the plan might not pay many claims but would be collecting premiums to off-set a future heavy wildfire season.

Another benefit of the Wildfire Plan is that it would alleviate pressure on the current California Fair Plan which is currently overwhelmed with submissions as traditional insurers would now be covering thousands more structures.

Needed Changes to Make the Wildfire Plan Viable

The current California Fair Plan needs major improvements to make it a useful policy. I recommend improving the current Fair Plan and implementing these changes to the Wildfire Plan. Changes to the Fair Plan for both residential and commercial buildings that would make the Wildfire Plan viable include the following. (Please note, I am only addressing a few of the larger changes as there are many aspects that can be improved).

- Increase the single building limit for residential to $10M and a policy limit to $15M
- Increase the single building limit for commercial to $20M and policy limit to $50M
- Include water damage with a $10K minimum deductible
- Remove the requirement to replace roofs every 10 years to get replacement cost valuations
- Add the option to purchase Building Ordinance for code upgrades
- Allow underwriting changes before a final quote is issued
- Cover buildings that have been vacant for up to (3) years
- Reduce rates in all areas so that people can afford to pay the premiums

The End Goal

The end goal is to create a sustainable and viable insurance partnership that once again encourages traditional insurers to enter and remain in our great state. By creating a wildfire specific policy, traditional insurers can now more soundly predict losses, homeowners and commercial building owners will feel relieved that they can purchase reasonable insurance for their property, and buyers and sellers can now more easily transact.

The cost of the Wildfire Plan needs to be reasonable. If the State of California needs to subsidize the plan for the short term to build up reserves, then this is worth it. Additionally, funds received from the PG&E settlement could also go towards the Wildfire Plan.

Wildfires are not going away, and so the California Wildfire Plan is a viable solution to this problem.