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Crime-scene tape marked off a burned structure in Malibu on Wednesday; analysts forecast the Fair Plan's share of the losses from the fires at up to $6 billion. STUART PALLEY FOR WSJ

Owners Across California Liable for Fires' Cost

BY JEAN EAGLESHAM AND SARA RANDAZZO

ALTADENA, Calif.—A littlenoticed rule change last year by California's insurance regulator will likely shift a large chunk of the cost of the Los Angeles wildfires to homeowners across the state.

Pushed by insurers, the change puts California homeowners on the hook to pay directly toward the cost of rebuilding from very large disasters through even fatter insurance bills—whether they were exposed to the L.A. fire or not.

"That would be a huge wake-up call for Californians because they have no idea that the rules have changed," said Dave Jones, a former California insurance commissioner.

The new policy affects the backstop for California's Fair Plan, the state's insurer of last resort, which sells fire-damage policies to homeowners who can't get coverage elsewhere.

The worry is that the Fair Plan lacks the resources to pay for the quickly escalating cost of the fires, which have destroyed tens of thousands of structures.

The rules change means insurance companies can bill their customers if they are forced to bail out the plan, which has an estimated $200 million in cash and $2.5 billion in reinsurance, according to data it reported last year.

That is likely not enough to cover the Fair Plan's share of

the losses from the fires, forecast at up to $6 billion by analysts at Evercore ISI.

The Fair Plan's business ballooned after private insurers pulled back from the state, preparing for a disaster by not renewing policies as their risk models warned of likely conflagrations.

As the blazes spread, estimates of the financial toll keep rising. Analysts at Morning--star DBRS now forecast insured losses of up to $30 billion— the highest for any fire in the world in recent times.

Private insurers have sufficient reserves to cover the expected claims, and none are expected to be pushed into insolvency by the disaster, analysts said.

Overwhelming cost

But the spiraling cost could financially overwhelm the Fair Plan, the government-created insurance safety net.

Like similar insurance safety nets in more than 30 other states, including disaster- prone places such as Florida, the Fair Plan wasn't set up as a typical insurer. It operates with little cash in the bank, as a way of keeping rates—while higher than private insurers' premiums— within reach of policyholders. Regulated insurers agree to bail out the plan, if needed, as a price of doing business in the state.

The Fair Plan is required to take all comers, which means its customers are heavily concentrated in fire-prone areas.

A heap of charred rubble marks where Henry and Brenda Sharp's $2 million Altadena building once stood. The couple, in their 70s, are scrambling to figure out their losses, and how much their insurer, the Fair Plan, will pay.

"It's burned down," Brenda Sharp said of their three-bedroom, three-bath home and three rental units on the property. "Our whole neighborhood burned down."

In the Sharps' Altadena ZIP Code alone, the plan had insured almost $1 billion of properties at the end of September, up 47% from the previous year, the latest data show.

If the Fair Plan breaches its financial resources, the state can call on commercial home insurers to pay the rest of the claims, by imposing what's called an assessment on the companies.

The charge on each company would be roughly proportionate to its share of the home-insurance market. The largest home insurers include State Farm, Farmers Insurance, Allstate and Mercury Insurance.

$2.5 billion ceiling

If the Fair Plan loses more than $2.5 billion, it will likely need to assess, said Michael Wara, director of the climate and energy policy program at Stanford University. "It's very likely they have lost more than $2.5 billion," he added.

A spokesman for the Fair Plan said it is "too early to determine if an assessment will be sought as claims are just beginning to be submitted and processed."

Because of the rule change made last year by the state's embattled insurance commissioner Ricardo Lara, companies can add to their customers' bills 50% of the first $1 billion of an assessment, and 100% of any amounts over that, subject to his agreement.

An assessment would put further upward pressure on California's already fast-rising home-insurance rates, according to analysts.

Many of those affected have suffered total losses. Karl Susman, a Los Angeles-based insurance agent, said 78—and counting—of his clients in the Pacific Palisades, one of the Fair Plan's biggest markets, have nothing left.

One client's family has been "left with the clothes on their back and a laptop" that was in their car as they fled the flames, Susman said.

The Fair Plan was set up in the 1960s when the Watts riots led to widespread fire damage in Los Angeles, prompting commercial insurers to pull away from the market.

The plan was initially intended to cover only a fraction of homeowners. It has taken on an outsize role as private insurers have curbed coverage.

Seven of the 12 biggest home insurers in the state have stopped or restricted sales of new policies, saying the rates allowed by regulators are insufficient to compensate for wildfire and other losses.

The Fair Plan, intended as a last resort, "is quickly moving to be the first resort for a lot of people," its president, Victoria Roach, told a state hearing last year.

Years of lobbying

For years the industry had lobbied lawmakers to allow companies to pass on any Fair Plan assessments to policyholders, without success. Last year, regulator Lara changed the assessment rules, part of a broader push to persuade leading home insurers to return to the fragile market.

"Insurers had a wish list of things and they got them all, [including] reducing their exposure to a California Fair Plan assessment," said Jones, who heads the climate-risk initiative at University of California, Berkeley's Center for Law, Energy & the Environment.

Laying off losses

As well as passing on costs to homeowners, insurers might be able to further reduce the pain of any assessment through reinsurance. Mercury, one of the top 10 home insurers in the state, said Friday it expects its losses to exceed the $150 million level at which its reinsurance kicks in. That reinsurance covers the Fair Plan assessments, the company said.

Consumer advocates are up in arms about the prospect of a potential charge of hundreds or even thousands of dollars being added to home-insurance bills.

"Homeowners across the state shouldn't pay because insurance companies dumped homeowners on the Fair Plan," said Carmen Balber, the Los Angeles-based executive director of Consumer Watchdog.

Regulator Lara said last year the rule was designed to protect consumers, by removing the risk that insurers would seek to land them with all the costs of an assessment. That "could lead to an escalating spiral of uncertainty and negative consequences for all California policyholders," he said.

The rules were changed last year to give consumers certainty " because we knew it was a matter of when, not if, there was going to be a major wildfire," said Michael Soller, a deputy California insurance commissioner.

Any assessment would need to be approved by the commissioner, he said. "We don't know yet if we're at that extreme worst-case scenario," he said.

Bailout proposal

It is possible the state could bail out the plan. A proposal from lawmakers would empower the California Infrastructure and Economic Development Bank to issue bonds to raise cash for the plan. The Fair Plan could also seek to recover money paid out in claims by suing utilities that can be shown to have sparked one or more of the fires.

The sheer volume of likely claims on the alreadystretched Fair Plan means victims of the fires could well face delays and bureaucratic tangles trying to get paid, agents and consumer advocates said.

"I shudder to think how it's going to be for some of these people to get their claims processed in a timely way," said Amy Bach, executive director of consumer group United Policyholders. Insurance agent Susman called the plan the "most challenging organization to have to deal with right now."

The Sharps say they are talking to their insurance broker and haven't yet submitted a claim. They hope to remain in the area, even if they decide not to rebuild their home.

"Our children and grandchildren are there, our church is there…our life is there," Brenda Sharp said. "Out of our church family, there have been over 60 families to lose their homes in these fires."

