Financial Planning Newsletter

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Earthquake Insurance

Earthquake insurance is a form of property coverage that covers some of the potential losses an earthquake can cause to one's home or belongings. California law mandates that every residential property insurer offer earthquake insurance in writing to its policyholders and must include the coverage limits, the deductible, and the premium.

Coverages

There are three main parts of basic earthquake coverage:

1. Dwelling/Structures Coverage – The limits on this are typically the same as the limit on one's homeowner's insurance for dwelling coverage. In most policies, only the damage in excess of the deductible (typically 15%) is paid by the insurance company. Some policies consider the building structure and its contents as separate entities. In these cases, any deductible will apply separately to the entire loss that occurs to the structure, damage to the external buildings such as a garage or shed.
2. Personal Property Coverage - This covers items within a home, such as furniture, TVs, and computers. In most cases, policyholders will be required to take out coverage for at least 10% of the cost of their dwelling to cover their personal property.
3. Temporary Housing, Additional Living Expenses (ALE) or Loss of Use - Depending on the insurance company, the policy may cover temporary housing (hotel, renting a home) if the home is too damaged to remain in while being repaired. Also, some cover storage, furniture rental, and utility installation at the temporary residence. It is important to check the terms of the policy as to what is and is not covered after the deductible is met.

Premiums

The annual premium for this insurance is quite high, especially for properties closer to fault zones. Also, the age of the home, the cost to rebuild, building material used, and the number of levels are other factors that determine the insurance premium. Newer homes must be built according to the latest codes, so they will likely have more favorable rates. For older homes that have been retrofitted for seismic resistance, insurance companies will also typically charge lower premiums.

Deductibles

The deductible for this coverage is typically 10-15% of the policy coverage amount, which is higher than compared to deductibles for homeowner and automobile insurance policies. For those homeowners with significant home equity, it protects the investment in the event of a catastrophe. However, earthquake insurance is of little value if the homeowner has not set aside funds to first pay for the deductible.

California Earthquake Authority (CEA)

This organization provides most of the earthquake insurance coverage for residential property owners in California and is quasi-public (publicly managed, privately funded) state agency started in 1996. The CEA does not offer policies directly, but works through insurance companies who participate in the agency's program and participating insurers can only offer CEA policies. Premiums are paid to the insurer, and then pooled into the CEA fund to cover claims from the policyholders of participating insurers. The state of California specifically stipulates that it does not back up CEA earthquake insurance, in the event that claims from a major earthquake were to drain all CEA funds, and it does not cover claims from non-CEA insurers if they were to become insolvent due to filed claims. In July 2012, a new CEA Homeowners Choice policy started being offered which provides for several coverage options. One can select separate coverage for dwellings and personal property, with different deductibles and also have different limits for loss of use. In addition, this policy includes $1,500 coverage for emergency repairs with a zero deductible.

Determining Need for Coverage

There are earthquake faults throughout much of the United States, and actual earthquakes have been recorded in 39 states since 1900, with an average of 5,000 per year. It comes as no surprise that most earthquake insurance coverage is sold in California, but any homeowner who resides in an area near a fault line, should consider having this coverage.