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image

Reinsurance costs have risen as fires and storms hit California. A Sacramento home damaged in a storm last year. PAUL KITAGAKI JR./ ZUMA PRESS

California Has Insurance Safety Valve

A segment of the market has shifted away from standard policies toward more-bespoke offerings

Many insurers have pulled back from offering standard California homeowners policies, but that isn't the only option.

Instead, homeowners can turn to what might be thought of as the wholesale side of the private personal- insurance business. This is distinct from what is known as the admitted market, which refers to the typical, state-regulated policies on offer from insurers to consumers. The nonadmitted market, such as coverage via so-called excessand- surplus lines, can be accessible to homeowners, though often only through specialized brokers or agents.

That coverage can be more bespoke, with higher limits than other policies—but with more-expensive premiums, or with tougher terms. Such policies might only be available after an applicant has sought and failed to get coverage in the standard market. Historically, this might have been where someone turned to insure a rare vintage car or a home with very valuable art. But this market has grown in re--cent years.

S& P Global Ratings in a note on Thursday said preliminary thirdparty estimates suggest that the wildfires in Los Angeles County could result in $10 billion to $15 billion of industrywide insured losses, potentially matching the roughly $16 billion loss from the 2017 Tubbs Fire in Northern California. Some estimates have even said insurance losses could exceed $20 billion.

So one big question after these fires is whether the surplus market might absorb an increasing amount of coverage needs—or if regulators' recent changes to the admitted market can draw more insurers back to offering standard policies.

A longer-term, secular shift away from standard policies toward bespoke ones could actually be a growth opportunity for some insurers, as well as wholesale brokers who help agents source that coverage.

Following the 2017 and 2018 wildfires in California and a recent increase in the cost of reinsurance coverage, some insurers have pulled back from offering standard policies in California. The years since also have coincided with an uptick in losses from other so-called secondary perils, such as severe thunderstorms or winter storms, across the U.S.

Nationally, excess-and-surplus premiums made up about 9% of total U.S. industry premiums in 2023, up from around 5% in 2018, according to S& P Global Market Intelligence. That growth has come via several lines, including for commercial insurance. For property premiums in some states, the share is much higher, including California (about 14% as of 2023), Florida (about 21%) and Louisiana (about 23%), according to S& P's figures.

Some bespoke coverage can come through insurers that in recent years have pulled back from the standard homeowners policy market in California. Insurers such as **Chubb** can provide coverage to California homeowners via units that serve high-net-worth individuals, for example. **American International Group** backs a business called **Private Client Select** that covers high-net-worth individuals.

Chubb shares fell over 5% last week and AIG declined over 3%, more than the overall 2.4% drop for S& P 500 insurance-industry companies.

But dynamics for insurers are complex when disasters like these fires strike. As long as losses aren't overwhelming to insurers' earnings or capital—and they almost certainly won't be for large, diversified providers—they might eventually play into their long-term growth and pricing.

Some providers have said that pricing in the E& S market was actually softening a bit recently, with more competition and capital coming in. But it is possible that an event like this wildfire will "harden" pricing, such as if there are some players who back away from the market.

Alternatively, demand for surplus coverage could jump as people look for more protection than they can get in the admitted market, or from California's state-backed Fair Plan, known as an insurer of last resort.

Wholesale insurance brokerage companies also have seen an uptick in activity in the surplus market. Speaking to investors last year, Joel Cavaness, chairman for the Americas for specialty insurance at **Arthur J. Gallagher** & Co., noted a "significant inflow of requests for E& S coverage for homeowners, both traditional homeowners as well as high net worth."

Insurance company **Ryan Specialty** recently teamed up with Private Client Select. The changing risks from perils such as wildfires, wind and severe storms have "accelerated way beyond what admitted markets can adjust to," Ryan founder and Executive Chairman Patrick Ryan said at an analyst conference. "Business has to go into the E& S market," he said. "Not everybody believes that, but we do."

In insurance, risks can eventually find a home—at the right price and terms.

—Telis Demos

E&S = ~~xxs~~ excess & surplus