Swiss Re

Property & Casualty Trend Spotlight

Growing wildfire losses (and the implications)

How bad have wildfires been of late? State emergency management officials say there hasn't been a month without a wildfire in California since 2012.[1] Global insured losses from wildfires in 2017 were the highest recorded at USD 14bn.[2] And California suffered its costliest wildfire year in history in 2017 — with 2018 costing insurers possibly even more.

One overarching truth from this: insurers and claim teams need to be prepared for a continuing increase in the frequency and severity of wildfire events — and the unique challenges they present.

What's happened, and still happening

In October 2017, 13 major fires roared through Northern California causing more than USD 11bn in insured losses. In December 2017, more fires burned in Southern California, causing another USD 2.5bn in insured losses. November 2018 brought the Camp Fire and the Woolsey Fire. Losses from those catastrophic events are estimated to be USD 9–13bn.[3]

It will likely get worse with the world facing warmer temperatures and longer periods of drought. More people are moving increasingly to the wildland urban interface (WUI)–area that is adjacent to undeveloped natural land and more exposed to wildfire risk. The number of homes in the WUI increased 42% from 1990 to 2010. Since 1990, 60% of new homes in the US were built in these exposed areas.[4] Commercial properties at the same time are moving into these at-risk areas to service the growing population.

A landscape fraught with underinsured risks

Most large catastrophic events bring "demand surge," a significant increase in the costs of labor and material to rebuild damaged properties. The usual demand surge can be exacerbated by the severity of the damage as seen in these recent wildfires. While hurricanes or hail events often result in a large number of smaller claims, an overwhelming portion of wildfire losses result in the total destruction of the dwelling and its contents. To illustrate, the average claim from the Tubbs wildfire in Northern California was USD 333,000 for personal lines and USD 579,000 for commercial lines losses.[5] Compare that to USD 19,700 and USD 6,254, respectively, for Hurricane Sandy losses.[6]

The homes that are located in the remote areas of the WUI are no longer simple cabins in the woods, but often large, custom-built retreats or part of densely-occupied subdivisions. Homeowners repair or rebuild with the same high-quality materials and the same skilled labor, often in markets that suffered from shortages of these craftsmen before the fires. These factors add to the costs of reconstruction. Thus, many homeowners find themselves underinsured after these wildfires.

The loss can exceed the limits for the dwelling and the contents and often eat through the additional limits found in extended replacement costs endorsements, which generally provide an additional 25% of the limits to replace the covered property. This "protection gap" has caught the attention of homeowners and insurers, as well as lawmakers.

The California legislature acted to protect homeowners following the recent wildfires and other catastrophic events, passing legislation that allows homeowners to combine dwelling and other structure limits and requiring insurers to offer extended replacement cost coverage to 50% above the dwelling limit or disclose that other carriers may offer such coverage.

With that said, it's best for insurers to ensure that agents and underwriters have the right tools to determine the appropriate limits for homeowners in areas at risk for wildfire, and can accurately calculate the amount required to rebuild a property following devastating events.

1 (https://www.npr.org/2018/08/04/635583192/constant-wildfires-leave-california-firefighters-strained)
2 [sigma]
3 https://www.rms.com/newsroom/press-releases/press-detail/2018-11-19/rms-estimates-insured-losses from-the-camp-and-woolsey-wildfires-to-be-between-usd-9-billion-and-13-billion
4 [sigma]
5 https://www5.iso.com/pcs/app/bul/bulreport.do?userId=amkwia&product=2&name=CB174818&icat=826&seq=18&rptType=Estimate&forwardType=rpt]
6 https://www5.iso.com/pcs/app/bul/bulresults.do?product=2&searchType=1&icat=644&ncat=90

The potential for fraud

Overwhelmingly, insureds just want to rebuild, be made whole, and resume their lives and businesses after catastrophic fires. Some people, however, see the potential for a windfall through fraudulent claims and schemes. These schemes often go further than inflating the homes' finishes or the value of the contents. The fraud can be complex and committed by sophisticated businesses.

The director of the California Department of Emergency Services alleged contractors retained by the US Army Corp of Engineers to remove debris after the 2017 California fires unnecessarily removed soil and undamaged sidewalks and drives in an effort to increase the weight removed, because they were paid by the ton of debris removed.[7]

Following the 2015 wildfires in California, insurers saw an unusual number of claims for "smoke damage" to homes well outside the area affected by the fires, often prompted by contractors offering to take "readings" and perform the necessary "remediation."

Insurers need to be aware of the potential for fraud. That means staying focused on helping those damaged by the fires, enforcing the terms of the insurance contract, and working with law enforcement when they uncover evidence of criminal fraud.

The regulatory risk

We often see a flurry of activity from state and local governments after catastrophic events. To be fair, regulatory agencies and legislative bodies are reacting to protect their constituents. That is their job. Fire coverages in policies are fairly clear and not subject to substantial re-interpretation by regulators. However, state and local governments, through legislation or regulation, will often work to change insureds' rights and insurers' obligations after a catastrophic wildfire event. Some recent examples:

- They extend the time in which an insured must rebuild[8] and during which the insured can collect additional living expenses.[9]
- They extend the time to rebuild and collect replacement costs from two years to three.[10]
- They allow insureds to collect replacement cost coverage regardless of whether the insured rebuilds on the same property or builds or buys in another location.[11]

With regulators' attention on wildfires, immediately after these events is the best time to seek more effective ways for preventing future events or lessen their damage. Insurers should work with governing bodies to encourage effective building codes and fire mitigation. The industry can and should take the lead before and after wildfires to educate insureds and their representatives on prevention and mitigation.

Recovery from responsible parties

Insurers owe their policyholders (and, yes, reinsurers) a duty to recover for the property losses paid. That's because the overwhelming majority of wildfires are caused by humans. Worldwide, more than 90% of fires are linked to human acts – both intentional and unintentional.[12] The most common causes are campfires left unattended, the burning of debris, negligently discarded cigarettes and intentional acts of arson. The remaining 10% are started by lightning or lava.[13]

Fire jurisdictions undertake extensive investigations to determine the cause and origin of these fires. Their primary objective is to understand the cause so they can work on effective prevention procedures, but these investigations also provide the chance to hold people and companies responsible for the damage these fires cause.

Governments can impose fines and seek costs for firefighting efforts, and insurers and private citizens should be made whole for the damage they suffer as well.

Final thoughts

Dry conditions and wildfire seasons are lasting longer and longer. There is more development in wildfire exposed areas. And the number of people and properties at risk for wildfires will continue to grow. Understanding and responding to the unique issues insureds face is just one more way Swiss Re is working with its customers to make the world more resilient.

[7] https://ktla.com/2018/10/08/victims-of-norcal-wine-country-fires-say-cleanup-crews-added-to-woes/
[8] [California AB 1772]
[9] [California SB 894]
[10] [California AB 1772]
[11] [California AB 1875]
[12] http://www.publish.csiro.au/wf/pdf/WF17026
[13] https://www.iii.org/article/background-on-wildfires