Buyer Beware: The Impact of Catastrophic Events on the Property Insurance Market

Willis Towers Watson

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By Michael J. Koenig Jr., West Region Leader, Private Client Group
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We continue into a pattern of escalating pressure on California and Florida homeowners to find adequate and affordable property insurance protection.[1] Increased catastrophic events in 2020 plagued the U.S., with 22 separate billion-dollar weather and climate disasters. In 2020, there were 30 named storms, of which 13 became hurricanes, including six major hurricanes totaling over $65 billion in total property damage. In three out of the last five years, the largest wildfires happened between 2015 – 2020, with an average of more than10 million acres burned, and an average of over 58,000 separate fires ignited. Buyer beware, it's not only the coastal areas that have been impacted by catastrophic events. On August 10, 2020, we experienced the Iowa derecho, one of the most destructive thunderstorms in modern times that wreaked havoc from Iowa to Indiana. While total financial impacts are still being analyzed, we know there was over $11 billion in property damage, more financial destruction than most single hurricane events. In 2020, multiple single event hail, tornado and thunderstorms brought severe weather across the nation's heartland (see Figure 1)

Figure 1. **2020 Billion-Dollar Weather and Climate Disasters**[2]

Spotlight on California and Florida

Intensifying negotiations between the California Department of Insurance (DOI) and top insurers have resulted in reduced placement solutions for California property owners. A staggering 2 million homes are categorized as "high or extreme wildfire-prone", with over $142 billion in exposure alone in Southern California at risk.[3] In comparison on the Atlantic coast, wind, rain, and flooding from excessive named tropical storms and major hurricane threats continue to loom over major insurer profits throughout the state of Florida. We should not be surprised to see California and Florida's property insurance market in turmoil, frequency and severity of catastrophic events have contributed to rising reinsurance rates and pressure on insurer financials. With limited capacity and restricted underwriting guidelines, questions are now shifting on where consumers can go to find affordable and comprehensive coverage in the current marketplace.

Background and current problem

As we further examine the current issues in California and Florida, there are distinct areas representing each position that create complexity with finding resolution. Most insurers in California are monitoring current aggregation concentration in specific high-to-extreme wildfire-prone zip codes. While many insurers refuse to offer capacity for new homeowner's insurance, many insurers are choosing to non-renew existing business, and make changes to existing coverage on renewal to reduce exposure. To combat this approach by insurers in 2018, Commissioner Ricardo Lara issued a mandatory one-year moratorium on insurance companies non-renewing policyholders – protecting at least 1 million homes in wildfire disaster areas in northern and southern California (see Appendix A). While this offered California homeowners a temporary reprieve, it failed to resolve a sustainable long-term solution for all parties.

It's not just California that should be preparing for long term disruption from premium increases, moratoriums and the possible exodus of insurance companies. The Florida insurance market is inching closer to potential crisis, as losses climb, and reinsurance markets retreat to salvage deteriorating conditions. Nearly 60 carriers suffered $701 million in losses and $351 million in negative income for all of 2019 (O'Connor, 2020). Another contributing factor in the Florida insurance market is litigation activity, up 500% over the last four years, with over 20,000 lawsuits in the first six months of 2020.[4] A long list of insurers in Florida have active rate filings ranging between 20 – 40% to combat water loss claims, several years of major hurricane damage, and assignment of benefits (AOB) claims.

Insurers have a vested interest in managing risk, capacity and assessing aggregation of insured homes throughout the states of California and Florida to keep profits and losses sustainable. Brokers and insurers work together for property insurance placement options within the insurance market framework. This internal alignment offers consumers various market options with knowledge-based decisions and provides on-going stewardship. The California Department of Insurance oversees the entire process, acting as the regulatory agency obligated to enforce statutory requirements to protect agents/brokers, insurers, and consumers. Solutions, like, Senate Bill 824 in California and House Bill 7065 in Florida are examples of how the Department of Insurance responds to help regulate and protect property owners from instability in the industry.[5] The homeowners are the end user, subject to regulatory controls, insurer volatility, and catastrophic events that influence insurability throughout California.

Solutions from the Past

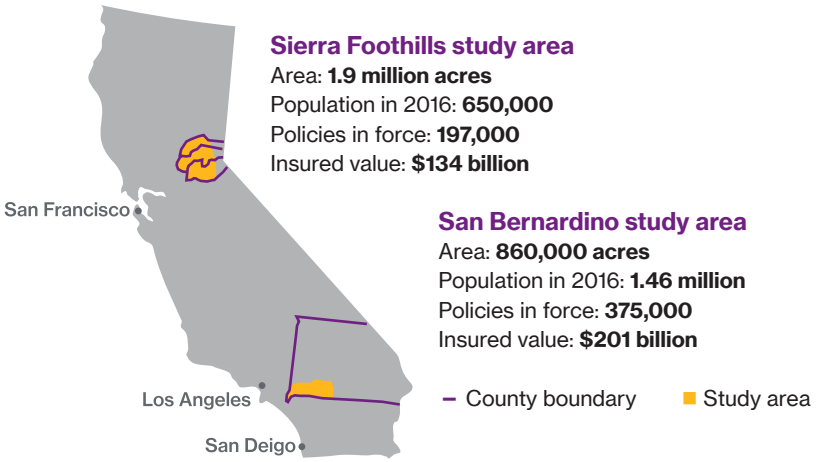
In 1996, after the devastating 1994 Northridge earthquake, California passed urgent legislation to create the California Earthquake Authority (CEA) to save the homeowners insurance market from devastation (Marshall, 2018). A similar approach might be suggested to tackle the current environment, but this would involve strategic collaboration from insurers, brokers, and the California Department of Insurance to navigate reasonable solutions, with a goal of keeping homeowners insurable and protected against potential catastrophic events. Considered a final option for rural California homeowners, the California FAIR Plan increased homeowners' rates effective January 1, 2021, with an average increase expected to top 15.6% statewide. This decision follows a 20% average increase about 18 months ago and reflects the strain in capacity for wildfire risks and continuance of insurers reducing capacity.[6]

Currently, property insurance rate filings have limitations in California, and the entire process is regulated by the California Department of Insurance. Insurers are required to file rates with the Department of Insurance for approval and there are many limitations that do not allow insurers to price premiums according to future risk, leaving insurers underpriced and not adequately charging for high risk areas. More flexibility with supporting evidence, allows insurers the ability to file according the risk profile.

Private insurers as an option

The sustainability of obtaining alternative property insurance from private insurance companies stands with regulatory actions and decisions enforced by the California Department of Insurance. The viability of risk transfer from insurance products by insurers is critical to the competitive landscape for consumers. Simply, without private insurance choices the burden is transferred back to the California and Florida Departments of Insurance to develop and fund alternative solutions. The total homeowners market share in California and Florida are far too big for each state to absorb, so dependency on the private insurance market is essential. Brokers need choices for clients, eliminating insurer markets, reducing capacity, and enforcing state sponsored programs will create deficiencies in coverage for clients.

Figure 2. **California study areas**



Our Call to Action

Awareness, education and exploring alternative solutions are crucial to finding capacity and placement options for properties in California and Florida. There is already unrest about the cost of insurance, a negative correlation between the premium amount and the insurance program adoption is common among most consumers. Our call to action for our clients and trusted advisory partners will remain focused on providing current and relevant data to key stakeholders for critical decision-making. Comprehensive due diligence and discovery will dictate how we design and implement sustainable insurance programs for our clients. Keeping pace with changing market conditions remains critical to meeting the needs of changing lifestyles. With current restraints in the property insurance market, research suggests, leveraging breadth, depth, and dedicated proficiency in navigating turbulent market conditions from a qualified national broker.

Appendix A

Zip Codes Covered by Mandatory One Year Moratorium on Non-Renewals

"This wildfire insurance crisis has been years in the making, but it is an emergency we must deal with now if we are going to keep the California dream of home ownership from becoming the California nightmare, as an increasing number of homeowners struggle to find coverage," said Commissioner Lara. "I am calling on insurance companies to push the pause button on issuing non-renewals for one year to give breathing room to communities and homeowners while they adapt and mitigate risks, give the Legislature time to work on additional lasting solutions, and allow California's insurance market to stabilize."

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