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# California's new insurance fix faces multi-billion-dollar wildfire test

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The Southern California wildfire crisis struck just when the Department of Insurance's "Sustainable Insurance Strategy" was set to go into effect.

Only days prior to the fires breaking out, the DOI announced the final step in implementation of the regulations designed to keep insurers in the state and stabilize the FAIR Plan. The DOI called this the final major element in the "largest insurance reform in 30 years in California." The Strategy's efficacy will be tested in its debut year by the largest and most costly fire losses in California history.

The intent of the Strategy is to prevent additional insurers from leaving the market by offering rate calculation incentives in exchange for guaranteed minimum coverage in high wildfire risk areas. Another goal was to take the pressure off the increasingly burdened FAIR Plan, which has grown exponentially in recent years in non-high-risk areas as well as wildfire-prone areas. As of September 2024, the FAIR Plan covered more than $450 billion in property value in California, an increase of more than 60% over the prior year. One of the main changes is that, going forward, insurers can calculate rates based on forward-looking wildfire catastrophe models. If nothing else, those models will be completely reshaped by this unprecedented wildfire event.

Under existing regulations and a bulletin issued by Commissioner Lara last week, insurers must immediately make determinations regarding total losses and make advanced payments, including at minimum four months of living expenses. This includes the FAIR Plan.

Recently, Commissioner Lara also expanded the State of Emergency one-year moratoriums on insurance non-renewals to residents of fire-adjacent zip codes, whether or not they suffered loss. But that is a band-aid. What happens in the next 12 months with respect to the FAIR Plan and the Strategy rate determinations will determine to what extent there is an appetite to renew policies once the moratorium lifts.

The FAIR Plan is governmentally mandated and regulated, but it is not government backed. It is a risk pool in which all California admitted insurers must participate; therefore, when it suffers significant losses, so do the insurers that back it.

Pacific Palisades was one of the top five cities with the most FAIR Plan exposure state-wide. The FAIR Plan estimates 22% of all Pacific Palisades fire losses and 12% of all Eaton fire losses are covered under the FAIR Plan. Already, more than 3,600 claims had been filed against the FAIR Plan by mid-January. As of Jan. 24, the FAIR Plan issued a statement that it estimated exposure for the Pacific Palisades and Eaton fires alone to be nearly $5 billion, with exposure from other fires still being evaluated. Nevertheless, the FAIR Plan is assuring the public "all covered claims will be paid."

The FAIR Plan has several funding paths, all of which are potentially implicated based on the scale of the damage.

First, the FAIR Plan has reserves, though sources vary on this figure and the FAIR Plan has declined to confirm the amount.

Second, the FAIR Plan is reinsured by private reinsurance. The amount of that reinsurance is not regularly disclosed, but records indicate that may be a small percentage of its overall exposure. In 2022-2023, the FAIR Plan had approximately $1.3 billion in reinsurance, including aggregate retentions. In a somewhat vague statement, the FAIR Plan indicated earlier this month that it had $1.25 billion in reinsurance including the $900 million deductible, and a combined total of $5.78 billion, shared between reinsurers and percentage-based coinsurance by admitted insurers. Based on the initial estimates, the losses could exceed that threshold.

Third, the FAIR Plan is authorized to issue assessments to admitted property insurers in the state on a sliding scale should it have insufficient funds to pay claims. This has happened only once before, following the Northridge earthquake, and resulted in a significant number of earthquake insurers leaving the market. Given the scale of the current losses, the private insurance market could be tapped with assessments to make up the difference in accordance with their market share if the exposure reaches the ten billions.

Fourth, FAIR Plan policyholders might be surprised to find that a deal brokered last year permits FAIR Plan insurers, "in the extremely unlikely event" that assessments are issued to insurers in the billions of dollars, with the consent of the Commissioner, to "collect temporary supplemental fees" from FAIR Plan policyholders to cover up to 50% of the assessments issued.

Just when the DOI was hopeful of incentivizing insurers to return to the market, this will undoubtedly cause those insurers to wait and see how the dust settles with potential assessments before considering a return. And a large FAIR Plan assessment, on top of the insurers' already enormous financial losses due to the fires, could cause more insurers to forgo writing California policies rather than face similar future risks. No matter what, these fires will seriously impact the already precarious insurance market and future premiums.

Another concern is that, even if the FAIR Plan is able to pay out claims in full, many fire victims may be underinsured. The FAIR Plan is generally more expensive than traditional insurance, and therefore policyholders are potentially at higher risk for being underinsured, especially given the increased construction and material costs that inevitably follow mass fires. Often FAIR Plans are placed by agents of private insurers, like Farmers or State Farm, as part of a package with supplemental "difference in conditions" insurance sold by the regular market. Although in certain circumstances insureds may have a claim against an insurer when an authorized agent dramatically undervalues the replacement cost, FAIR Plan insureds are likely without recourse. In a case decided last year, the California Court of Appeal held that a consumer who purchased a FAIR Plan with the assistance of their Farmers insurance agent could not sustain a claim against Farmers for underinsuring them, even though the Farmers agent helped the insured apply for the FAIR Plan using Farmers software to calculate the replacement cost coverage. *Hughes v. Farmers Ins. Exch.*, 107 Cal. App. 5th 73 (2d Dist. 2024).

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