Wildfire
California's Newest Insurance Crisis

WHITE PAPER

TABLE OF CONTENTS

OVERVIEW

Global insured losses continue to outpace historical averages, destroying the hope for a swift return to a more stable insurance market environment. Many challenges will continue in 2023 for insureds with significant exposure to wildfire, named storm, convective storm, and flood.

After a record year of wildfires in 2018, it was estimated that over 350,000 California homes and businesses could not purchase adequate property and casualty insurance because of the increased risk of wildfires that insurance carriers were facing; this number has increased substantially every year since.

Wildfires, a longstanding and frequent threat to California, are expected to increase in intensity and frequency due to climate change. Climate change is considered the main cause for the increase in the number and severity of wildfires in California over the past decade

Stats:

- California is by far the most at-risk state for wildfires in the U.S., with nearly triple the number of properties at-risk in 2022 as the second-highest state. While Texas has less than 717,000 at-risk properties, California has more than two million at high or extreme risk from wildfires. (Verisk). [1]

- The Insurance Information Institute (Triple I) data shows the Top 10 Worst and Costliest Wildfires were all in California, causing several billions of dollars in losses.[2]

- Five of the top 20 largest California wildfires occurred in 2020, with four in 2021.[3]

- 2020 wildfires in the U.S. caused $16.5 billion in damages, making it the third-costliest year on record; 2017 being the highest at $24 billion and 2018 a close second at $22 billion. According to Yale Climate Connections, these figures do not account for indirect damages, which experts estimate cost around $150 billion for the record-setting 2018 wildfire season.[4]

- The average claim paid out by State Farm for a wildfire as of March 2022 was $224,000, which shows an 8% increase over 2021. California, Colorado, and Oregon make up 95% of paid claims.[6]

California Legislative Change in Response to Catastrophe Loss and Past Insurance Crises

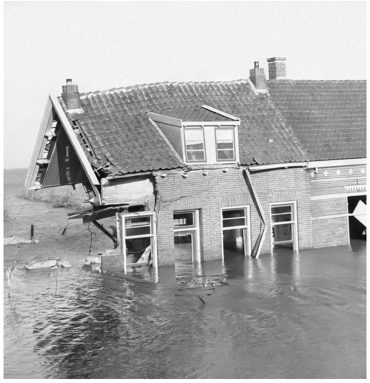
Historically with each Insurance crisis, legislators respond critically and try to force insurance carriers to bend to their desires. Then the insurance carriers push back by leaving the state. Those that stay take advantage of high rates, high deductibles, and less coverage until the Department of Insurance and Legislators back down and enact new legislation until the next crisis.

1968 The CFP:

The California FAIR (Fair Access to Insurance Requirements) Plan was established in July 1968 following the brush fires and riots that wreaked havoc in California in the 1960s as the state's insurer of last resort. The FAIR Plan was created to ensure access to basic property insurance for California homeowners who have been unable to obtain homeowners insurance from the voluntary market for reasons outside of their control.

1968 The NFIP

Congress created the National Flood Insurance Program in 1968 through the National Flood Insurance Act of 1968. NFIP was created in response to the lack of availability of private insurance and continued increases in federal disaster assistance due to floods. NFIP's primary goals are to ensure affordable insurance premiums, to share the risk of flood losses through private carriers, which were nearly nonexistent following frequent, widespread flooding along the Mississippi River in the early 1960s; to be backed by the federal government and to reduce flood damages by restricting floodplain development.



1986 RRG & RPG

During the volatile economic period during the mid to late 1980s, California business owners saw their liability premiums increase by 300% and more; several classes of liability became unavailable, policies were non-renewed without prior notice, liability coverage was reduced from an occurrence form to a claims-made form, exclusions were expanded upon, deductibles were increased, aggregate liability limits were introduced. In response to this crisis, Congress responded by enacting federal legislation known as the Risk Retention Act (RRA) of 1986, which authorized the formation of purchasing groups and group self-insurance programs for certain types of liability exposures.

1994 THE CEA

The Northridge earthquake nearly bankrupted several insurance carriers following payouts exceeding $20 Billion in damages/losses. This exceeded the earthquake premiums collected in the preceding 80 years. Insurance carriers again responded by canceling California property policies in protest of a law forcing any insurance property carrier to offer Earthquake coverage. To solve this crisis, the California legislature created the CEA/The California Earthquake Authority to provide California insurance consumers an avenue to procure earthquake coverage.

WHAT IS THE STANDARD FIRE POLICY AND HOW IS IT CREATING TODAYS' INSURANCE CRISES?

In 1873, Massachusetts became the first state to introduce a standard fire insurance scheme. In 1886, New York passed similar legislation. The standard fire policy was later revised in 1918, then in 1943. The 1943 New York Model Fire Policy is still used in most states, and some states use small variants. This policy form is also known as the 165-Line policy because it contains 165 lines in its entirety.

> **California Code, Insurance Code - INS §2070 states that "*all fire policies on the subject matter in California shall be on the standard form, and, except as provided by this article shall not contain additions thereto. No part of the standard form shall be omitted therefrom except that any policy providing coverage against the peril of <u>fire only</u>, or in combination with coverage against other perils, need not comply with the provisions of the standard form of fire insurance policy; provided, that coverage with respect to the peril of fire, when viewed in its entirety, is substantially equivalent to or more favorable to the insured than that contained in such standard form fire insurance policy.*"**

The standard policy does not *define fire and it states all fire is covered except fire by arson of the owner, a fire caused by war, or insurrection,* ***<u>and</u>*** *as such allows for broad interpretation. The California Department of Insurance has consistently interpreted it very broadly in favor* ***of the consumer but never less than.***

Examples of Broadening this form:

- Fire following an earthquake has been redirected from the primary peril of earthquake to fire
- Fire Following an act of Terrorism has been redirected from the primary peril of terrorism to fire
- Flood and Mudslides following a Fire have been redirected from the primary peril of flood to fire
- Protecting the Innocent Insured when another insured commits fraud.

The Problem with this form today

- The inability to separate the single peril of wildfire from other fires and treat wildfire as the catastrophe peril that it is
- Politicians view this form as the consumer's holy grail; to change it means to weaken it

What are the Issues?

1. Inability to separate the peril of Fire from the peril of Wildfire. Fire under the Standard Fire Form is 'Any" Fire, except Arson by an Owner. California requires insurance carriers to treat ALL fires the same for coverage and for rates, even going so far as to suggest the standard fire policy requires the same deductible as any other fire.
2. Growth in the Urban Interface Wildland (WUI) is the zone of transition between unoccupied land and human development. It is the line, area or zone where structures and other human development meet or intermingle with undeveloped wildland or vegetative fuels. California has the greatest number of homes located in WUI; which represent 30.1%-45% of all homes in the State of California
3. Catastrophe Losses in The Billions from Wildfire are forcing carriers out of the State of California

Obstacles

The CDI Perception that anything less than today's Standard Fire Form is a bad change

Legislators that do not fix the issue, but simply make temporary and partial solutions, further jeopardizing the insurance market

California Fair Plan, admitting they are undercollateralized taking on more limits, and coverage than intended.

Feb 6, 2023: James Barba, Consultant to Senate President pro Tempore, Toni G Atkins makes a successful bid on behalf of 18 senators to the CDI to increase the California Fair Plan commercial limits by more than double its limit of $8.4 Million to $20 Million per location to accommodate condominiums projects. This followed an increase in November 2021 from $4.5 million to $8.4 million; the first time they were increased since 1997. In this request, Senator's state: "We recognize that this is a partial and temporary solution."

Victoria Roach, president of the California Fair Plan warns the CDI

- A dramatic increase of $20 Million per location could further destabilize the overall voluntary insurance market and adversely impact insurance customers over the long term
- The FAIR plan does not have sufficient funds to cover its losses and expenses, by law it will have to assess the voluntary insurance market. This means that many Californians, including those who live outside the wildfire areas, will be subsidizing the cost of insurance provided to those who live in the wildfire areas.
- The risk of assessments, in the near and long term, could lead additional insurers to further withdraw from the homeowner and commercial insurance markets. This would leave California consumers, including those outside the WUI, with even fewer insurance options at potentially substantially higher rates – an unintended consequence California cannot risk.
- AB 1754, requires that the FAIR Plan have actuarially sound rates
- The FAIR Plan has been operating without actuarially sound rates and without reinsurance factored in as it has yet to obtain an approved CDI filing that included actuarially sound rates and the net cost of reinsurance. Currently, the FAIR Plan is significantly undercapitalized.

Solution

We find ourselves in the same situation once again and like the insurance crises before this wildfire crisis, our legislators need to step up.

The difference between all other crises before and the one that we face today is we do not require a new CEA, CFP, NFIP, or RPG/RRG; all that is needed to end this crisis is to open up the market by amending the standard fire form to allow for one exception for the single peril of wildfire. Admitted and non-admitted markets will respond with enthusiasm. In 1943 when the Standard Fire Form was drafted, catastrophe wildfires were unheard of. With respect to wildfires, the standard fire form is out of date.

California Code, Insurance Code - INS § 2070; with suggested change added

> All fire policies on the subject matter in California shall be on the standard form, and, except as provided by this article shall not contain additions thereto. No part of the standard form shall be omitted therefrom except that any policy providing coverage against the peril of fire only, or in combination with coverage against other perils, need not comply with the provisions of the standard form of fire insurance policy; provided, that coverage with respect to the peril of fire, when viewed in its entirety, is substantially equivalent to or more favorable to the insured than that contained in such standard form fire insurance policy ***[[****with the exception of the catastrophe single peril of wildfire.*
>
> ***Wildfire is defined*** *as any wildfire, wildland fire, forest fire, brush fire, vegetation fire, grass fire, peat fire, bushfire, hill fire, desert fire, veldfire, escaped prescribed fire, escaped wildland fire, or any other uncontrolled or unplanned fire, which may (but is not required to) also consume houses, buildings, or other structures and agricultural resources. A rapidly spreading fire, that is difficult to bring under control, whether controlled or uncontrolled, in an area of combustible vegetation (such as trees, grass, brush, or bush) causing damage to property, wherever located and of any type and kind, regardless of the original source of ignition of the fire.*
>
> *"****Wildfire" includes*** *all risks associated with or resulting from such fire(s), such as smoke, heat, soot, or fumes.****]]***

CONCLUSION

Everyone benefits when California property owners has options.

- The FAIR plan remains the carrier of last resort for homeowners and small commercial property owners
- Wildfire is removed from the peril of 'all fires' and placed in the more appropriate Catastrophe category.
- The Voluntary Insurance Markets will have the ability to treat wildfire the same as they do all other catastrophe perils such as wind, tornados, hurricanes, named storms, earthquakes, and floods.
- The admitted markets can return to the market secure in the knowledge that if they cover 'fire' they will not be exposed to financial ruin during a catastrophe wildfire season unless they choose to include wildfire exposures.
- Insureds can better control their risk by purchasing the full value for their properties for fire, other than wildfire, and for extended perils and protect against wildfire as they would all other catastrophe perils.
- This solution would not be unique to California. Any State that mandates the Standard Fire Policy Form, such as Arizona, Oregon & Washington State should consider if insurance becomes unavailable due to increased wildfires.

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END NOTES

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2. Triple I, Facts + Statistics: Wildfires, https://www.iii.org/fact-statistic/facts-statistics-wildfires //www.verisk.com/insurance/campaigns/location-fireline-state-risk-report/
3. CAL Fire, Top 20 Largest Wildfires, Statistics, https://www.fire.ca.gov/our-impact/statistics
4. Yale Climate Connections, Author Jeff Masters, January 4, 2021, Reviewing the horrid global 2020 wildfire season, https://yaleclimateconnections.org/2021/01/reviewing-the-horrid-global-2020-wildfire-season/
5. State Farm, Preparing your property and having a plan before a wildfire strikes can help reduce damage, https://newsroom.statefarm.com/wildfire-claims/