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Informational Hearing

# The Current State of the Insurance Market: Ongoing Challenges and Opportunities

Wednesday, March 1, 2023, 10am-noon
1021 O Street, Room 1200

## Summary

In recent years, California's growing natural disaster risk has created challenges for its insurance market as characterized by rising premiums and deductibles, declines in coverage, and sometimes even policy discontinuance.

This hearing is intended to provide a broad-based, high-level update on the current state of California's market, including ongoing availability and affordability challenges, and discuss opportunities to improve consumer access and ensure long-term market stability in the event of future disaster-related disruptions.

## Insurance Market Overview

Most California households cover their primary residence through standard homeowners insurance policies provided by insurers in the 'admitted' market, which are those companies that are regulated by the California Department of Insurance (CDI). Homeowners who are unable to find coverage in the admitted market can purchase a policy from the 'nonadmitted', also known as 'surplus line' market, which consists of insurers that are not regulated by the CDI. Insurance products are delivered through captive agents, independent agents, brokers, and directly to the consumer.

California’s insurance market is not monolithic; individual insurers vary in scope and size. While they might act similarly based on market trends, each insurer is responsible for managing their own risk exposure. Currently, according to information from CDI, California has 111 insurers writing comprehensive homeowners’ policies and 139 surplus line carriers offering insurance policies.

## New, Renewal, and Nonrenewal Policy Data

The number of policies issued, renewed, and non-renewed in California can help measure insurance access. The CDI collects this data annually from insurance companies in California that write $5 million or more in premiums in homeowners and dwelling fire insurance lines. The CDI states this represents approximately 98% of the homeowners’ insurance market. According to the CDI’s latest residential insurance market policy count data, insurers issued and renewed nearly 9 million policies and nonrenewed approximately 240,000 in 2021.

Insurers have many possible reasons for refusing to issue or renew a policy, such as prior claims history or exposure to civil liability (such as the likelihood a homeowner’s dog would bite.) However, policyholders tend to nonrenew policies at a much higher rate than insurers. Reasons for nonrenewal might include death and the sale of the home. The CDI’s data shows consumers statewide terminated roughly 877,000 policies in 2021. Generally, areas with the highest risks have higher insurance premiums and higher rates of nonrenewals.

## The Wildland Urban Interface (WUI)

According to the Insurance Information Institute (III), in an April 2022 issue brief, people moving into risk-prone areas, broadly referred to as the Wildland Urban Interface (WUI), are one of the key factors driving the state’s insurance market challenges. The III notes that more people, homes, businesses, and infrastructure locating to the WUI means more costly damage when extreme events occur. A September 2022 article in the New York Times, titled “As Wildfires Grow, Millions of Homes Are Being Built in Harm’s Way,” states that California has roughly 5.1 million homes, a number that is rapidly rising, in WUI areas, which are often on the outskirts of cities, where houses and other development are built near or among flammable wild vegetation.

While there is no single reason to explain the rise of development in the WUI, those who live there tend to be a socioeconomic mix of people interested in living closer to nature, those with families who cannot afford to live in city centers, and/or residents of little towns that have existed there for generations, among others. Moreover, as noted in the article, many cities in California have restricted development in denser downtown areas, further pushing people to the state’s outer fringes.

Unfortunately, when disasters strike, they tend to inflict most of their damage in these transitional zones where homes and businesses encroach on otherwise undeveloped wilderness. For Californians living in these areas, insurance can be a critically important tool to aid in post-disaster recovery.

**The FAIR Plan**

When homeowners are unable to find coverage through the private market, they can turn to the state-mandated Fair Access to Insurance Requirements (FAIR) Plan, which is made up of all admitted insurers in the state. FAIR Plan policies are not intended to replace standard coverage, and, as such, they are expensive and offer slim benefits. The FAIR Plan is intended to serve as a temporary safety net for property owners until traditional insurance coverage becomes available.

According to background material provided by the FAIR Plan, roughly 44% of FAIR Plan policies cover properties in California's urban areas while the rest are in the WUI. Unlike the normal market where traditional insurers can select a mix of low- to high- risk properties and manage the number of properties in a given area to limit their risk, the FAIR Plan, as an insurer of last resort, covers a higher concentration of high-risk properties, which means there is a greater risk of a disaster affecting many policyholders at the same time.

Although the CDI reports that the FAIR Plan covered less than 3% of California homeowners in 2021, enrollments continue to steadily increase. According to the FAIR Plan's data, the total number of FAIR Plan policies in California were 272,846 in 2022, up from 242,318 in 2021, and 209,874 in 2020.

**Permanent and Potential Market Solutions**

California has taken a few steps to address disaster-related disruptions to its insurance market. As noted in a November 2022 issue brief by the nonprofit research firm, Resources For the Future, in 2018, the Legislature passed Senate Bill (SB) 824 (Lara), which prohibits insurance companies from canceling or refusing to renew a policy for one year after a state of emergency is declared, provided the structure is within a wildfire area; and SB 894 (Dodd), which requires insurers to renew policies for at least 24 months, if the property suffered a total loss in a declared disaster. Since then, the CDI has issued 24 moratoria covering zip codes throughout the state.

Separately, the RFF points out that the CDI has also taken a number of actions to address market challenges relating to access and affordability. In September 2021, the CDI issued an order requiring the FAIR Plan to offer a more comprehensive homeowners policy that covers dwelling damage, loss of personal property, and liability. Moreover, in October 2022, the CDI adopted regulations requiring insurance companies to adopt rates that reflect homeowner and community disaster mitigation activities, specifically related to wildfires.

More recently, however, the Legislature has called on the CDI to immediately order the FAIR Plan to increase its commercial property coverage limit from the current level of $8.4 million to at least $20 million. In so doing, the Legislature acknowledged such an action would be a short-term solution to assist homeowners' association communities and residents of condominium developments in WUI areas that are having difficulty accessing coverage due to high concentrations of climate-related risks, particularly from wildfires. In response, the FAIR Plan has indicated that it is carefully reviewing the potential consequences of such an increase.

## Conclusion

As the number of natural disaster-related insurance claims filed in California increases, so, too, will the cost of insuring homes in high-risk areas. While nonrenewal moratoriums and other measures passed by the Legislature, combined with actions taken by the CDI and the industry, can provide market stability in the short term, they may not provide a longer term solution to California's insurance affordability and availability challenges and insurers facing rising costs may eventually exit the market. Successful collaborations between government and non-government entities alike to minimize disaster risk in communities and the development of policies that align premiums to better reflect risk should be considered among the strategies to deploy in order to sustain the market in the long-run.