

California faces an under-insurance crisis. Here's how to fix it.

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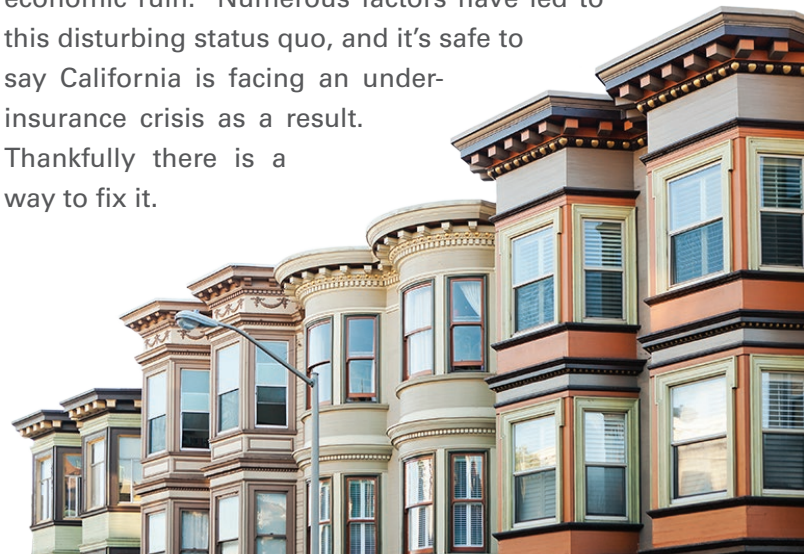
California is well-known for earthquakes. From San Francisco in 1906 to Northridge in 1994, the state has experienced its share of large seismic events, several of which have caused massive damage and loss of life. In the 21st century alone, there have been ten earthquakes above a 5.0 on the Richter scale, including the 2019 Ridgecrest earthquakes east of Bakersfield. The U.S. Geological Service **predicts** that, in the next 30 years, there is a 99.7 percent chance that California will be struck by a magnitude 6.7 earthquake (the same strength as the 1994 Northridge quake), and a 46 percent chance of a magnitude 7.5 earthquake (which is 45 times stronger).

Quakes of this magnitude carry massive economic losses. The business intelligence and analytics firm CoreLogic recently **modeled** a potential 8.3 magnitude earthquake along California's 800-mile San Andreas Fault affecting Northern and Southern California simultaneously. The impact is sobering: it would damage 3.5 million homes and require \$289 billion in construction and repair costs.

But despite this risk and the enormous costs of rebuilding, Californians remain dangerously under-prepared for future earthquakes.

Approximately 90% of Californians have no insurance coverage against earthquake damage to their homes, putting them at serious risk of financial ruin after the next disaster strikes. The lack of insurance coverage would potentially leave the state in physical and economic ruin. Numerous factors have led to this disturbing status quo, and it's safe to say California is facing an under-insurance crisis as a result.

Thankfully there is a way to fix it.



A Preventable Problem

Earthquake insurance coverage is meant to stem these losses for both home and business owners and help them rebuild their lives. Given the fact that most Californians live within 30 miles of an active fault, earthquake insurance seems like it should be a necessity in the state, similar to the requirements for Californians living in high risk flood zones. The *California Earthquake Authority (CEA)* is actively working to raise awareness of earthquake risk and help Californians secure private earthquake insurance policies. However, unlike flood insurance, which is mandated by the federal government for homes located on or near a flood zone, there is no requirement that homeowners purchase earthquake insurance, no matter where they reside. That's right, you can build a house right on the San Andreas fault line without having to purchase earthquake insurance.

As a result, barely 10% of California residents have any sort of earthquake coverage, despite the CEA's efforts and the availability of options through multiple private insurers in the state. This is far too low, and the situation is getting worse.

The high cost of California's recent wildfire seasons could convince certain insurers to limit their presence in the state for a variety of risk products, including earthquake insurance. The State is aware of this risk: California Insurance Commissioner Ricardo Lara recently announced a **one-year moratorium** on policy cancellations and non-renewals covering about 20 percent of California's residential insurance market. The remaining 80 percent of the market, though, remains vulnerable to dislocation due to insurer flight.

This is not just a problem for under-insured homeowners, it's a problem for all of us. Uninsured earthquake exposure would be assumed by mortgage lenders such as banks and government-sponsored enterprises like Fannie Mae and Freddie Mac, potentially exposing the financial system to a series of major stresses. A breakdown in the private insurance market would also certainly require greater public expenditures to rebuild lives and property, exposing federal and state taxpayers to considerable risks.

Possible Solutions

The current situation is untenable, but there are solutions.

Private insurance is a necessary link in the chain of economic resiliency that helps communities and states recover from disaster, and the State of California should consider new approaches to encouraging Californians to buy private insurance policies both inside and outside the CEA consortium. These could include a variety of incentives to home and property owners to encourage take-up; a redoubling of the CEA's efforts to raise awareness of earthquake risk; and more extensive risk mitigation efforts to harden infrastructure and promote safer, more resilient new construction. Congress should work with government-sponsored enterprises like Fannie Mae and Freddie Mac to assess each organization's earthquake exposure (**estimated** by some to total \$205 billion of uninsured risk) and take steps to transfer risk from the taxpayer to the private sector.

Much of this problem, of course, would be solved if lenders required proof of earthquake insurance from applicants to obtain a mortgage in the highest-risk areas of the state or nation. As noted above, federal

law requires lenders to verify proof of flood insurance for properties located in a Special Flood Hazard Area or SFHA (Flood Disaster Prevention Act, 1973). While fault lines are not as easy to identify as bodies of water, the federal government could identify the most active known fault lines in the country (or a state like California) and create an SFHA-style regime requiring some form of earthquake insurance for the highest-risk homeowners.

Palomar has provided earthquake policies since our founding, and unlike other insurers we are working to expand, not shrink, our footprint in California. We look forward to working with the CEA, the State of California, and the communities we support to address the urgent issue of under-insurance before the next major quake.

Each newly covered home represents a link in our chain of economic resiliency, protecting California families while also ensuring the continued health and viability of our state's economy. We must strengthen that chain before it is tested by the major earthquake that scientists tell us is inevitable. This is an urgent task, and one which Palomar will support with all our efforts.

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