California not ready for big quakes, and they're coming

Robert Ferris, CNBC, 1-21-15

Earthquakes may be impossible to predict, but many experts are certain of one thing: Most people living in high-risk regions will be disastrously underprepared when one does strike.

Insurers in California, one of the country's highest-risk regions for seismic activity, say many residents could lose everything if a catastrophic quake hits the state.

Seismic activity has been relatively moderate in the state over the last several years. In places such as the small town of Hollister in the central region of the state, scarcely a week goes by without some kind of small shaker. Many of the events can be felt, but are moderate, like the 4.4-magnitude earthquake that hit the Monterey area on Tuesday.

Scientists agree there is a virtual certainty that a 6.7-magnitude or stronger earthquake will strike the state in the next 30 years, according to the CEA, but no one has any way of predicting it.

Japan, for example, is considered one of the most well-prepared countries for seismic events. But the 2011 Tohoku quake off the coast took the country by surprise, causing a nuclear meltdown at the Fukushima power plant and a tsunami that killed more than 15,000 people and caused $200 billion in damage, according to a report by the National Oceanic and Atmospheric Administration.

"I would come down and say, financially most Californians are pretty poorly prepared," said Glenn Pomeroy, chief executive of the California Earthquake Authority (CEA), a non-profit insurance company run by the state government. "When you consider that for many people, their homes are their primary investment assets, that is pretty bad."

California's vulnerability to quakes led to an interesting quirk in its insurance market: Homeowner insurance policies are forbidden from covering earthquake damage.

The California Legislature created the CEA after the 6.7-magnitude Northridge earthquake of 1994 resulted in huge losses for commercial insurance companies paying out claims for earthquake damage.

The state passed a law requiring that companies separate earthquake coverage from their homeowner and rental policies and gave companies the option of selling a CEA policy instead of underwriting the risk themselves. Now the CEA covers about 75 percent of the state's outstanding policies (the agency does not handle commercial real estate). A few companies, including Chubb, Fireman's Fund and Travelers Insurance, offer their own policies.

But the primary concern Pomeroy has is that many people aren't adequately considering about the danger. Based on his own experiences and CEA data, residential and commercial property owners and tenants are not buying insurance. More than 90 percent of Californians lack quake insurance.

"If you walk up to a Californian on the street and ask them if earthquakes happen, they will say, sure, but there is a sense that it won't happen to them," he said. "And that is frightening."

As of 2014, the CEA had roughly 865,000 policyholders, a 19 percent increase since 2003. The rest of the industry had fewer than than 270,000 policyholders in 2013, representing a decline from roughly 400,000 only six years earlier.

The CEA, like much of the insurance industry, makes use of actuarial science—the assessment of potential financial risks based on statistics and data—to evaluate how much money it needs to keep on hand for claims payouts and how much it should charge policyholders.

The authority is required to keep enough money on hand to cover all of the potential claims that would result from the worst possible quake, the kind that only comes around about every 450 years. Right now, that number is about $10 billion, Pomeroy said.

Pomeroy said the agency charges different rates based on a number of factors: how close a house is to a known fault, how old a house is (newer is better), how many floors a home has. It will also give a discount if the house has been retrofitted for earthquake damage, which the agency will help pay for if it's needed, and which Pomeroy says is not all that expensive.

Varying the rates according to risk is one of the factors that has helped the agency avoid the sort of financial trouble that has plagued the National Flood Insurance Program, a federal insurance program that covers flood damage, another threat to homes typically not covered by homeowner's insurance policies.