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Informational Hearing

California's Homeowners' Insurance Market:

A Report by the FAIR Plan

Wednesday August 21, 2019
10:00 a.m.
State Capitol, Room 437

Introduction

In recent years, California has experienced a massive increase in the loss of life and property caused by wildfires. Beginning in 2015 with a spate of fires in Lake County, wildfires have devastated communities around the state including enormous fires in Butte, Shasta, Sonoma, Napa, Ventura, Santa Barbara and Los Angeles Counties. Among the many consequences of the losses caused by these fires are significant changes in the homeowner's insurance market in high fire risk areas.

A study of the homeowner's insurance market released in 2018 as part of the Governor's Fourth Climate Assessment found that insured losses through 2017 wiped out the entire underwriting profit insurers earned since 2000. The 2018 fires continued with another round of enormous losses. These losses have triggered rate filings by many property insurers, which have generally been approved by the Department of Insurance (DOI). The DOI's approval of these rate applications has increased rates (and therefore premiums for most policyholders – see discussion of "rate" vs "premium" below). These rates also generally reflect the widely recognized "new normal" of increased wildfire risks in many areas of the state by focusing the price increases in high risk areas.

In addition to increasing rates, insurers are re-evaluating whether they have an overconcentration of policies in high risk areas. This has resulted in many homeowners in these communities receiving a notice of non-renewal from their insurance company. Homeowners searching for new coverage invariably find it significantly more expensive than their prior policy. In some high risk counties, significant numbers of homeowners do not find a new policy from an admitted insurer, and therefore turn to either the FAIR Plan (California's "insurer of last resort") or a policy in the surplus lines market.

The combination of this process of *selective* non-renewal (see data from the FAIR Plan, below, that shows that California is not witnessing a wholesale withdrawal from the market) and premium increases has created significant stress among homeowners in high-risk areas. Some of this stress is likely temporary as some insurers reduce their exposure while other insurers take up policies in these high risk areas, with the FAIR Plan and surplus lines providing coverage for the remainder. Absent another event that significantly increases the projected risks in these high risk areas, the results of this market adjustment, once complete, are likely to remain stable for some time. However, it is reasonable to expect continued increases in premiums in high-risk areas so long as we continue to see major loss wildfire events associated with the "new normal."

Homeowners Insurance Basics

A typical homeowner's policy will protect against a variety of property and casualty losses, with each type of loss typically having a separate coverage limit. Dwelling coverage (referred to as "Coverage A") pays for damage to or destruction of the dwelling itself. Damage to or destruction of other structures on the property, such as fences and freestanding garages (referred to as "Coverage B"), is considered separately from the dwelling loss. Damage or destruction to personal property such as furniture, clothes, appliances, and electronics (referred to as "Coverage C") is also separated out from dwelling coverage. Standard policies also cover additional living expenses (referred to as "ALE"), such as temporary housing, while a home is replaced or repaired. A homeowners' insurance policy also typically covers losses due to theft or vandalism, as well as providing liability protection in the event the homeowner is sued as a result of an event associated with the property. Some risks, such as earthquake and flood, are not covered by a standard homeowner's policy (separate coverages are available for those risks). To the extent that a policyholder has not selected coverage limits sufficient to rebuild or repair the home, the homeowner is responsible for the remaining expense.

There are a few basic types of homeowner's insurance policies available in the market:

- **Actual Cash Value** – This type of policy provides for the cost to repair or replace the home (less depreciation) and caps the coverage based on the estimated normal cost of rebuilding.
- **Replacement Cost** – This type of policy provides for the cost to repair or replace the home (without depreciation) and caps the coverage provided based on the estimated normal cost of replacement.
- **Extended Replacement Cost** – Like the replacement cost policy, this type of policy provides for the cost to repair or replace the home (without depreciation) up to the estimated replacement cost, but provides additional coverage should the cost of replacement exceed the dwelling limit. This additional coverage typically increases the dwelling coverage limit by 25% - 50%.
- **Guaranteed Replacement Cost** – This type of policy does not have a limit on the dwelling coverage (although premium is charged based on the estimated normal replacement cost). Very few insurers sell this type of policy, as the open-ended expense due to "demand surge"[1] in the aftermath of a major catastrophe is highly volatile and unpredictable.
- **Stated Value** – This type of policy provides coverage for a predetermined amount in the event of a loss. Stated value policies are commonly used to cover mobilehomes.

[1] "Demand surge" is the polite term that many observers would replace with "price gouging."

Most policies require a deductible, which is an amount the insured is responsible for before coverage applies. Limits, deductibles, and exclusions are ways to define both the scope of coverage provided by the policy and the risk borne by the homeowner (sometimes referred to as "risk retention" or "self-insurance"). Risk retention provisions are included to eliminate/reduce small value claims for losses easily borne by the homeowner, and to provide a financial incentive to the homeowner to take responsibility for protecting the property. The less risk transferred to the insurer (higher deductibles and lower limits), the lower the premium charged for the policy. However, lower premium (and the associated reduced coverage) increases what the homeowner may have to pay out-of-pocket.

Usually, Coverage A establishes the baseline for calculating other limits. The chart below describes the various coverages and common limits for those coverages.

Coverage	Description	Common Limit
A. Dwelling	Pays for damages to the house and attached structures.	Consumer selects
B. Other Structures	Pays for damages to fences, tool sheds, freestanding garages, etc.	10% of Coverage A
C. Personal Property	Reimbursement for the value of lost possessions such as furniture, clothing, appliances, and other personal property items.	50% of Coverage A
D. Additional Living Expense (ALE)	Reimbursement for living expenses while the home is repaired or rebuilt, and therefore uninhabitable.	20% of Coverage A
E. Personal Liability	Pays for financial losses arising from some forms of legal liability.	Consumer selects
F. Medical Payments	Pays for medical expenses for people injured on the property.	Consumer Selects

Policies may also provide code upgrade coverage (typically with an additional premium charged) to pay for costs of rebuilding based on updated building codes that have been adopted since the home was originally built. One expert notes that code upgrades for a home built before the early 2000s can drive up construction costs by as much as 20%.

Some insurers offer to increase the limit annually based on inflation and/or the increased cost of rebuilding. The premium charged will reflect the increased coverage. These mechanisms are designed to prevent the value of the Coverage A limit from eroding over time, but these increases may not suffice when the cost of rebuilding increases dramatically after a catastrophe.

The FAIR Plan Structure and Purpose

The California FAIR Plan – "Fair Access to Insurance Requirements" – is an "association" of all admitted (licensed) insurance companies that sell property insurance in California. It was created by statute[2] in the 1960's, following urban disturbances, notably the Watts Riots in Los Angeles. Similar associations were created in other states for the same reasons. The purpose of the FAIR Plan was to ensure that urban property owners, mostly businesses, would have "access" ("fair access") to the property insurance necessary to continue to operate in a market that insurers viewed as too risky to cover. That risk evaluation resulted in a substantial market withdrawal by insurers from the urban property market. Despite its initial creation as an urban/business "insurer of last resort," the FAIR Plan expanded to provide coverage in "designated" brush fire regions of the state. It operated fairly well in this manner until the mid-1990's, when, as a consequence of the genuine homeowners' insurance crisis that followed the Northridge earthquake in 1994, the entire state was designated as the appropriate FAIR Plan coverage region.

The enabling statute provides, in part, that the purpose of the FAIR Plan is to "provide for the equitable distribution among admitted insurers of the responsibility for insuring qualified property for which *basic* property insurance *cannot be obtained* through the normal insurance market." (Emphasis added.)

In a broad sense, the purpose of the FAIR Plan is to be the insurer of last resort for "basic" property insurance in the event of a market failure. At inception, that was essentially urban commercial property. Ultimately, it has expanded to include homeowners' insurance anywhere in the state, provided that the insurance "cannot be obtained" in the normal manner in the market.

There appears to be some sentiment in the market that a FAIR Plan policy is not "real" insurance or is, in some way, inferior to private market insurance. While it is true that, by statute, the FAIR Plan policy is not as broad as traditional homeowners' policies, it is nonetheless a fully sound and guaranteed policy that satisfies lenders' security requirements and protects the property against the primary risk factor faced by homeowners in the Wildland Urban Interface (WUI) – fire. Other coverages are readily available in the market (typically through the purchase of a "difference-in-conditions" or "DIC" policy), which provides wraparound coverage that, coupled with a FAIR Plan policy, results in the same protection provided by a standard homeowner's policy. Because the FAIR plan's role is to provide coverage when the regular market won't, it is not the role of the FAIR Plan to provide DIC policies when there is a healthy market for those policies.

Market Withdrawal – Insurance After the Northridge Earthquake

The current role of the FAIR Plan is largely a result of the aftermath to the 1994 Northridge earthquake. A brief review of California's experience in the mid-1990's in comparison with today's current market conditions is helpful in evaluating the extent of the current problems and the efficacy of *existing* solutions.

Just as the past 3 or 4 years of wildfire losses has shaken the insurance industry's confidence in its prior assessment of the scale of wildfire risk, the Northridge earthquake generated a comparable re-evaluation with respect to earthquake risk in California. The market response was

[2] Technically, the statute does not "create" the FAIR Plan. Rather, it directs the insurers to establish, subject to approval by the Insurance Commissioner of a plan of operations, the Plan which is governed by a "governing committee" comprised of representatives of members insurers.

predictable. As long as state law mandated insurers to write earthquake insurance for any homeowners' insurance policyholder who chose to buy it, insurers would simply not write new homeowners' policies.

In the absence of a statewide coverage area for the FAIR Plan, the homeowners' insurance market for new policies virtually collapsed, and there was a serious and immediate risk of widespread non-renewals of existing policies. Escrows on home sales were failing for lack of available insurance (not merely insurance that prospective buyers found to be more expensive than had historically been the case). There was a complete lack of availability of homeowners' insurance to be purchased at any price.

The administrative/legislative response was essentially two-fold. Administratively, the FAIR Plan was expanded to statewide, thereby ensuring access to essential coverage so that the state's real estate market would not collapse. Legislatively, the California Earthquake Authority (CEA) was established to address earthquake insurance in a manner that would enable a recovery of the basic homeowners' insurance market. Both of these efforts succeeded. [3]

There are several lessons to be drawn from the 1990's crisis:

1) The extent of the crisis was widespread, affecting all regions of the state, and severe in the sense of direct threats to an otherwise healthy statewide real estate market. We have not seen the current wildfire-driven market dislocations expand to the magnitude of the 1990's crisis.

2) It is very difficult to mandate that insurers write policies that their risk analysis shows to be unmanageable. This remains true either because the aggregate risk posed is too great or because existing rate structures do not permit insurers to charge adequate premium based on the risk created by issuing the policies.

3) There was credible evidence that insurers were delaying a more drastic market withdrawal across the state, absent administrative/legislative action to address the crisis.

4) The primary administrative tool (expansion of the FAIR Plan statewide) both served its immediate purpose, and in the years since, has not been tested in any sort of market crisis.

The challenges in the current insurance market caused by wildfire, and the FAIR Plan's effectiveness in answering these challenges, is discussed in more detail below.

<u>Insurance pricing in the WUI (and elsewhere)</u>

Recent media reports have described homeowners in the WUI facing insurance rate increases of double and triple what they have historically been paying. There have also been reports of homeowners being "unable" to obtain insurance, and of home sales that have failed because the prospective buyer could not afford the quoted premium to insure the home. Each of these

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[3] It bears mentioning that for the portion of the market that did not join the CEA, earthquake insurance rates increased shortly after the Northridge quake in excess of 50% across the state – and higher in high risk regions. Part of the 1990's "new normal" with respect to earthquake insurance was significantly higher costs for consumers.

"reports" deserves thoughtful consideration in light of market reality which is substantially driven California's rate regulation system and the premium structures it creates.

There is a difference between insurance "rates" and the "premium" a particular homeowner pays to their insurer. In insurance regulatory parlance, "rate" means the average price to be paid by customers that will generate an adequate amount of money required to cover the insurer's anticipated expenses and make a reasonable rate of return.[4] The "premium" that any particular homeowner pays is the result of the approved "rating plan" or "class plan" that uses a series of positive and negative factors to determine that actual price paid. This class plan spreads the cost required to cover insurer's losses, expenses, and return (all defined by DOI regulations) among the insurer's policyholders based on a set of factors also approved by DOI. Allocating premium within these rules is essentially a zero-sum game where a factor that reduces the premium charged in one area must be offset by a factor that increases the premium charged in another area. When those factors result in an insurer charging premium inadequate to pay the losses associated with a category of homes, that gap must be filled by higher premiums charged for categories of homes with lower losses.

As an example, the FAIR Plan recently was granted (after filing a lawsuit against the DOI) a 20% rate increase and a new rating plan to reflect changes in the risk exposure presented by homes in the WUI. That 20% increase translates into premium reductions of as much as 20% for policyholders in low risk areas and premium increases of 50-60% for policyholders in high risk areas. This new rating plan authorized for the FAIR Plan is in recognition of the fact that homeowners in the WUI have historically been significantly *subsidized* by homeowners in low-risk regions of the state, who have paid higher premiums so that WUI premiums could be lower.

Pooling risks through insurance mechanisms creates the possibility, in fact a likelihood of, creating subsidies. In its most basic operation, insurance literally "subsidizes" those with losses with the premiums paid by those without losses. That is not the sense in which the term is used here. Rather, it is used in a broader sense. Determining how risk will be priced and how groups of insureds will be assembled to share that risk will create some financial incentives and disincentives. Financial incentives and disincentives are not determinative of individual behavior, but they do influence behavior that is not limited only to the insurance market. Thoughtful consideration of how the incentives/disincentives are created by the rules imposed for pricing risk (rating) and for assembling insureds (underwriting) create subsidies and those subsidies can either support or undermine the insurance market, as well as broad public policy goals. To the extent that subsidies are created on purpose, to serve identified public policy goals, those decisions ought to be made by policymakers with eyes wide open to the facts and consequences of the decision to create the subsidy.

In the private admitted market, this subsidy factor is even more pronounced than it has been with respect to the FAIR Plan, and as a result, homeowners in the WUI are not merely experiencing a "new normal" but also losing a long-term discounted price that was far below the actual cost of providing insurance in the WUI. This point needs to be clearly understood, *the premiums*

[4] Pursuant to Proposition 103, and the current regulations adopted by the Department of Insurance, an admitted insurer cannot charge a rate before it has been approved by the Insurance Commissioner, and that rate is set at the constitutionally minimum that can be imposed without resulting in a "taking" that would violate the United States constitution's "Takings Clause".

historically paid by homeowners in the WUI have already been substantially subsidized by low-risk policyholders. Actions to reduce this subsidy will cause WUI premiums to rise independent of any consideration of the "new normal" and the billions of dollars in recent losses. Each of these factors will inflate property insurance cost in the coming years for all homeowners, but the increases born by homeowners in lower risk areas would be reduced to the degree that the current subsidy to the WUI is reduced.

Insurers point to two current regulations adopted by the Department of Insurance, that Commissioner Lara has the authority to change, as contributing to the underpricing of policies in WUI.[5] First, and most surprising, the rate regulation system *precludes* counting actual and proven reinsurance expenses as legitimate costs that can be built into the rate base.[6] It is widely accepted that insurers need to buy reinsurance to guard against catastrophic losses that may exceed expected losses. This is, now, especially true with respect to policies that cover homes in the WUI, and reinsurance prices have been rising in the face of substantial losses reinsurers have experienced in recent years. Thus insurers are bearing increasing reinsurance costs without being able to recover those costs through premium. Insurers argue that the current rate regulation system inherently underprices premiums in high risk areas. Second, the rate regulation rules *prohibit* the use of even the most sophisticated forward-looking risk modelling tools.[7] Rather, the rules require a retrospective look at historical losses. Insurers argue that if, in fact, we are facing a "new normal" with wildfires, limiting rate regulation analysis to historical losses inherently underestimates the risk, and results in underpricing. It is an unpopular and uncomfortable truth that price and availability go hand in hand. If insurers are facing underpriced premiums in high risk areas, their willingness to issue or renew policies in these areas will be low or non-existent.

In addition to potential pricing concerns, large market share companies are also reconsidering the mix of risks presented by their current policyholders. The losses in recent years and the reality that this likely represents a "new normal" does require most insurers (particularly those with a large piece of the market) to reconsider if their policyholders are over-concentrated in high risk areas. Concentration of risk is an essential consideration when selling homeowner's insurance. The insurance community was reminded of this last year when a small insurer (Merced Casualty Insurance Company) became insolvent following the Camp fire. While large California insurers are backed by immense financial resources, it would be foolish for any company not to re-evaluate its current risks through the lens of the "new normal."

While the homeowner's insurance market is generally quite competitive (dozens of insurers offer homeowner's policies in California), there is commonly a wide variation in the premium charged by different insurers for the same home. That variation has a number of causes. As noted above, rates are primarily based on the losses that the insurer is likely to bear among the homes it insures. If the insurer has a riskier group of homes, its rates will be higher. Each insurer also develops its own class plan based in part on the mix of homes it insures. Lastly, while homeowner's insurance is a fairly standard product, policy design choices made by individual

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[5] The Legislature does not have the authority to direct the Insurance Commissioner to make these two changes, as the rate regulation system adopted by initiative statute specifically delegates that role to the commissioner.
[6] See California Code of Regulations, Title 10, Section 2644.25.
[7] See California Code of Regulations, Title 10, Section 2644.4, subdivision (e).

insurers do have a cost impact. Some insurers offer more generous coverage for contents or ALE than others and that generosity comes at a cost.

One consequence of California's rate regulation system is that many of the large market share insurers tend to have lower prices than small market share companies simply because few small market share companies' rate applications are challenged by interveners. Interveners exert pressure to reduce requested increases (or even turn requested increases into rate reduction orders) from large market share companies. Since many of the non-renewals in the WUI are from larger market-share insurers, when homeowners in the WUI find coverage from another admitted company they are likely get that coverage from a smaller market share company with higher rates.[8]

California Insurance Cost

As a general matter, Californians have had very low premiums for homeowner's insurance. A recent comparison of costs conducted by Insurance.com found that the average premium in California for a $200,000 replacement cost policy was 37th among the 50 states. The national average premium for that policy was $1288 and the average cost in California was $793 (35% lower than the national average.) For comparison purposes, the highest cost state was Florida with the same coverage costing $3575. West Virginia was the mid-point with $1288 and Hawaii was the lowest at $337.

While the sample limits used to generate those figures are certainly well below typical values in California, the study does highlight that California has been a low cost state for homeowner's insurance. We should expect that premium cost will increase across the state in response to the massive losses experienced in recent years, and the recognition of the "new normal" associated with Climate Change. However, California homeowners will continue to enjoy lower rates than many states despite these expected rate increases.

FAIR Plan Market Activity

The FAIR Plan recently provided the Committee with data regarding its issuance of new policies throughout the state in the past 12 months (June 2018 – June 2019). The Committee sought this data as an indicator of conditions in the homeowner's insurance market. We would expect to see increases in new FAIR Plan policies in areas where insurers are issuing non-renewal notices in substantial numbers.

There is not a one-to-one correspondence between newly issued FAIR Plan policies and non-renewals because homeowners[9] are required to conduct a diligent search of the private market for new coverage before resorting to the FAIR Plan. After receiving a non-renewal notice, some homeowners will find coverage from the private market in the course of that diligent search -- information provided by the FAIR Plan supports the inference that coverage from the regular

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[8] It may also be possible that homeowners are experiencing the effect of getting new rebuild estimates. There has been heightened scrutiny on the rebuilding estimates that are used to establish the Coverage A limit in a homeowner's policy. As most homeowners do not shop for insurance very often, many may not have adjusted their Coverage A limits for years or decades and their new policy may reflect a higher Coverage A limit and the price that comes with it.

[9] Or, more specifically, the homeowner's insurance agent or broker.

market is available in many areas. However, where there are significant increases in FAIR Plan policy counts, it is a sound assumption that there has been an increase in the number of non-renewal notices sent to homeowners.

The data show that there has been significant increases in the number of new policies issued by the FAIR Plan in a number of counties in the Sierra foothills, indicating a substantial increase in non-renewal activity in those communities. New policy issuance in the most affected counties accelerated strongly beginning in December 2018, and that pattern continued in the ensuing months. Counties that have seen the greatest increases include Amador, Calaveras, El Dorado, Mariposa, Nevada, Trinity and Tuolumne, while counties such as Butte, Lake, Lassen, Mendocino, Mono, Placer, Plumas, San Bernardino, Shasta, and Sierra have seen smaller, but still significant, increases. In the most affected counties, there has been as much as a ten-fold increase in the number of policies issued on a monthly basis. Individual communities within these counties have seen even more dramatic increases in the proportion of homeowners obtaining coverage from the FAIR Plan.

It is also notable that counties substantially (or entirely) outside of high-risk fire areas did not see meaningful increases in new FAIR plan policies. This data indicates that insurers are largely limiting non-renewal activity to high-risk fire areas, and insurers are not broadly withdrawing from the homeowner's insurance market. The FAIR Plan reports issuing over 43,000 new policies in the past 12 months. To put that number in perspective, the Department of Finance estimates that there are over 8 million single-family/detached homes in California which means that the overwhelming majority of homeowners in California have access to insurance in the regular market.

Clearly some communities (primarily in the Sierra foothills) are experiencing a major market adjustment. However, that adjustment is likely a one-time phenomenon as homeowner's policies are generally renewed on an annual basis, and insurers are likely to reduce their risk exposure over one or two renewal cycles. The FAIR Plan has also experienced a notable volume of new policyholders cancelling their policies within months of issuance (17% of policies issued in October 2018 have been cancelled by the policyholder). Because insurance is not optional for a homeowner with a mortgage, these policyholders have found other coverage that is most likely in the regular insurance market. Some of this activity likely reflects that these homeowners are becoming more sophisticated consumers. The majority of homeowner's policies in California are issued by a relatively small number of insurers that work through "captive" agents (who are essentially limited to selling coverage from a single company) which means that most homeowners have not experienced interacting with an independent insurance agent. When these large market share companies issue a non-renewal notice, homeowners are most likely to find coverage with a smaller market share company, and those companies generally work through independent agents who sell policies from many insurers.

Increasing Fire Risk and the Insurance Market

A recent study sponsored by the California Natural Resources Agency and published by the RAND Corporation compared the insurance market in certain areas of the Sierra Foothills and San Bernardino County. The study also looked at the potential impact of climate change on that market based on recent trends. Although the study only looked at two areas in California, the findings are useful for all Californians who live in or near similar forested areas. That study made several findings pertinent to any conversation on high-risk areas and the insurance market.[10] The study found that:

- The average acres burned annually in the Sierra Foothills will double by midcentury and likely double again by the end of the 21st century.
- Homeowners in high-risk areas purchase less coverage relative to structure value, meaning that these homeowners, facing increased expenses, appear to have chosen to be underinsured.
- Climate change could substantially affect the insurance market in some parts of the Sierra Foothills. In some of the highest fire risk, by 2055 the rate per $1,000 of coverage in the admitted market is projected to rise by 18%, the insurance-to-value ratio is expected to drop by 6.5% (homeowners will be even more underinsured), and deductibles will increase by $121.

The study also discusses the recent catastrophic loss on insurers underwriting profits. Underwriting profit represents that portion of the premium that is set aside to pay claims but is not used for that purpose. What is not used one year, may be reserved and used in future years. The authors examined the underwriting profits in the homeowners multiple peril line (policies that cover a variety of damage types) and noted that they were highly negative in 2017. Many insurers lost money, and a good portion of those losses were due to wildfire. Those losses were paid for by profits from prior years. The study notes:

> The underwriting experience between 2001 and 2017 illustrates that an extended period of underwriting profits can be wiped out by a very large wildfire or other catastrophic event (a fire following an earthquake, for example). Underwriting profits in the Homeowners Multiple Peril and Fire lines totaled $12.1 billion from 2001 through 2016 combined, and were almost completely wiped out by the results for 2017. Insurers may not believe that the return is adequate to justify the risk, even once investment returns are included. [11]

<u>Recent Legislative Actions</u>

There appears to be some sentiment that the Legislature must "do something" despite the fact that existing law mechanisms are in fact performing as planned in the face of the current market response to wildfires. It bears recalling that last Session, the Legislature passed and the Governor signed a broad scope of insurance market reforms specifically targeted at addressing a number of problems that the recent wildfires highlighted. Many of these 2018 bills included a delayed effective date to allow either the Department of Insurance or the insurers' time to implement the changes in law. Thus, a number of the 2018 reforms are just now, or in the

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[10] Lloyd Dixon, Flavia Tsang, and Gary Fitts, *The Impact of Changing Wildfire Risk on California's Residential Insurance Market*, RAND Corporation and GreenwareTech (Aug. 2018), p. 47, available at https://www.rand.org/content/dam/rand/pubs/external_publications/EP60000/EP67670/RAND_EP67670.pdf.
[11] *Id.* at 55.

immediate future, being implemented. Further Legislative action prior to an evaluation of the efficacy of the 2018 reforms may be premature. These insurance bills include:

SB 30 (Lara), Chapter 614, Statutes of 2018, requires the Insurance Commissioner to convene a working group to assess new and innovative investments in natural infrastructure and insurance products in light of California's worsening fire vulnerability due to climate change.

SB 824 (Lara), Chapter 616, Statutes of 2018, prohibits an insurer from canceling or refusing to renew a homeowners' insurance policy for one year from the date of a declaration of a state of emergency, as specified; and requires admitted insurers with at least $10 million in written premiums in California to biennially report to the California Department of Insurance specified fire risk information on residential property policies.

SB 894 (Dodd), Chapter 618, Statutes of 2018, requires insurers to renew a residential insurance policy for at least two renewal periods (24 months); requires an insurer to grant an additional 12-month extension for a total of 36 months for additional living expense if an insured acting in good faith encounters a delay in the reconstruction process, subject to policy limits; allows an insured to combine payments for actual losses up to the policy limits for the primary dwelling and other structures, limited to the amount necessary to rebuild or replace the home if the policy limits for the dwelling are insufficient; and specifies that the payments for losses under this provision shall be full replacement value without requiring the replacement of the other structures.

SB 917 (Jackson), Chapter 620, Statutes of 2018, provides that if loss or damage results from a combination of perils, one of which is a landslide, mudslide, mudflow, or debris flow, an insurer shall provide coverage if an insured peril is the efficient proximate cause of the loss or damage and coverage would otherwise be provided for the insured peril; provides that this is declaratory of existing law.

AB 1772 (Aguiar-Curry), Chapter 627, Statutes of 2018, extends the minimum time limit for an insured to collect the full replacement cost of a loss related to a state of emergency to 36 months; requires an insurer to provide additional extensions of 6 months if the insured, acting in good faith and with due diligence, encounters a delay or delays in approvals or reconstruction of the home; and requires all policy forms issued or renewed by an insurer to be in compliance with these changes on or after July 1, 2019.

AB 1797 (Levine), Chapter 205, Statutes of 2018, requires an insurer that provides replacement cost residential property insurance to provide to the policyholder, every other year at the time of the offer to renew the policy, an estimate of the cost necessary to rebuild or replace the insured structure, with certain exceptions as specified; and takes effect on July 1, 2019.

AB 1799 (Levine), Chapter 69, Statutes of 2018, requires the complete copy of a residential insurance policy provided to an insured after a loss to include the full insurance policy, any endorsements to the policy, and the policy declarations page; and provides that if the request for a copy of the policy is a result of a loss in a state of emergency, the insurer may, upon the request of the insured, provide an electronic copy of the entire policy, as specified.

AB 1800 (Levine), Chapter 628, Statutes of 2018, prohibits, in the event of a total loss, a residential property insurance policy from containing a provision that limits or denies payment of building code upgrade cost or replacement cost, including extended replacement cost, to the extent those costs are otherwise covered under the policy, based on the fact the insured has chosen to rebuild or purchase a home at a new location.

AB 1875 (Wood), Chapter 629, Statutes of 2019, establishes the California Home Insurance Finder that will connect consumers who need residential property insurance with agents and brokers to help ensure they obtain plans and coverage that suit their specific needs and requires insurers to annually report the amount of extended replacement cost coverage to the Department of Insurance as specified.

AB 2229 (Wood), Chapter 75, Statutes of 2018, requires a residential property insurer to disclose any fire safety discounts it offers upon offer or renewal of a homeowner's insurance policy on or after January 1, 2020.

AB 2594 (Friedman), Chapter 639, Statutes of 2018, revises the standard form fire insurance policy to extend the statute of limitations to bring suit to 24 months after the inception of the loss if the loss is related to a state of emergency, as defined.

Concluding Thoughts

There is no "right" answer to the problem of how to provide homeowners with financial protection from catastrophic wildfire losses. Wildfires wreak tremendous personal and financial havoc on many Californians. The grim truth is that these losses will occur and the losses will be spread in varying amounts to insurers, government, homeowners generally, or individual homeowners who suffered losses. Much of that spreading will be driven by decisions we collectively arrive at regarding how insurance is priced (rate regulation) and what rules insurers must follow when deciding to offer coverage (underwriting). There is a virtually infinite number of combinations of rate making and underwriting rules, and each combination will spread these costs (both previous and future costs) differently.

To the degree we adopt policies to subsidize homeowners in high risk areas through insurance, that subsidy will be paid for by homeowners outside the high risk areas. This subsidy for homeowners in the WUI will act as any other subsidy will by tilting (ever so slightly) the economics in favor of those living in the WUI. The question of whether that subsidy is desirable and, if so, whether providing that subsidy through the mechanism of insurance is most likely to be effective, are both questions that should considered when making policy in this area.

Finding the balance between individual responsibility (i.e., paying higher premiums and buying more insurance in high risk areas) and collective protection (i.e., spreading costs and raising premiums in low fire risk areas) is an inherently subjective endeavor. Any balance found is likely to clash with other difficult and important public policy issues, such as the availability and affordability of housing, planning and land use policy, protection of property rights, environmental protection, and climate change. Legislating in an area so interconnected greatly increases the likelihood of any policy change to generate unintended consequences – for example, retaining or increasing subsidies for homeowners in high risk areas of the state will encourage continued development in places many environmentalists argue are not appropriate for this sort of development.

Policies that shift these losses, and the cost of bearing the risk of future losses, would create incentives that sometimes support and sometimes impinge on policies being pursued to address these other issues. For example, spreading the losses widely across homeowner's insurance policies and suppressing the cost of insurance in high fire-risk areas will reduce the cost of homeownership in those high risk areas, but increase it in low risk areas. While insurance is a relatively small portion of the total cost of owning a home, for those on the margins[12] an added insurance cost may be the difference between affording a home or not. Assessing how strong an incentive this might present and how it interacts with other policies being pursued regarding further development in the WUI, and the absolute need to build more housing units is a complex and nuanced task. By the same token, pursuing a policy that focuses insurance costs more strongly in high fire risk areas creates the opposite incentives with no less complex and nuanced implications. Any significant policy proposal in this area is based (implicitly or explicitly) on a series of value judgments regarding the relative priority of competing policy priorities and conceptions of fairness. It must also contend with the structural limitations imposed on the Legislature by Proposition 103, which effectively precludes passing bills governing rate setting for property/casualty insurance. There is great risk that legislating extensive new rules for underwriting alone (without compensating changes in rate making) would significantly disrupt a homeowners' insurance market that is effectively serving the great majority of California homeowners.

As noted above, it is an unpopular and uncomfortable truth that property insurance costs in California are going to rise, and this is especially true in the WUI. It follows that as the impact of this reality moves through the market, there will be disruptions and discomfort. However, until the volatility of the current market has had an opportunity to settle, it would be perilous to propose major "reforms" to a market where it is yet unclear where and to what extent it may be failing.

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[12] Recent media reports have identified anecdotally home purchase transactions that have "failed" due to unexpected insurance costs. For those prospective purchasers who have "maxed out" their borrowing ratios on the premise of historical insurance costs, some may discover that they no longer qualify for a loan at the desired purchase price. However, most buyers will face a personal choice – do I "want" to buy in the WUI in light of the reality of current cost structures.