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LA Wildfires' Effect On Calif. Insurer Of Last Resort

By **Kara Baysinger, Stephanie Duchene and Laura Geist** (January 24, 2025)


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Ignition of the Pacific Palisades fire on Jan. 7, and subsequent wildfire outbreaks in the Los Angeles region over the past few weeks, have drawn increased attention to the role of the California Fair Access to Insurance Requirements Plan in the state's property and casualty market.

As a state insurer of last resort, the FAIR Plan has taken an outsize role in insuring residential and commercial properties that have been increasingly unable to obtain coverage on the admitted market. In neighborhoods like Pacific Palisades that have faced high homeowners' insurance nonrenewal rates in recent years, property owners have increasingly turned to the FAIR Plan, as well as the surplus lines market, to obtain necessary coverage.

As losses mount from this outbreak, policyholders, insurance carriers and media have asked what the implications may be for the FAIR Plan and the California-admitted insurers that comprise its risk pool. This article discusses the background of the FAIR Plan, the process of assessing member insurers, and relevant recent developments in the California property insurance market.

FAIR Plan

The California FAIR Plan is established pursuant to California Insurance Code, Section 10090 and onward, which mandates establishment of the California FAIR Plan Association as a joint reinsurance association formed by insurance carriers licensed to write and engaged in writing basic property insurance in California.

Under Section 10095 of the code, the FAIR Plan is administered in accordance with a plan of operation approved by the California insurance commissioner, most recently amended in August 2024. Member insurers are those "licensed to write" and "engaged in writing," on a direct basis, basic property insurance.[1]

Pursuant to Section 10095 and the plan of operation, member insurers "shall participate in the writing, expenses, profits, and losses of the [FAIR Plan] in the same proportion that [their] premiums written during the second preceding calendar year bear to the aggregate premiums written by all insurers in the program, excluding that portion of the premiums written attributable to the operation of the [FAIR Plan]."[2]

Notwithstanding that, member insurers are only subject to assessment by the FAIR Plan upon approval of the commissioner.[3]

Many admitted carriers have recently limited new business or sought to not renew existing property business in California and some attribute that, at least in part, to difficulties in obtaining rate increases reflecting current risks. As the admitted market has shrunk, FAIR Plan exposure has grown significantly. As of September 2024, FAIR Plan exposure totaled

$458 billion, including $5.9 billion in wildfire exposure in Pacific Palisades alone.[4]

Funds for potential payment of claims are obtained through FAIR Plan policyholder premiums, as well as substantial reinsurance coverage purchased by the FAIR Plan under its statutory authorization. According to one report, the FAIR Plan has access to $2.63 billion of reinsurance through a partially placed tower with a limit of $4.85 billion and an occurrence retention of $900 million.[5]

Assessment of Member Insurers

If additional funds are required for the FAIR Plan to pay claims, the FAIR Plan may, with the commissioner's authorization, levy assessments against member insurers to fund claims and expenses. If levied as a result of the current wildfires, it would be the first assessment since 1994.[6]

To trigger an assessment, the FAIR Plan would first need to exhaust its retained earnings, then its proceeds from reinsurance, lines of credit and catastrophe bonds, if any sold.[7] If such funding sources are insufficient and the FAIR Plan is "substantially threatened with insolvency," it shall then levy a pro rata assessment on member insurers.[8]

The assessment amount is "based on the proportion that the insurer's premiums written during the second preceding calendar year for that line of business bear to the aggregate premiums written by all insurers in the program for that line of business, excluding that portion of the premiums written attributable to the operation of the association," bifurcated between dwelling and commercial property policies, or Division I policies, and multiperil businessowners' policies, or Division II policies, to reflect losses proportionate to that line of business.[9]

Assessments accrue interest (at the Federal Reserve discount rate plus 250 basis points) if unpaid within 30 days of notice, and an insurer that fails to pay may have its certificate of authority suspended or revoked unless granted an exemption or deferment by the commissioner on the basis that payment would bring it below statutory minimum capital and surplus requirements.[10]

Where affiliated insurers are affected, the insurance group may designate a carrier to pay the assessment on behalf of the group.[11]

Recent guidance from the commissioner allows insurers to recoup the cost of assessments from policyholders under certain circumstances. Under Bulletin 2024-8, insurers may seek the commissioner's approval to recoup from policyholders up to 50% of amounts assessed where assessments are levied on member insurers in a single calendar year of up to:

- $1 billion on member insurers writing residential property insurance policies with available limits of $3 million or less;
- $1 billion on member insurers that write commercial property insurance policies with available limits of $20 million per location or less; or
- $2 billion on member insurers that write residential and commercial property policies with available limits of $20 million per Location or less.[12]

For assessments in excess of these accounts, insurers may seek approval to recoup all such amounts from policyholders.[13] Requests to recoup assessment amounts are subject in all instances to the filing and prior approval requirements of California's Proposition 103,[14] which would likely delay the immediate impact on insurer policyholders of such recoupment.[15]

In the event of an assessment, this recoupment would be an unprecedented approach, and it remains to be seen how the California Department of Insurance would address such requests through the approval process. For the overall health of the market, it would behoove the FAIR Plan, insurers and the commissioner to work cooperatively on the timing of any assessments and the development of an expedited filing process for recoupment of any assessments.

Recent Developments in the California Property Market

Reinsurance Costs and Catastrophe Models in Developing Rates

Given the recent depletion of admitted capacity in the California property market, California Insurance Commissioner Ricardo Lara and the Insurance Department have taken steps to attract new business from admitted carriers in wildfire risk areas, while addressing concerns raised by industry with the existing ratemaking regime under Proposition 103.

Following discussions with stakeholders throughout the course of 2024, the Insurance Department adopted new regulations permitting insurers to use catastrophe models and to account for costs of reinsurance in developing rates, subject to insurer commitments to increase coverage in wildfire-prone regions.[16]

The catastrophe modeling regulation allows eligible insurers to use catastrophe models in ratemaking to determine catastrophe adjustments for wildfire risk, subject to certain parameters.[17] This substitutes for the prior regime under which insurers were required to base the catastrophe factor on historical wildfire losses with such accounting for predicted future risk.

The reinsurance costs regulation provides for the department to develop a standardized "net cost of reinsurance" factor based on market data that may be used by property insurers in developing rates.[18]

In both instances, to access these new ratemaking tools insurers must comply with a new regulation that requires them to commit to periodic increases in their written policies in certain "distressed areas" of heightened wildfire risk or FAIR Plan exposure.[19]

Although these new regulations should work prospectively to slow or reverse the FAIR Plan's growing exposure, their recency means that the FAIR Plan remains exposed to substantial losses from current wildfires until admitted carriers reenter the market.

Moratorium on Cancelations and Nonrenewals

Substantial press coverage of the Los Angeles wildfires has focused on recent insurer nonrenewals in the affected areas — and consequential FAIR Plan exposures. Section 675.1 of the code permits the commissioner to impose a moratorium on cancellations and nonrenewals due to wildfire risk of policies in an area subject to a wildfire state of emergency.

The commissioner swiftly issued a moratorium for affected ZIP codes in this instance, issuing Bulletin 2025-1 on Jan. 9.[20] As fire events continue, we expect the commissioner to continue using this power as a tool to limit depletion of the admitted market and FAIR Plan exposures pending the impacts of the new ratemaking regulations.

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[1] California FAIR Plan Association Plan of Operation dated August 27, 2024 § III (the "Plan of Operation"). Basic Property Insurance is defined as:

insurance against direct loss to real or tangible personal property at a fixed location in those geographic or urban areas, as designated by the commissioner, from perils insured under the standard fire policy and extended coverage endorsement, from vandalism and malicious mischief, and includes other insurance coverages as may be added with respect to that property . . . with the approval of the commissioner or by the commissioner, but shall not include insurance on automobile risks, commercial agricultural commodities or livestock, or equipment used to cultivate or transport agricultural commodities or livestock. Cal. Ins. Code § 10091(c)(1).

[2] Plan of Operation § XXI.

[3] Cal. Ins. Code § 10094(c); Plan of Operation § XXI.

[4] California FAIR Plan Association Key Statistics & Data (no date), https://www.cfpnet.com/key-statistics-data/.

[5] Chris Munro, The Insurer, CA FAIR Plan Reinsurance Program Provides up to $2.63bn of Limit (Jan. 10, 2025), https://www.theinsurer.com/ti/news/ca-fair-plan-reinsurance-program-provides-up-to-263bn-of-limit-2025-01-10.

[6] See CDI Bulletin No. 2024-8 (Sept. 3, 2024) ("Bulletin 2024-8"), available at https://www.insurance.ca.gov/0250-insurers/0300-insurers/0200-bulletins/bulletin-notices-commiss-opinion/upload/BULLETIN_2024-8__RE_INSURER_RECOUPMENT_PROCEDURES_IN_THE_HIGHLY_UNLIKELY_EVENT_OF_ASSESSMENT_BY_THE_FAIR_PLAN.pdf.

[7] Plan of Operation § VII.D.4. These procedures apply to Division I and Division II policies under the plan except for "High Value Commercial Property Policies," which are commercial

property policies with a limit over $20 million per Location. The need for assessment with respect to High Value Commercial Policies is calculated separately based on income from those policies, which also may be subject to additional supplemental fees on issuance and in case of an assessment in accordance with the Plan of Operation.

[8] Id.

[9] Id. § VII.D.

[10] See id. § VII.D.3.

[11] Id. § VII.D.8.

[12] Bulletin 2024-8 pp. 2–3.

[13] Id. at 3.

[14] Cal. Ins. Code § 1861.01 et seq.

[15] See id.

[16] Described in our prior client alerts available here, with respect to catastrophe modeling, and here, with respect to reinsurance in ratemaking.

[17] Catastrophe Modeling and Regulation, Reg-2023-00010 (Nov. 13, 2024), available at https://legaldocs.insurance.ca.gov/CyberDOCS/autopapiact.asp?AppINT=-1&mode=no&autopapiurl=%2FCyberDOCS%2FLibraries%2FDOCS_WEB%2FCommon%2Fviewdocact%2Easp%3Flib%3DDOCS_WEB%26doc%3D364123%26rendition%3Dhtml%26noframes%3Dyes&SCICO=false.

[18] Net Cost of Reinsurance and Ratemaking, Reg.-2024-00016 (Dec. 27, 2024), available at https://legaldocs.insurance.ca.gov/CyberDOCS/autopapiact.asp?AppINT=-1&mode=no&autopapiurl=%2FCyberDOCS%2FLibraries%2FDOCS%5FWEB%2FCommon%2Fviewdocact%2Easp%3Flib%3DDOCS%5FWEB%26doc%3D364346%26rendition%3Dhtml%26noframes%3Dyes&SCICO=false.

[19] See 10 C.C.R. § 2644.25.2.

[20] CDI Bulletin No. 2025-1 (January 9, 2025), available at https://www.insurance.ca.gov/0250-insurers/0300-insurers/0200-bulletins/bulletin-notices-commiss-opinion/upload/Bulletin-2025-1-One-Year-Moratorium-for-Palisades-and-Eaton-Fires-9-January-2025.pdf.