Perspectives on the Future of Fire Insurance in California

PAUL SOMERVILLE, TAHIRY RABEHAJA

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Iglesias et al. (2022) noted that:

"Recent fires have fueled concerns that regional and global warming trends are leading to more extreme burning. We found compelling evidence that average fire events in regions of the United States are up to four times the size, triple the frequency, and more widespread in the 2000s than in the previous two decades. Moreover, the most extreme fires are also larger, more common, and more likely to co-occur with other extreme fires."

This briefing reviews recent developments that have impacted the cost and availability of fire insurance in California, and describes the most recent events in PG&E's entanglement with deaths and losses caused by fires that it sparked during the past decade.

NATIONWIDE INSURERS STOP SELLING NEW FIRE INSURANCE IN CALIFORNIA

In February 2023, US national insurance company State Farm sought permission from the California Department of Insurance to increase rates on homeowners by an average of 28.1% in response to increasing wildfire risks and skyrocketing construction costs. The request was not widely reported at the time, but its significance grew when State Farm announced it would cease accepting new applications for both commercial and residential insurance in California on May 26. The company will continue to service its current customers, but if the rate increase is approved, a process that usually takes at least six months, State Farm's current customers would face increased monthly premiums when they renew their policies.

State Farm is California's largest single provider of bundled home insurance policies, with 20% of the market in 2021. Allstate, another nationwide insured, followed suit the next day. These moves follow American International Group, which informed thousands of customers last year that their home insurance policies would not be renewed, while Chubb also withdrew renewal from some of its customers.

State Farm blamed high construction costs that make it very expensive to rebuild after a home is destroyed in California, in addition to growing natural disaster risk, particularly from wildfires, and a challenging reinsurance market. California law prohibits insurers from passing along the cost of reinsurance to customers, which industry groups are lobbying to change.

Although this might suggest the beginning of a new emergency with insurers abandoning a fire and flood ravaged state, the withdrawal of California's largest home coverage provider is only the latest development in a wildfire crisis that has impacted the state's insurance market for years. After the disastrous fires in 2017 and 2018, the number of Californians who were informed that their policy would not be renewed increased by 42% to almost 235,000 households, as these two severe wildfire years wiped out decades of industry profits. Late last year, thousands of condominium owners in San Diego County also found themselves among the uninsurable as the state's regulated insurers dropped suburban homeowner association members.

All this has not yet caused house prices to decline: California is an extremely expensive place in which to live, in part because it is grappling with a roughly 1 million-unit housing shortfall. This is caused in part by the reduction in the number of places where it is safe to build because of the fires, as well as other zoning restrictions that have limited new construction projects.

REGULATION OF HOME INSURANCE IN CALIFORNIA

High rebuild costs, increasingly severe and more frequent wildfires and high prices of reinsurance are all risks that insurance companies might be willing to take on, but only at the right price. Increases in insurance premiums in California are approved or denied by the state's elected insurance commissioner. Industry groups have long argued that this office has not allowed providers to set prices commensurate with the cost of doing business in fire-prone California. Specifically, the office only permits retrospective actuarial approaches to estimating future losses, thereby ignoring the trends noted by Iglesias et al. (2022) and summarised in the introduction to this briefing note. The consequences of a continued exodus of insurers from California could be far more costly in the long run. For example, after the 1994 Northridge Earthquake caused about $42 billion in damage across Southern California, many home insurers stopped doing new business in California entirely. Since home insurance is a basic requirement for most home loans, the exodus of insurers caused a severe slowdown in the state's real estate industry. The State of California now has an ambitious program to increase the housing stock, but there is concern that it is being hampered by the lack of availability of fire insurance. There is a need for the insurance industry and the insurance commissioner to reach a realistic solution to the pricing of fire insurance before there is further erosion in the availability of fire insurance in California.

CAN THE LAST RESORT FOR CALIFORNIA HOMEOWNERS SURVIVE?

Another threat to the state's insurance industry is the possible demise of the FAIR Plan, the limited insurance plan Californians can turn to when no standard private company will cover them. It is funded by levies on private insurance companies that do business in the state. As the risk of catastrophic wildfire increases across California, that risk falls disproportionately on the FAIR Plan. Enrollments have surged 70% since 2019 to 272,846 homes in 2022.

If an especially severe fire season renders the FAIR Plan bankrupt, the cost would fall on those insurers still doing business in the state in proportion to their share of the market. State Farm, as the largest insurer, would have to pay the most. That may explain why State Farm decided to not issue new policies anywhere in California rather than just limiting new policies to places with low wildfire risk.

The problem is not unique to California. In Texas, the increasing severity of Gulf Coast hurricanes has driven tens of thousands of homeowners onto that state's chartered backstop insurer leading to talk of an inevitable crisis. In Florida, the crisis may have already arrived. Recently, Florida's insurance commissioner authorized a $1.25 billion line of credit to that state's insurer of last resort, which is now the single largest insurer, in preparation for the coming hurricane season.

PG&E LARGELY EVADES ACCOUNTABILITY FOR DEATHS AND FIRE DAMAGE IT CAUSED BUT PAYS FINES

In recent years, the Pacific Gas and Electric Company (PG&E), the largest electric utility in the United States, has faced years of reckoning over its role in California's wildfire crisis (Risk Frontiers Briefing Notes 372 and 403). Between 2017 and 2022, the company was blamed for at least 31 wildfires that wiped out entire towns, burned nearly 1.5m acres and 24,000 structures, and killed 113 people (Anguiano (2023).

PG&E has been found responsible for devastating fires linked to its power equipment that have killed 113 people across the state, resulting in mass payouts and the threat of criminal consequences. On Tuesday May 30, 2023, PG&E, was set to go on trial in Shasta County, California for manslaughter for sparking a wildfire known as the 2020 Zogg fire that claimed the lives of four people. However, the judge dismissed the charges and as it has done in many cases before, PG&E agreed to a multimillion-dollar settlement. In this case, the utility did not have to admit wrongdoing as part of the agreement.

According to Anguiano (2023), PG&E has sought to avoid judgments or face as few judgments as possible and has been largely successful in avoiding being held accountable and forced to change. PG&E has paid billions of dollars to settle claims from fire victims and pleaded guilty to 84 counts of involuntary manslaughter in the 2018 Camp fire, sparked when a crumbling piece of equipment, overdue for replacement by decades, cast sparks into the dry Sierra Nevada foothills, creating a fire that killed dozens of people, destroyed about 14,000 homes and leveled the town of Paradise. In the aftermath, it filed for bankruptcy. The company was still dealing with the fallout from the Camp fire when it sparked the Zogg fire in Shasta and Tehama counties.

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ABOUT THE AUTHOR/S

PAUL SOMERVILLE

Chief Geoscientist at Risk Frontiers

Paul is Chief Geoscientist at Risk Frontiers. He has a PhD in Geophysics, and has 45 years experience as an engineering seismologist, including 15 years with Risk Frontiers. He has had first hand experience of damaging earthquakes in California, Japan, Taiwan and New Zealand. He works on the development of QuakeAUS and QuakeNZ.

TAHIRY RABEHAJA

Software Engineer at Risk Frontiers

Tahiry is a Software Engineer with years of experience working with multiple operating systems, container technology, programming languages and various software stacks. Tahiry holds degrees in Mathematics and a PhD in Computer Science