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State of Emergency: Examining the Impact of Growing Wildfire Risk on the Insurance Market

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Good morning, Chairman Cleaver, Ranking Member Hill and members of the Subcommittee. I am Matthew Auer, Dean of the School of Public and International Affairs at the University of Georgia's School of Public and International Affairs. I began a career in forestry and environmental policy in the 1990s. Back then, policy experts predicted that climate change would challenge how insurance companies typically model and price risk when they underwrite insurance policies. According to the National Oceanic and Atmospheric Administration, "Climate change, including increased heat, extended drought, and a thirsty atmosphere, has been a key driver in increasing the risk and extent of wildfires in the western United States during the last two decades" (NOAA, 2022; Zhuang, 2021). As predicted, these environmental changes are playing havoc with insurance markets and this affects everyday policy holders, including lower income homeowners.

I became especially interested in the problem of wildfire risk and insurance nonrenewal in 2018 after learning about policyholders in wildfire-prone areas of California who were receiving letters from insurance companies declaring the termination of their coverage. My own mom received a letter like this. But she was lucky. She could find replacement insurance, and it was insurance she could afford. As committee members know, when homeowners cannot find regular, replacement insurance, they can opt for insurance of last resort which is called FAIR Plan insurance. This is bare bones insurance that will cover losses due to fire or smoke. But typically, a homeowner must obtain a difference in conditions policy to make up the gap between FAIR Plan and regular homeowners insurance so as to cover claims like water damage, theft, and liability. Even when a homeowner is able to find regular replacement insurance, they can typically expect to pay more for the same or less coverage (United Policyholders, 2022). In many markets, these trends are particularly disadvantageous for lower income homeowners.

Benjamin Hexamer, a University of Georgia graduate student, and I, wanted to gain a clearer sense of which homeowners are at particular risk in the most wildfire-prone states. Research we authored on the subject of wildfire, income, and insurance is attached to this testimony. We found that, among the 14 states with the highest total acreage burned by wildfires between 2016 and 2020, 98 counties had a moderate to high wildfire hazard potential or WHP, which the U.S. Forest Service developed to measure wildfire risk. We found that 60 percent of these counties had a poverty rate exceeding the official national poverty rate (Auer and Hexamer, 2022). Hence, the majority of homes in the most at-risk counties in the American West and in Florida are in areas with comparatively higher poverty rates.

We were also struck by how different data sources provide different estimates of risk. Hence, when considering counties that have high concentrations of homes with significant wildfire risk, combined with higher poverty rates, it matters a great deal whether you use data from the Forest Service or from organizations with more up-to-date, higher resolution data. This has implications for how Congress and the federal government understand the problem of wildfire and risks to homeowners. Technology companies that help insurance carriers estimate risk – or insurtech companies – tend to have more powerful tools and methods for estimating risk than do federal agencies, but algorithms they use are generally proprietary.

Our research also pointed to a potential red flag for wildfire prone states when it comes to the concentration of insurance underwriting. We were interested in market share or the proportion of net premiums held by the largest insurance companies. There are nine states where the cumulative market share of the top-10 property and casualty insurers is 60 percent or more of the market. Seven of those states are among the 14 most wildfire-prone states in the lower-48. There is research showing that higher market concentration is associated with lower financial stability of insurance firms (Shim, 2017). Even in the seven states with comparatively highly concentrated markets for underwriting, the carriers tend to be large, name-brand companies with strong balance sheets and high credit ratings. So, most of these firms are financially stable. Yet, we have observed even major underwriters leaving natural disaster-prone markets due to losses from wildfire and hurricanes (Florida Chamber of Commerce, 2022). One bad fire season or handful of major natural disasters can rapidly change market share composition in different states. Going forward, it would be prudent for Congress and for insurance regulators in these states to consider whether a dwindling set of insurance companies are making risk decisions for large numbers of policyholders – regardless of whether those companies are admitted or approved surplus line insurers.

Increasingly, insurance companies as well as state and local authorities require homeowners to adopt fire safety measures. For some homeowners, this is a condition for a new policy or for renewal of coverage. Property owners can and should play a significant role in protecting their own homes from wildfire. However, we must do a better job of helping disadvantaged homeowners help themselves.

For lower income homeowners, the financial burdens of home hardening and creating defensible space can be considerable. Consider, for example, the situation in some wildfire-prone counties in New Mexico that have median household incomes of $35,000 or less. Lower income residents are already burdened by relatively high rates for homeowners insurance in that state. New Mexico ranks among the top-15 in the nation (Vitu, 2022). If an insurance company were to require a homeowner to implement wildfire safety measures, those costs will add up. The premium for $250,000 worth of dwelling coverage in New Mexico is around $1,900. That represents over six percent of median household income in a county like Mora, New Mexico. Mora was one of the counties hit by this year's Hermit's Peak-Calf Canyon fire – the largest wildfire ever recorded in New Mexico.

Some strategies for reducing the cost of insurance are impractical for lower income homeowners. When we urge policy holders to increase the deductible on dwelling coverage instead of lowering the actual dwelling coverage limit on the home, that's good advice in general, but it is unreasonable to expect lower income homeowners to rebuild on a high deductible policy. We also tell homeowners to shop around for their policy. Again, that is good advice. However, underserved communities may be the least likely to shop around. Many property owners may not even be aware of the services of independent insurance agents.

Underserved communities may not be the loudest or best organized voices reaching the ears of state insurance commissioners. In fact, there are a great many stakeholders, not limited to homeowners, who are pressuring insurance commissioners about wildfire. These voices are not always in concert. On the one hand, commissioners are watchdogs for consumers. On the other hand, they must be fair-minded as they regulate and respond to demands for rate increases by insurance companies who incur higher costs and losses. If a state commissioner's decisions are arbitrary, unfair, or simply deemed harsh by insurance companies, those firms can decide to close shop and leave the market.

Increasingly, insurance commissioners are hearing and responding to the wildfire-related concerns of homeowners, in particular. Yet, the present context in many states resembles a game of whack a mole with commissioners responding to complaints that insurance companies are placing limits on fire-related coverage, denying claims, or failing to recognize and reward the fire safety measures taken by homeowners. Since coming into office, California Insurance Commissioner Ricardo Lara has been especially proactive at addressing these concerns. His efforts include ordering California's FAIR Plan to offer comprehensive or HO-3 coverage and to raise the ceiling on coverage limits (California Department of Insurance, 2019). The California Fair Plan Association has resisted the call for comprehensive coverage, specifically, and has lost a relevant case in court, yet, as of Monday of this week, the FAIR Plan continued to advertise only HO-1 coverage for fire and lightning, smoke, and internal explosions while directing customers needing additional insurance to consider difference in conditions coverage (California FAIR Plan, 2022).

The problem of protecting homeowners from losing their insurance or having to replace it with expensive or bare-bones FAIR Plan insurance is not exclusively the responsibility of insurance companies nor of state insurance commissioners. Federal assistance will continue to loom large for the most at-risk communities. Consider, for example, the $100 million in FEMA Hazard Mitigation Grant funds that are flowing to California to help homeowners make their homes safer from wildfire. The Office of Emergency Services and CAL FIRE are distributing these funds in a pilot project called the California Wildfire Mitigation Program. Communities selected for assistance have higher concentrations of people over the age of 65, residents with disabilities, people living in poverty, and populations with limited English or lack of access to a car. This is a cost-share program. FEMA pays up to 75 percent of the cost of eligible mitigation projects. The California state legislature has enabled California's Office of Emergency Services to make a 25 percent match at the local level. The local communities in this case are fortunate insofar as the state is making this match possible. Sometimes the match simply is not on the table. Consider that FEMA's Building Resilient Infrastructure and Communities program requires a 30 percent match. There are communities that cannot find the match nor have the staffing to manage the grant. A stronger, consultative role by states in the allocation of these funds could help address these problems.

FEMA-supported programs like the California Wildfire Mitigation Program and the Safer from Wildfires initiative spearheaded by California's Insurance Commissioner are designed not only to directly help homeowners make their homes safer but also to inspire insurance companies to re-enter the market as homeowners and communities become more resilient to wildfire. These strategies and others could shift the insurance industry's thinking, transforming risk into opportunity (Sidoti, 2022). Nevertheless, even as insurance and reinsurance companies become more proficient at estimating risk, lower income homeowners and lower income renters will not be the primary beneficiaries, particularly if better risk forecasting leads to higher premiums and lower coverage limits.

When it comes to protecting the most vulnerable communities in harm's way, present and future funds authorized by Congress are essential. Indeed, FEMA, with support from Congress, has made strategies like the California Wildfire Mitigation Program possible. All the relevant trends indicate that today's pilot programs to harden homes and create defensible space, supported by federal agencies, will need to evolve into longer-term, sustained programs that help underserved communities with fire safety measures in multiple states.

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I wish to thank the Committee for their attention to this important matter and for inviting me to join today's hearing.

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