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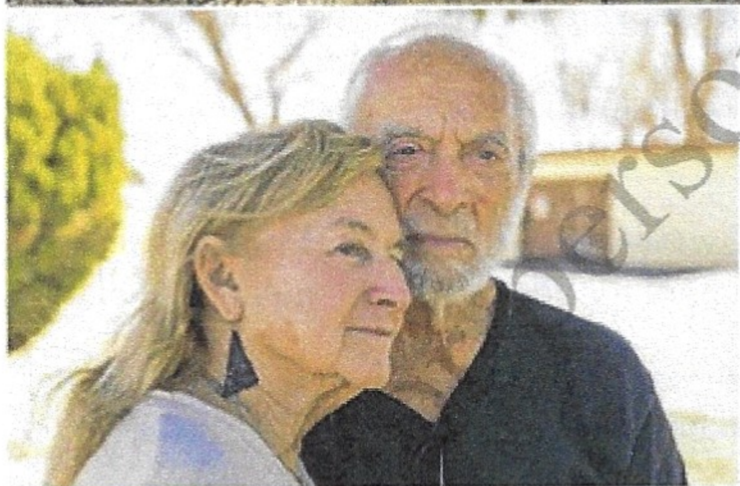

State Farm last year didn't renew the insurance policy on the Pacific Palisades home of Sandra Kaler and Burritt Newton, left. It burned to the ground last month, above. Right, Scott Wilk, an independent insurance agent in Los Angeles county, said State Farm was 'super aggressive' in the market. ALISHA JUCEVIC FOR WSJ (3)

State Farm's L.A. Reversal

Home insurer aggressively grew in California, despite high risk of fires, but decided to cut thousands of policies last year

BY JEAN EAGLESHAM AND SUSAN PULLIAM

After the pandemic, most home insurers were fleeing wildfire-prone areas of California. But State Farm was there—and making a huge bet.

It gobbled up market share—and generated substantial commissions for its agents—by insuring high-value homes in the Pacific Palisades and other Los Angeles neighborhoods that many of its competitors rejected as too vulnerable to wildfires. By 2022, State Farm had more than 20% of the California market, dwarfing its competitors.

In 2023, the insurer took in $2.7 billion of home-insurance premiums in the state, more than a third higher than its nearest rival, and a 70% increase from five years earlier, according to data from ratings firm AM Best.

But behind the scenes, red flags were emerging, as State Farm faced up to years of internal warnings about its levels of risk. Its own actuaries repeatedly said the California

subsidiary's premiums weren't high enough and its outside consultants warned of the seriously escalating risk of a devastating fire.

Just months before the January conflagration, the insurer slammed on the brakes. It said it would drop around 30,000 homeowners—including 9,500 in neighborhoods that burned last month, according to an analysis by The Wall Street Journal—and moved to substantially raise premiums.

That left thousands of homeowners in fire zones without traditional policies, including Sandra Kaler, whose insurance on her Pacific Palisades house wasn't renewed by State Farm just weeks before the fire. She was forced to switch to the California Fair Plan, the state's insurer of last resort, which offers bare-bones fire coverage at typically high rates.

By the morning of Jan. 8, her home had burned to the ground. "It was gone in an instant. There is only a chimney left," she said of the home where she raised her children.

Afterward, the 74-year-old filed a claim with State Farm, hoping they might pay toward her losses on her house, which was recently appraised at $3.5 million. The claims specialist told her he would pray for her family and denied the claim.

Last month's fires killed 29, destroyed around 16,000 homes and caused an estimated $30 billion or more in losses to insurers. The disaster has also thrown California's insurance landscape into a state of chaos.

State Farm, long one of the few private insurers taking on risky properties in Los Angeles, is at the center of that crisis. For years it sold policies at premiums it knew were unsustainably low—which allowed it to dominate market share. Its shocking reversal upended the status quo—and funneled even more homeowners into the state-designed Fair Plan, which took on coverage of more homes in areas with high fire risk as private insurers pulled out. The Fair Plan may need bailing out by insurers and homeowners to pay its expected billions of dollars in claims. *

Complicating matters is a structure in which State Farm has split off its California homeinsurance subsidiary, in an effort to insulate itself from potentially catastrophic losses, according to analysts. It has said in state filings that the California subsidiary is expected to run as a stand-alone, without help from the parent. *

State Farm, the nation's largest home- and auto-insurance company, with more than 90 million customers nationwide and a million home policies in California, has a strong credit rating and a surplus of well over $100 billion. The California unit, by contrast, was heavily in the red even before the latest fires. Over the past nine years, it has spent $1.26 for every dollar collected in premiums, resulting in over $5 billion in underwriting losses, the insurer said Monday.

State Farm said it is helping people recover from the January fires and has paid more than $1 billion to customers impacted. The company added that over the past decade, it has tried in California to "responsibly limit overexposure in high-risk areas," while allowing for growth elsewhere in the state. State Farm's "rate requests and underwriting decisions were made to try to appropriately match price to risk" in the state, it said.

Sales blitz

State Farm's sales drive in California surprised rivals as it pushed further into risky neighborhoods. Competitors were more selective about insuring homes in fire-prone areas, according to the companies and agents.

State Farm, by contrast, was expanding with few apparent limits. A 2021 internal list restricted sales of new policies for particularly high-risk areas—but that included only six of the 97 ZIP Codes that were at the heart of the recent fires, according to the Journal's analysis.

"State Farm was the only— and I mean the only—big insurer that would take everything" in that period, said Timothy Gaspar, who owns an independent insurance agency in the Woodland Hills neighborhood of Los Angeles. "All homes, big or small, no matter where they were."

Its relatively low rates shocked competitors. "Other agents in the industry would look at each other and say, 'How is State Farm doing this? Do they know something we don't know?'" Gaspar said.

Scott Wilk, an insurance agent in Los Angeles County's Valencia community said the only quote he could get in 2022 for a high-value home in the mountains was $20,000 from the specialist Lloyd's of London market. In the end, State Farm insured the property for $6,000, he said. "They were super aggressive, until they shut down production," he said.

State Farm itself knew its rates were too low for the level of risk it was taking on—and that the risk could overwhelm the company.

CoreLogic, paid by the insurer to advise it on risks, said in an interview it first warned State Farm four years ago of a heightened danger in the Los Angeles neighborhoods that were hit by the latest fires.

In 2022, State Farm's board of directors learned there was a one-in-20 risk every year of fire that could cripple the California subsidiary, a person close to the situation said. More typically, insurers hold enough capital so they can comfortably weather the risks in their portfolio, rather than being vulnerable to what was seen as a relatively likely disaster.

"Our California homeowners insurance product line has not been rate adequate since 2007," the company said on its website. For years, its in-house calculations had been warning that its rate increases were much lower than what was needed to balance its risks.

Yet State Farm repeatedly asked the state for a fraction of the increases that would be needed to bring its rates up to the necessary levels.

In 2021, State Farm asked California regulators to approve a 6.9% rise in home-insurance rates, less than a quarter of the 31% increase its own in-house calculations showed was needed to cover the risks of its policies, state filings show. In 2022, it again asked for 6.9%, rather than the 23% rate its own math indicated was needed.

Insurers in general kept rate requests low to navigate California's tough price controls. Unlike State Farm, many other companies tried to manage that limitation by cutting back sales in high-risk areas.

Instead, the low rates fueled State Farm's rapid growth. "We were happy to be able to steer people in their direction as the only alternative to the Fair Plan," the insurer of last resort, said Amy Bach, executive director of consumer group United Policyholders. Consumers preferred it to the Fair Plan's limited coverage and high prices.

Policy reversal

A leadership change in the California unit in 2023 changed everything. Thomas Conley, who had come up through the agency ranks and was seen as sympathetic to the sales force, ran the California unit during its big bet on the homeowners business. State Farm agents pocketed big commissions on the high-value homes.

When Conley retired, his replacement, Arizona-based executive Denise Hardin, took a different tack: Seeing a sea of red due to high underwriting losses in the subsidiary's books, she decided it was time to play hardball with regulators to increase premiums, among other demands, a person close to the situation said.

Conley and Hardin didn't respond to requests for comment.

In February 2023, State Farm executives met with California Insurance Commissioner Ricardo Lara, regulatory records show. He had kept insurance prices low, slow-walking ratehike requests for almost two years during the pandemic in a bid to help consumers.

Within days of the February meeting, State Farm put in for a 28% increase in home-insurance rates—a shocking request after Lara had typically approved increases of less than 7%. Weeks later, State Farm upped the ante by announcing it would stop selling new home-insurance policies in the state, matching moves by other insurers and paralyzing the market.

After blasting State Farm and its competitors for creating "uncertainty and anxiety" among consumers, Lara later that year announced a new "sustainable insurance strategy" that mostly met insurers' demands for reforms to California's rules. He also began greenlighting much bigger rate increases for leading insurers. The new policy allowed companies to use their models that had been forecasting rising wildfire risks for years in their rate-setting. Lara later approved a 20% rate increase for State Farm.

State Farm wasn't satisfied. In March 2024, it announced its plan not to renew around 30,000 residential property policies, many in high-risk areas. Many of the dropped homeowners ended up on the Fair Plan, paying much higher rates for less robust coverage, according to agents and homeowners.

In June, State Farm applied to increase homeowner rates by 30%, on top of the 20% increase agreed to in 2023.

Michael Soller, a deputy insurance commissioner, said the regulator's changes help consumers by requiring insurers to sell more home-insurance policies in high-risk wildfire areas. "Under the new rules, insurance companies cannot retreat from California if they want to do business here," he said.

On Monday, State Farm asked California regulators to approve a 22% emergency rate hike for homeowners.

State Farm hasn't disclosed how much it expects to pay out in claims for the January fires, its likely loss, or how badly that will eat into the already thin financial cushion of its California company. So far, it has received over 8,700 claims, according to the company.

Subsidiary structure

Consumer advocates said they believe State Farm may be exploiting the separation between the California subsidiary and the parent company to make the unit appear distressed and alone—rather than part of an extremely healthy national insurer—and so bolster its rate demands.

"Chicken Little in Blooming--ton will tell you that the sky is falling," said Douglas Heller, director of insurance at the Consumer Federation of America, a consumer-advocacy group, referring to the insurer's national headquarters in Illinois.

A State Farm spokesman said the company "strongly disagrees" with any suggestion of financial engineering.

State Farm reorganized in 1998 to silo its subsidiary that sells home-insurance in California— called State Farm General Insurance. The company created a similar structure for its Florida home-insurance subsidiary, which operates in risky, hurricane- prone coastal areas. The Florida subsidiary threatened to leave that state in 2009 before dropping tens of thousands of policyholders in hurricaneprone areas.

California regulators have pushed back on State Farm's previous demand for a 30% rate increase. Among their questions to the insurer, according to state filings: Given its claims of financial distress, does it plan to cut bonuses for executives? Or commissions for agents? State Farm responded no to both queries, according to the filings.

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