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INSIGHT

Homeowners Insurance and California Wildfires

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Insurance premiums for homeowners across the United States have significantly increased over the past few years, with some homeowners encountering difficulties in obtaining insurance. While such market disruptions have occurred in Gulf Coast states for many years due to hurricanes, California and other western states have developed such insurance market problems more recently, starting with wildfires in 2017. The 2025 Los Angeles wildfires have already produced multi-billion dollar damage estimates and will likely exacerbate the state's insurance market disruptions. This Insight addresses common questions related to homeowners insurance and the threat of wildfires.

Does homeowners insurance cover wildfire damage?

Wildfires are typically included as a covered peril in standard homeowners insurance policies. The exact amount of damage covered, however, depends on policy specifics, such as deductible amounts and maximum coverage limits. After disasters, people commonly discover that rebuilding their home costs a good deal more than their insurance coverage, a phenomenon known as "underinsurance" or a "protection gap." A study on a 2021 Colorado wildfire found that 74% of those filing claims were underinsured.

How is insurance regulated?

Unlike other financial services companies like banks, there is no federal regulator for insurers; instead companies offering homeowners insurance are regulated by the states they operate in. While each state has their own specific laws, products offered to individuals, like homeowners and auto insurance, are typically regulated on features such as exact policy language and the premiums to be charged. Some states, including California, require regulatory approvals before insurers raise premiums, while other states allow insurers to raise premiums on their own recognizance (but may examine such increases after the fact to ensure they are not "excessive" or "unfairly discriminatory.")

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What was happening in California insurance markets before the recent fires?

Since 2017, California has experienced 13 of its most destructive wildfires with losses so large that observers have called the California insurance market "troubled" or on an "unsustainable path" as insurers raise premiums and withdraw from the market.

Insurers argue that California insurance market difficulties are driven not only by increasing damage from wildfires but also from an inflexible regulatory system that limits rate increases. Many of the restrictions on insurers originated with Proposition 103, a ballot measure California voters passed in November 1988. Among other provisions, Prop. 103 required the prior approval of rates and that all information used to set insurance premiums be made public. Most forward-looking insurance models, however, are considered proprietary by modeling firms. Because of this, California insurers have generally set rates based on historical losses, which may not fully capture recent increases in wildfire risk. Prop. 103 also made California the only state in which insurers could not incorporate reinsurance costs into their premiums. Consumer advocates, however, claim $2.2 billion in consumer savings though Prop 103's rate setting requirements.

The 2017 and 2018 wildfire seasons are estimated by an insurance consulting firm to have caused losses nearly twice the combined underwriting profits for the previous 26 years, although this does not account for insurer profits on investment income or the effect of reinsurance. Insurance companies in California reacted to these losses by increasing rates and not renewing policies in high-risk locations, with seven out of the 12 largest insurers limiting their coverage over the past two years. For example, State Farm, the largest insurance company, stopped issuing new homeowners policies in the state in 2023, and dropped over 1,600 policies in the Pacific Palisades neighborhood (more than any other zip code in California.)

In response, the California Insurance Commissioner issued a series of one-year moratoria on non-renewals and cancellations in specified zip codes between 2018 and 2025, including a moratorium addressing the current Los Angeles fires. In 2023, the Commissioner embarked on a "Sustainable Insurance Strategy" aimed at expanding insurance availability, with a regulation allowing for forward-looking modeling announced in November 2024. The final major step allowing reinsurance costs to be considered in rate setting was announced December 30, 2024. In order to make these changes, insurers must increase their coverage in high-risk areas and offer discounts for specified mitigation actions. Insurer reaction to these reforms were generally positive.

How do homeowners get insurance when an insurer drops their coverage?

If homeowners are unable to find private insurance, they may be able to turn to state-operated insurers of last resort, often referred to as FAIR plans (Fair Access to Insurance Requirements), which provide coverage to those who are unable to obtain insurance in the regular market. FAIR policies are typically more expensive and have limited protection. The California FAIR plan has grown substantially in recent years, with policy numbers increasing 41% and plan exposure increasing by 61% between September 2023 and September 2024 alone. The plan's current total exposure across California is $458 billion. If the plan is unable to pay all claims, assessments may be placed on other homeowners insurance policies to cover unpaid claims.

What do the California fires mean for other insurance markets?

Insurance premiums are primarily set on the basis of individual, local risks. Insurers offering local policies, however, may depend on national (or international) capital and reinsurance markets to pay claims. This is particularly the case when large scale disasters occur. Initial damage estimates made a week after the 2025 Los Angeles County fires ran as high as $40 billion (with some fires still uncontrolled.) For context, this initial estimate doubles that of the final estimate for the 2018 Camp Fire, previously the costliest wildfire in the United States. Should that number increase, other points of comparison include the September 11, 2001 terrorist attacks (the largest man-made disaster at nearly $60 billion of insured losses in current dollars) and Hurricane Katrina (the largest natural disaster at over $100 billion of insurance losses).

Large losses from California wildfires may spill over into the costs incurred by insurers for capital or reinsurance. However, whether this spillover will be significant depends on a number of other factors including not just insurance market activity but also macroeconomic factors such as inflation and interest rates.

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