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California Regulator Caves on Rates to Bring Insurance Companies Back

Even Governor Newsom is on the last-resort FAIR Plan

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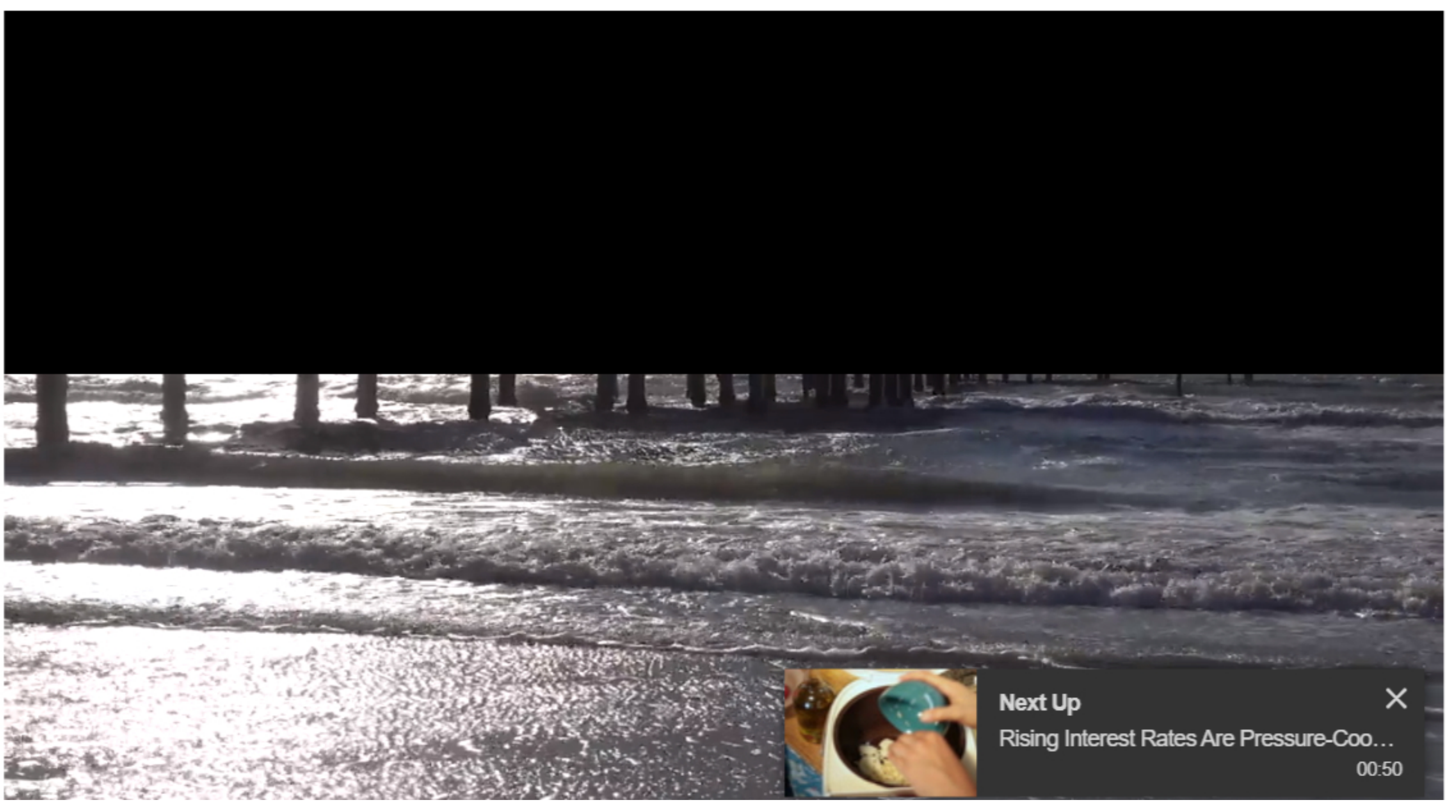

The irony is palpable.

California's state insurance regulators were trying to protect homeowners from being overcharged for property insurance, but rate restrictions and bureaucracy ended up having the opposite effect: Several of the nation's biggest insurers retreated from the wildfire-prone state, leaving many people with only one very expensive option — the state's insurer of last resort.

That's why California Insurance Commissioner Ricardo Lara, with the backing of Democratic Governor Gavin Newsom, last month gave in on two of the industry's key sticking points, announcing that insurers would be allowed to factor in the risks of climate change when seeking approval for their home insurance rates and most likely what they're being charged for reinsurance (insurance for insurers) too.

In exchange, the insurers must guarantee homeowners in wildfire-prone areas have options: They must sell policies in high-risk areas at least 85% as often as they do elsewhere in the state so that homeowners are able to leave the state's FAIR Plan, the high-priced last resort for people shut out of the private market. Even the governor himself is stuck with a FAIR policy.

"It is clear we can't keep going down the same road," Lara said at a press conference last month announcing what he called the biggest overhaul of insurance regulations since California voters passed Proposition 103 in 1988. "We're not going to get to affordability if we don't tackle the availability issue."

To some consumer advocates, the state is surrendering to the demands of an industry that — even after a series of devastating wildfires — made more money in California than it did nationwide in 2019, 2020, and 2021, according to data from the National Association of Insurance Commissioners on the share of insurance premiums paid out for claims.

"This is the state completely capitulating to the insurance companies' threats," said Harvey Rosenfield, the author of Proposition 103, which rolled back insurance rates and for decades has required insurers to get state approval for any increases.

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But to Lara and the Newsom administration, the changes are a necessary response to an unsustainable situation. They're an inescapable recognition of the growing threat of climate change — a threat that could require reforms in other parts of the country as well.

"Every other state watches California closely," said Rex Frazier, president of the Personal Insurance Federation of California, which represents State Farm, Allstate, Farmers, Nationwide and other insurers.

Indeed, the risk of wildfires is growing beyond California, which saw its seven largest-ever wildfires between 2018 and 2021. Average annual losses from wildfires there are expected to rise at least 13% by 2030, and they're estimated to grow even faster in Colorado, Arizona and Oregon, according to the property data company CoreLogic.

It's unclear whether California's changes will entice insurers to come back, and the new rules won't be finalized until December 2024 anyway. But Lara did say the commitment to covering 85% of high-risk areas reflected a "historic agreement" with insurers, suggesting he may have received some reassurances.

"Today's actions are an important first step in stabilizing California's insurance market," Frazier's trade group said in a statement to the press. "We look forward to the next steps of reforming the system in a way that can increase insurance availability and signal the realities of what it will take to adapt to climate change."

“We’re not going to get to affordability if we don’t tackle the availability issue,” the state’s insurance commissioner said. Grant Faint/Getty Images

State Farm, the largest home insurer in the state, stopped selling all new policies in California except individual auto coverage in May, and shortly afterward, Allstate confirmed it had quietly stopped adding new home insurance customers there months earlier.

According to Lara, another five of California’s 12 biggest insurers have either pared back or stopped sales of homeowner policies since 2022, including Farmers, USAA, Travelers, Nationwide, and Chubb.

Insurers contend that the state’s rate restrictions prevent them from making money, given the increasing costs associated with wildfires and other extreme weather. Not only are these events more frequent but rebuilding homes is more expensive, as is the cost of reinsurance — when they reinsure, or offload some of their risk to other insurers.

“If you're not making any money, it doesn't make sense to sell it,” Allstate Chief Executive Officer Mark Wilson told investors during an earnings conference call in August. “I don't really understand the logic of: We're losing money, let's go out and spend a bunch of money to get business, and we'll continue to lose money until we can raise the prices later.”

Even a slide show Lara’s office prepared for the media sympathizes, citing the desire from insurers to “earn a fair return.” It also references additional NAIC statistics indicating home insurers have actually been less profitable in California than nationally if you average the past 10 years, rather than look at more recent years.

The Fair Plan — a syndicated insurance pool created in 1968 to help homeowners who couldn’t get coverage anywhere else — not only provides homeowners with far more expensive and limited coverage, but its growth means greater risks to the entire industry, Lara said.

More concentration of the highest risk properties increases the chance that the FAIR Plan will be unable to afford a major disaster, he said, and all licensed insurers that do business in California participate in its profits and losses.

Newsom recently told Politico rising costs are only part of the problem.

“People are being dropped every single day. People cannot get insurance,” he told the outlet last month. “As someone who owns a home that’s on the FAIR Plan, I understand intimately the issue because it’s brought to my attention almost on a daily basis.”

At the core of Lara’s reforms is more freedom for insurers to justify their proposed rate increases and a smoother, faster process for rate approvals.

New rules will let insurers weigh the future risks of climate change by incorporating natural catastrophe models into their rate requests. Their own cost of reinsurance may also be included (only what they pay for reinsurance in California), though Lara simply said the department would explore that idea in public hearings.

“We can no longer rely on historical data,” he said of the new rules around climate change modeling. “In doing that, we’re actually putting consumers and communities in danger.”

Correction: A previous version of this story misspelled Rex Frazier's name. He is the president of the Personal Insurance Federation of California.

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