Home Insurance Market Structural Crisis:

The wildfires are devastating the home fire insurance market and the industry is adapting to the risks based on the current insurance market structure. Bankruptcy of insurance companies, customer dissatisfaction, Department of Insurance complaints, and underinsurance have not been fully realized; it will get worse if gone unchecked. But the structure can be altered to lessen the impact on consumers while the underlying wildfire fuel and land management is addressed. To understand the Crisis you need to understand the industry structure first.

Current Home Insurance Market Design:

Admitted Market: Made up of insurance companies, it is the voluntary market that participates in the state's guarantee fund. Insurance companies pick and choose the risk they want to insure and manage the risk of a particular pool of customers they choose to accept. It is held to solvency standards by the Department of Insurance (DOI) and the state's guarantee but in turn is also regulated to make sure the membership isn't price gouged with overly high reserves or savings of capital for catastrophes. Common insurers in this market are: Farmers, State Farm, Allstate, AAA, Liberty Mutual, Travelers, and Nationwide.

Non-Admitted Market: Made up of insurance companies, it is a voluntary market that does not participate in the state guarantee fund. This market can save or retain more capital for higher risk perils like wildfire, volcano, flood, and liability. This market is more agile and can rapidly change because it doesn't have the same oversight of finances and rate filings. It also is more at risk for insolvency to a consumer because they don't have a state authority like the DOI and guarantee fund to sure up claim payments in bankruptcy. Common insurers in this market: Lloyd's Of London, Scottsdale, Hippo, and Lexington.

CA Fair Plan: This is the back stop, the last resort insurer for the voluntary admitted home insurance market. In theory, an insurance market can have insurance companies decline customers if the market allows for a final place for the consumer to get insurance as a last resort. The ability of an insurance company to decline and manage risk keeps the market solvent and prevents adverse selection of only high risk customers. In every voluntary insurance market, a last resort insurer sponsored by the state must exist (California worker's compensation has State Worker's Compensation Insurance Fund, Flood insurance has FEMA National Flood Insurance Program, California auto insurance has California's Low Cost Automobile Insurance Program). This policy only covers the following named perils: fire, lightning, smoke, internal explosion, windstorm, hail, riot, aircraft, vehicles, vandalism, and malicious mischief. Each line of coverage is purchased at will, not in a package, and notable coverage options absent are: extended replacement cost, additional living expense (evacuation expenses), and liability.

Difference In Coverage Policy: An insurance policy sold in tandem with the CA Fair Plan. It covers the remaining perils the Fair Plan does not. The perils of consumer concern covered by this policy typically are: theft, limited water, falling objects like trees, weight of snow collapse, freezing, power surge, liability, and medical payments. There are only a few DIC policies in the market for stick built uniform building code homes that are owner occupied. There is limited access to a DIC policy for mobile or manufacture homes, rentals, vacant homes, or commercial risks.

Reinsurance: A secondary market of insurance that the primary voluntary market purchases with reserves to replenish the membership pool when a catastrophe occurs. The primary admitted market buys reinsurance for the insurance company so when a catastrophic wildfire occurs, they can replenish the membership's pool of money by filing a claim with the reinsurer.

Crisis Explained:

Cause: Since the Santa Rosa Fires, Camp Fire, and Carr Fire, a new development in the insurance market has been realized; the cost to insure homes is greater than the policy holder memberships and stock insurance companies can bear. In the past the insurance memberships would collect from reinsurance and use reserves to pay for these kinds of catastrophes. The reinsurance market for wildfire is changing, becoming more costly, and the reserves are depleted. Insurance companies have more risk than they can pool capital for under their current rate structures; they can't adapt quickly enough due to the nature of the risk and how they file for rates.

Effect:

*Many consumers are taking on insurance company solvency risks, either knowingly or unknowingly, to purchase insurance from the non-admitted market. The non-admitted market is exceptionally at risk because perils like fire can quickly deplete their reserves and accordingly many non-admitted insurers have chose to non-renew their customers or increase their rates as high as 300% in one renewal period. In bankruptcy, a consumer would have no coverage apart from what is left of the fund and directed by the court.

*Many admitted insurance companies are converting their customers to a combination of Fair Plan and Difference In Coverage policies. Other's have left the market by non-renewal or blocked areas by certain counties, zip codes, and with use of topography based brush mapping. The ISO, one insurance industry based product provider, developed Fireline to map areas of greater concern. The non-renewal and rewrite efforts are focused on Fireline scores greater than a score 3 or they are using density metrics to limit their exposure in a particular areas.

*The California Fair Plan, once a last resort insurer for properties that could not find insurance in the admitted market, is being used as a primary source of insurance for large areas. This creates a density problem for the Fair Plan, it's more exposed to losses and is adjusting rates rapidly.

*The real estate market is severely impacted. Homes only able to be insured by the Fair Plan are viewed as uninsurable. It depresses property values to not be insurable by the admitted market. It has become an arbitration and disclosure issue in real estate contracts.

*An underinsurance crisis is brewing because of the design flaws of the Fair Plan. An example: code upgrade is inside the limit of insurance for the dwelling, not in excess. It does not have guaranteed replacement cost or extended replacement cost to protect against demand surge in construction costs. Perils like wind blowing off a roof and causing water damage creates a unique coverage claim dilemma when two perils occur and involve two different policies to cover the two different perils.

Solutions:

This is a moment in the home insurance market where less dramatic corrections in the market design can greatly impact the consumer experience, fix the market structural flaws, and help reduce the underlying catastrophes affecting the insurance industry and state. Here are 4 steps to take:

1. Repurpose the CA Fair Plan to be a reinsurer for wildfire or segment the peril to pool risk industry wide rather than at each admitted company. This would make the admitted market the only and primary source of a vibrant insurance market place. The cost of that peril would be assessed by the Fair Plan with use of data driven tools like the ISO Fire Line scoring system. This removes all the deficiencies in the Fair Plan design. It fixes the admitted market non-renewals, gives consumers true choice again, and opens up competition. Similarly we accomplished this before with the California Earthquake Authority legislation, but with one important difference than that of the CEA, wildfire should be mandatory rather than optional. Management, servicing, claims, and sales could be handled by the industry for less disruption to the consumer.
2. Introduce a state mandated system of discounts and penalties for the admitted market consumers, similar to the California Good Driver legislation. A discount for making a property defensible, validated by a copy of the local fire department inspection showing it passed. A surcharge for failure to comply with an inspection. A progressive penalty for continual non-compliance and eventual cause for non-renewal. Discounts and Surcharges for behavior reduce insurance risk over time. It must be an annual inspection.
3. Achievable inspection rules: currently the inspection guidelines for Cal Fire are not enforced. They are based on fire science that little to no properties can adhere to because they're so idealistic and foreign to the average homeowner. The fire departments don't enforce or ticket every property at this time and instead focus on the most egregious offenders. A mutually agreed standard needs to be set by the insurance industry and fire scientists. A bridge from the current non-compliance to the future science based standards needs to be created. An enforcement of what types of fuel can be left on the property, a footage of defensible space, and tree spacing need to be stressed. Defensible space fuel management should also include a landowner's responsibility to remove vegetation that jeopardizers a neighbor's structures. If a landowner has fuel within defensible space of a neighbor's structure, it needs to be removed.
4. SB 901 funding for fuel reduction should be purposed to clear the defensible space standards set. The officer inspecting a property should be able to make the standard clear, identify which vegetation should be removed, and issue a non-compliance notice if necessary. Compliance and buy-in from constituents would only happen if the inspection included a means tested application allowing the homeowner to get a voucher from SB 901 funding to bring the property up to the defensible space standards.

Conclusion: Without a comprehensive understanding of the issue, the insurance market place will be in crisis for some time. We need to have a pragmatic approach and solution. There are past examples of how to lessen the impact insurance consumers face and mistakes that can be avoided.

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