UC Center Sacramento
Policy Brief
Volume 06 Issue 07 • November 15, 2023

Insuring Against Climate-Related Disasters: A Challenge for California and the World

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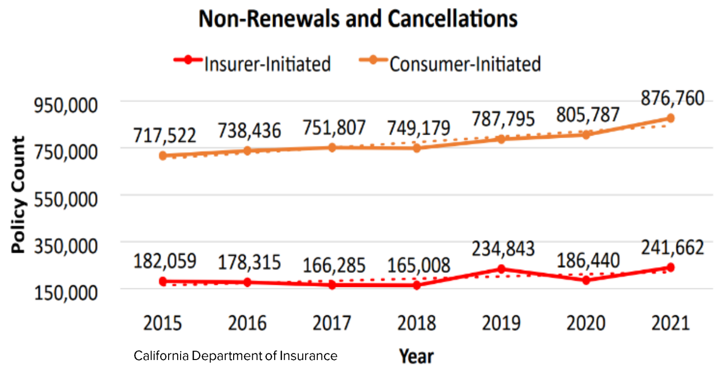
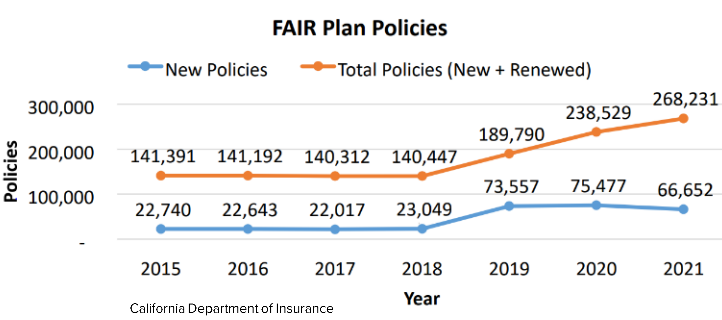
Climate change presents new challenges to California's homeowners and insurance providers alike. The increasing severity and frequency of climate-related disasters in our state requires addressing the risk and loss-related challenges that arise from these disasters. This paper discusses how intensified climate threats have limited housing insurance availability and affordability in recent years. It also proposes several possible steps that the state – in collaboration with the insurance industry -- can take to mitigate risks to California residents and homeowners.

The Current Problem

California is suffering increased losses from climate-driven events. Temperature increases forecasted to exceed 2 degrees Celsius over pre-industrial levels are already contributing to more frequent and severe weather-related events, including wildfire, floods, severe convective storms, drought, and extreme heat. These natural disasters have caused human deaths and injuries, as well as increased property damage and destruction and insurance losses. Population and economic growth has also contributed to increased insurance losses from these climate-driven disasters.





These climate-related events pose major challenges to the insurance market in California. Recent years have seen an **increase in insurer-initiated policy non-renewals** across the state. Seven of the 12 largest home insurers have announced caps or pauses in writing new insurance. This has led to an **increase in Californians having to buy home insurance from the California FAIR Plan,** which provides basic fire insurance coverage for properties that private insurance companies are not willing to insure due to wildfire risk.

Possible Solutions

California's Insurance Commissioner has proposed a **Sustainable Insurance Strategy** which would, among other things, **allow home insurers to use forward-looking probabilistic models for rate setting and to include reinsurance costs in rates,** if insurers agree to insure a share of homes in high-risk areas proportionate to 85% of their market outside the high-risk areas.

While increasing rates may enable insurers to reduce non-renewals and resume writing new insurance in the short and mid-term, it may also be the case that over time, the growing losses from climate change will overwhelm benefits to insurers from increased rates and other regulatory changes.

For example, Florida's insurance market remains in crisis from climate-driven hurricanes despite allowing forward-looking probabilistic models for rate setting, including reinsurance costs in rates, establishing taxpayer-funded reinsurance for insurers to reduce their reinsurance costs, limiting lawsuits against insurers, and having rates three times the national average. Despite Florida's policy and regulatory interventions, five insurers are nevertheless pulling out of the Florida market entirely, 15 companies have stopped writing new policies, and Florida's version of the FAIR Plan has 1.3 million policyholders who cannot otherwise find insurance.

Other solutions to address insurance availability in California include **more public and private investments in nature-based mitigation efforts** like forest treatment to reduce wildfire risk, **requiring underwriting models and rates to include the risk-reduction benefits of forest management, improving and enforcing building codes and land use requirements** to mitigate risk (i.e. home hardening, defensible space, and resilient infrastructure), **strengthening market transparency and financial oversight** by requiring TCFD-aligned climate disclosures, **insurers adopting net zero investment strategies**, catalyzing sustainable insurance practices by **launching the Climate Insurance Database**, and **helping communities to address extreme heat by creating the first-ever heat ranking tool.**

The most important and critically needed solution to make sure that insurers can continue to offer insurance in the long run is to **phase out use of fossil fuels** and to **reduce greenhouse gas emissions to net zero in all sectors of the economy.** California needs to continue to lead the nation in phasing out fossil fuels and reducing emissions, and all states need to follow suit – otherwise, we will continue to march towards an uninsurable future not only in California but across the United States.