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New wildfire rules aim to ignite coverage in high-risk areas

By Shanti Eagle

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Sept. 21, 2024 marked the one-year anniversary of Governor Newsom's executive order directing the Department of Insurance ("DOI") to take accelerated "regulatory action to strengthen and stabilize California's marketplace." Commissioner Ricardo Lara is continuing the roll-out of his "Sustainable Insurance Strategy," announced a year ago, in what the DOI has proclaimed California's "most significant insurance reform in 30 years."

Background

Proposition 103, passed in 1988, was intended to prevent insurers from arbitrarily raising rates, by capping allowable increases and requiring Department of Insurance "prior approval" of any rate changes. But it was also flawed, in that it allowed insurers to cherry-pick if and how much coverage they were willing to write in any particular area within the state. That has gradually led to many large regions where few options exist, and more than 15% of residents are using the California FAIR Plan Association (FAIR Plan). The overburdening of the FAIR Plan, which was never intended to insure such a large number of Californians, puts the plan at risk and causes a feedback loop which increases insurers' reluctance to write policies in those overburdened areas.

Citing the difficulties and limitations on getting rate increase approvals under the current system, and the increased costs due to wildfires and climate change, State Farm, Allstate and others ceased writing new policies in California entirely over the past two years, and many more have pulled back.

Proposition 103 left it to the Department of Insurance to issue regulations to enforce the law and determine the rate approval process. Following the failed attempt to codify changes last year, Gov. Newsom turned to Commissioner Lara and charged him with reform using the agency's regulatory powers. Beginning in September 2023, Lara has issued regular press releases regarding the progress of his Sustainable Insurance Strategy, which is proceeding on pace for implementation by year-end. The process has included the involvement of insurers, actuaries, and consumer groups, as well as Cal-FIRE and the FAIR Plan, in crafting the new proposed regulation.

Updates to the Sustainable Insurance Strategy and the draft regulation

In June, Lara released draft language for the proposed regulation that will allow insurance companies to "use forward-looking catastrophe models for ratemaking," in exchange for commitments to serve high-risk and currently underserved insurance markets within the state. "Catastrophe models are computerized processes that simulate potential catastrophic events," which are "used in virtually all other states today, except California."

At the same time, Lara unveiled a detailed, data-driven map that shows the underserved areas where the increases in the percentage of non-FAIR plan policies are targeted. This includes areas where more

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than 15% of all policies are currently FAIR-plan policies, and also takes into account low-income and comparatively high-cost premium areas. Preliminary lists of "undermarketed" residential and commercial zip codes, as well as distressed counties, were also released. Distressed counties include Napa, Marin, Santa Cruz, Monterey, San Luis Obispo, and Ventura, as well as most of Northern California.

Following public workshops, a public comment period, and hearings, the language of the revised draft regulation has been published for final public comment by Oct. 17. Commissioner Lara stated he was "proud of the progress we've made, and we are working diligently to meeting our deadline. As we approach the final phase of implementing these reforms by December 2024, I remain focused on delivering a modern insurance marketplace that protects homeowners and businesses while promoting resilience across California's communities."

Simultaneously, the DOI has committed to "modernizing" the FAIR Plan. In July, Commissioner Lara announced a "breakthrough agreement" to strengthen the FAIR Plan and provide increased coverage to homeowners, condo associations, farms, builders and businesses with multiple buildings in the same location. The FAIR Plan entered a stipulation to establish a new "high-value" commercial coverage option with limits up to $20 million per building, among other changes.

So, what does this mean for consumers?

Under the accelerated process urged by Gov. Newsom, Lara stated an intent to have updated regulations in place within the year. Any change to the insurance regulations and resulting impact on the market is not soon enough in light of the bottled-up need and skyrocketing costs. But we're close to seeing those regulatory changes come to fruition.

Under the new regulation, slated to go into effect December 2024, "insurance companies will be allowed to use forward-looking catastrophe models if—and only if—they increase writing of policies in these wildfire distressed areas."

In addition to promising an increase to 85% market coverage in under-served and high-risk wildfire areas for homeowners, Commissioner Lara's new regulation will require Commercial insurance companies to "increase coverage by 5% in wildfire distressed ZIP Codes statewide, which will increase coverage options for farms and wineries, homeowners and condo associations, and other businesses."

Next year will be an interesting year for the California property insurance market, as the impact of the new regulation gradually works its way through the rate approval process, and the DOI begins monitoring compliance with the mandates. The changes will not be felt instantaneously, but they should start to relieve the press