September 16, 2024

The Honorable Sean Casten
Representative
2440 Rayburn House Office Building
Washington, DC 20515-1306

The Honorable Maxine Waters
Ranking Member, House Committee on Financial Services
2221 Rayburn House Office Building
Washington, DC 20515-0543

The Honorable Sheldon Whitehouse
Chairman, Senate Budget Committee
530 Hart Senate Office Building
Washington, DC 20510-3904

Dear Representative Casten, Ranking Member Waters, and Chairman Whitehouse:

Thank you for your interest in the National Association of Insurance Commissioners' (NAIC)[1] climate-risk and resilience-related efforts in the supervision and regulation of insurers. No other financial product or service so directly and acutely illustrates the economic cost of climate-related risks as property insurance, so state insurance commissioners, individually and collectively through the NAIC, have long been focused on this issue. Safeguarding insurer solvency to be able to pay claims across multiple lines of business and preserving a competitive market that balances insurance supply and price is a unique challenge, particularly as risks and claims expenses increase, but one we are dedicated to addressing every day.

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1 As part of our state-based system of insurance regulation in the United States, the National Association of Insurance Commissioners (NAIC) provides expertise, data, and analysis for insurance commissioners to effectively regulate the industry and protect consumers. The U.S. standard-setting organization is governed by the chief insurance regulators from the 50 states, the District of Columbia and five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer reviews, and coordinate regulatory oversight. NAIC staff supports these efforts and represents the collective views of state regulators domestically and internationally. For more information, visit www.naic.org.

NAIC members have dedicated significant attention and resources to climate risk and resilience as well as the current property insurance market challenges, supporting efforts both to expand coverage and lower the risk, making coverage more attainable for consumers and markets more stable. Our Climate and Resiliency Task Force has looked holistically at the issue, with commissioner-led work on pre-disaster mitigation and home hardening, insurer solvency, climate risk disclosure, and the role of innovation and technology. Evaluating and understanding the impact of climate risk and severe weather on insurers and insurance markets is embedded throughout our regulatory system, from data, to analysis, to solvency, to disclosure.

The strength of the U.S. state-based insurance regulation system to protect consumers and ensure solvent markets lies in both the flexibility of individual states to employ diverse strategies that respond directly to unique risks and market developments and the commitment of regulators to take collaborative action, gather and share data, promote best practices, and respond to national issues through the NAIC.

We understand and witness the challenges some consumers are facing in finding and affording property insurance first-hand – these are our fellow residents, and in some cases our friends and neighbors. When it comes to property and casualty losses and expenses, state insurance regulators have a front-line perspective on what consumers are experiencing and the challenges that insurance companies are facing as the mix of inflationary pressures and natural perils persists across our nation. When disaster strikes, long after national attention turns elsewhere, state insurance regulators remain in the community helping policyholders understand their insurance coverage and ensuring claims are paid properly so they can rebuild their homes, reopen businesses, and ultimately strengthen the economic and physical recovery of local communities in the wake of climate-related losses. Members of Congress can refer their constituents directly to their state insurance department when severe weather impacts their district, and the NAIC is investing in consumer education and awareness to educate policyholders on what to do before they have a loss, with tools like our Post Disaster Claims Guide.[2]

Current Market Conditions

The current trend for property insurance in some parts of the country, where rates are rising and coverage is more challenging to obtain, is well documented, but understanding what is driving this market trend is imperative to put regulatory actions in context. Insurers and reinsurers send important signals about the risks that threaten our homes and property in the form of underwriting and pricing decisions for insurance products. If climate-related risks and extreme weather events are impacting more of our communities more often, the price we pay to insure this risk will increase, and insurers, with finite capital to deploy and solvency to maintain, will adjust where and how much coverage they can safely offer in a particular region – especially if extreme weather is more prevalent.

[2] National Association of Insurance Commissioners, *Post-Disaster Claims Guide*, https://content.naic.org/sites/default/files/publication-post-disaster-claims-guide.pdf

In addition to climate-related risks, there are other important dynamics impacting the insurance market that have little to do with the climate. For example, your letter cites rising insurance costs as a contributing inflationary factor, but it is important to remember that property insurance costs reflect the underlying cost of claims, which include construction materials, underlying home values, the cost and availability of labor, the impact of litigation, and other factors. Put another way, insurance claims reveal the impact of inflation on the things we insure, which in turn is reflected in the price.

As a sector, property insurers have experienced several challenging years of underwriting performance with a combined ratio over 100% (i.e., the ratio of claims and expenses to earned premium), which means that on average, they have been losing money on underwriting for several years. While investment returns have helped offset that underwriting loss, insurers have had to respond by raising prices significantly in some markets more prone to catastrophic losses and adjusting how much business they can safely offer in these areas. The mix of elevated risks and elevated costs due to inflation are now being felt directly by policyholders. The sector experienced an underwriting loss of $24.9 billion in 2022 and $21.2 billion in 2023 (according to AM Best). On a positive note, preliminary industry reporting suggests that underwriting performance has improved in some areas in 2024 with declining loss ratios for some of the largest carriers; however, we remain in the middle of another active hurricane season, there are ongoing wildfires across the country, and so-called "secondary perils" (i.e. unnamed weather events such as tornados, hailstorms, blizzards, and other convective storms) continue to cause tens of billions of dollars of losses each year. Policyholders who live in areas prone to these events, which is not an insignificant portion of the country, are still experiencing higher rates and, in some cases, fewer coverage options.

State Regulators/NAIC Activity

State insurance regulators and the NAIC have been attuned to climate risk's impact on property insurers for over a decade, but as insurers internalize this risk and pass it on to their customers, attention and awareness of this issue has understandably broadened. Your letter notes recent attention to climate risk, though not limited to insurance, by the Financial Stability Oversight Council, Treasury's Federal Insurance Office, and other regulatory agencies focused in particular on housing and banking. Last June, in response to Executive Order 14030, the Treasury Department's Federal Insurance Office (FIO) released a report on "Insurance Supervision and Regulation of Climate-Related Risks."[3] The report makes 20 policy recommendations directed primarily at the NAIC and its members. First, we appreciate federal agencies engaging with us on climate risk issues to better understand the impact on insurance markets and coverage, and ultimately how that in turn impacts their areas of responsibility. We have had extensive conversations with FIO, the Federal Housing Finance Agency (FHFA), the Consumer Financial Protection Bureau (CFPB), the U.S. Department of Housing & Urban

[3] Federal Insurance Office, U.S. Department of the Treasury, *Insurance Supervision and Regulation of Climate-Related Risks* (June 2023), https://home.treasury.gov/system/files/136/FIO-June-2023-Insurance-Supervision-and-Regulation-of-Climate-Related-Risks.pdf

Development (HUD), and others about how risk is managed in insurance, how risk can impact housing affordability, and how they are responding to supervise housing, banking, and other financial services. We welcome their feedback and engagement on our work, and they have been receptive to our feedback on theirs.

Specific to FIO's recommendations, many align with efforts state regulators were already taking to factor climate risk into various regulatory tools and processes, while some encourage the NAIC to expand our work and coordination. While we appreciate this feedback on our regulatory regime, state regulators have been working to supervise property insurance markets for over 150 years and have open and transparent systems in place to gather feedback from stakeholders of all kinds – including the federal government. Tailoring regulation, analysis, data requirements, and regulatory processes to provide necessary insights for regulators is what we do each and every day. In the following section, we will elaborate on some of this work, both completed and underway.

This spring, the NAIC and state regulators continued to put the focus on reducing losses and speeding recovery from natural disaster by adopting the first-ever National Climate Resilience Strategy for Insurance to protect the nation's property insurance markets.[4] The goal of the strategy is to drive faster and more effective risk reduction by state insurance regulators to ensure that insurance continues to be available and reliable as a crucial backbone to communities facing climate risks. This strategy focuses on promoting pre-disaster mitigation efforts targeted at the unique natural disaster risks experiences in different parts of the country, effective data collection, better risk assessment tools for regulators, and coordinating on disaster recovery. The strategy builds on nearly a decade of work by regulators individually and collectively through the NAIC.

An important part of the strategy is the states' Property & Casualty Market Intelligence data call (PCMI) to collect and analyze ZIP-code level data covering more than 80% of the U.S. property insurance market by premium volume. [5] The PCMI data call gathers more than 70 distinct data elements from nearly 400 property insurers operating locally and across the country in more than 40,000+ ZIP codes to give state regulators a more granular sense of what is happening in their individual property markets and the nation overall. The data call is presently ongoing with data validation underway this month. For more detail on the design of the PCMI data call, please see the June 18, 2024, letter the NAIC sent to members of Congress in response to their request for more information.[6]

Another one of the states' strategic regulatory tools to address climate-related insurance market risks, which has been in place for more than a decade, is the Climate Risk Disclosure

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[4] National Association of Insurance Commissioners, *NAIC National Climate Resilience Strategy for Insurance* (April 2024), https://content.naic.org/sites/default/files/draft-naic-national-climate-resilience-strategy-12-1-2023-updated.pdf

[5] National Association of Insurance Commissioners, *Property & Casualty Insurance Market Intelligence Data Call* (2024), https://content.naic.org/industry/data-call/property-ho.htm

[6] National Association of Insurance Commissioners, *Letter to Representative Levin et al. on the PCMI Data Call*, (June 2024) https://content.naic.org/sites/default/files/naic-response-to-rep-levin-et-al-on-pcmi.pdf

Survey. As a global sector, we have aligned the survey with guidance from the international Task Force on Climate-Related Financial Disclosures (TCFD) to promote consistency across jurisdictions, and it requires insurers to publicly disclose their governance, strategy, risk management practices, and how they measure and monitor climate-related risks.[7] The annual survey, currently issued by 29 states, provides robust insights from a broad range of insurance companies covering nearly 85% of the U.S. insurance market.

Insurers are no longer relying solely on historical loss data to predict future losses, and many now leverage sophisticated catastrophe models that factor in severe weather, the density and construction quality of housing, and economic variables to assist insurers in pricing and underwriting coverage. To keep pace, regulators have created the Catastrophe Modeling Center of Excellence (COE) within the NAIC's Center for Insurance Policy and Research (CIPR) to evaluate catastrophe model usage and provide regulators with technical training and expertise regarding catastrophe models and information on their use within the insurance industry. The COE also conducts research utilizing outputs from catastrophe models to assess the risk of loss from natural hazards. Risk assessment is a foundational tool to identify potential economic and insurance market disruption and can be applied to support policy and legislative action to reduce the risk.

A core function of insurance regulation is ensuring the solvency of the market, which protects consumers, allows claims to be paid, and promotes a healthy and competitive market where risk and price are in balance. In 2023, significant revisions were made to further incorporate climate and catastrophe risk considerations into both the NAIC's Financial Analysis Handbook and its Financial Condition Examiners Handbook. These handbooks are utilized in every jurisdiction and guide the exam process and our ongoing financial analysis work. Revisions will ensure that both transition risk (i.e., potential impact on assets due to climate risk) and physical risk (i.e., potential impact of increased underwriting losses due to climate risk related events) are appropriately considered in ongoing financial surveillance. The NAIC's focus in this area has now shifted toward regulator training and development, as financial regulators receive technical training on catastrophe models and climate risk concepts in order to effectively implement this new guidance.

In 2024, climate risk scenario analysis requirements were added to the NAIC's Risk Based Capital filing, which will require property insurers to project the potential future impact of climate risk on their hurricane and wildfire losses (at 2040 and 2050) and disclose those results to regulators to help both the company and regulators forecast and anticipate market conditions. Additional considerations for insurers' Own Risk and Solvency Assessment (ORSA) filings are currently under development now that the climate scenario analysis requirements have been finalized. Also important to note is that the existing RBC catastrophe charges continue to be enhanced and refined, with the wildfire charge first being effective as of December 31, 2024, (previously for informational purposes only) and severe convective storm modelling results to be reported for informational purposes for the first time as of December

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[7] Lisa Groshong, PhD, CIPR Communication Research Scientist, *National Association of Insurance Commissioners, Climate Risk Disclosure Survey / TCFD Comparison* (March 2021) https://content.naic.org/sites/default/files/inline-files/Appendix%20C.pdf

31, 2024. In addition, a new CAT (catastrophe) reinsurance disclosure has been added to the RBC CAT section for December 31, 2024, which will require insurers to disclose information about changes in their CAT reinsurance coverage to regulators, which is important given the current hard market.

Pre-disaster mitigation is another critical tool to offset the risks from natural perils. [8] While the availability of insurance coverage for a particular set of risks will fluctuate over time, steps taken to minimize those risks before they become losses on an insurer's balance sheet will help protect our citizens and bring down the costs associated with natural catastrophes. Part of this work involves educating consumers about ways to reduce their risks before a disaster strikes and any incentives that might be available to them for undertaking certain property fortifications. The Climate and Resiliency Task Force tracks risk-mitigation programs to facilitate sharing best practices among the states.

In recognition of the value of sharing best practices and fostering mutual learning, the Climate and Resiliency Task Force established a dashboard of risk mitigation programs in 2022. [9] This serves as a collective tool enabling states to access and establish mitigation programs similar to those used in other states, promoting the adoption of effective adaptation strategies. Each location has its own complexity of hazard risk, combined with unique building characteristics, making risk reduction a very localized issue that requires localized expertise. Local expertise combined with shared knowledge sets the stage for a successful resilience strategy. The California Safer From Wildfires program, for example, provides premium incentives for reducing wildfire risk through home hardening, while the Strengthen Alabama Homes Program provides grants to homeowners to retrofit properties based on the Insurance Institute for Business & Home Safety (IBHS) Fortified standard. In 2023, the state of Minnesota passed a similar law requiring incentives for homes that meet the Fortified standard, demonstrating the regional diversity of such approaches. A growing number of states have either put in place or are in the process of developing similar programs to help their citizens reduce their risk.

The NAIC is also engaged internationally on this topic, both in terms of developing international regulatory best practices through our leadership at the International Association of Insurance Supervisors (IAIS), and in understanding offshore insurance and reinsurance market conditions directly from our regulator counterparts in other jurisdictions. A significant portion of U.S. natural catastrophe risk and loss is spread globally, through reinsurance transactions, insurance linked securities, catastrophe bonds, and direct investment by foreign insurers. We work directly with other regulators to ensure that U.S. policyholders remain protected even as the economic cost of claims is spread outside our borders.

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[8] National Association of Insurance Commissioners, *Climate Risk and Resiliency Resource Center – Pre-Disaster Mitigation*, https://content.naic.org/climate-resiliency-resource.htm

[9] National Association of Insurance Commissioners, *State Mitigation Programs* (2022), https://content.naic.org/sites/default/files/inline-files/State%20Mitigation%20Programs.pdf

Conclusion

There is more work to be done. Through the NAIC, state insurance regulators are coming together to execute on a national strategy for climate risk and resilience with clear, actionable goals and objectives to assist regulators, consumers, and insurers in managing the risks of climate-related disasters. While much attention is focused on our Climate and Resilience Task Force, climate risk issues cut across multiple areas of focus, from solvency and financial reporting, to technology and innovation, to market conduct reporting. Our Catastrophe Modeling Center of Excellence has inspired regulators across the globe in other catastrophe prone regions of Europe and Asia, and we are a leading voice in climate risk discussions among global financial regulators as perhaps the first financial regulators in the U.S. to have climate risk disclosures in place for the majority of our market since almost a decade ago.

Building on the solid foundation of the work of state regulators described above, the NAIC and state regulators are creating a long-term framework to better understand property insurance markets and address protection gaps, as we know the current market conditions are straining already stretched pocketbooks for many citizens. We also know that for many Americans, their home is their most valuable asset, and this stored wealth is directly threatened by the increasing frequency and severity of natural disasters exacerbated by climate risk. Insurance pricing and availability exists at the intersection of these escalating forces, and state regulators work every day to ensure that, despite these forces, consumers are treated fairly, and U.S. insurers remain strong, solvent, and competitive.

States are best positioned to do this work, and more importantly, they have the statutory and regulatory power to act quickly. However, insurance alone is not going to address our national response to the increasing frequency and severity of weather events that impact all aspects of our economy. Other financial regulators and policymakers must take appropriate steps to manage and mitigate this risk, but to the extent that insurance has a role to play, so too will state insurance commissioners and the NAIC.

Members of Congress can help by supporting any of the myriad mitigation and risk reduction bills pending before them.[10] Additionally, we urge Congress to pass the Disaster Mitigation and Tax Parity Act of 2023 (S. 1953 and H.R. 4070), which excludes from gross income, for income tax purposes, any qualified catastrophe mitigation payment made under a state-based catastrophe loss mitigation program. Essentially, Congress can fix it so the federal government stops taxing citizens for state-provided disaster mitigation grants, just as federal grants are tax free. NAIC members support efforts to respond to the underlying cost drivers of property insurance.

We thank you for your interest in state regulators' climate-related leadership in the supervision and regulation of insurers and for your leadership on these important issues.

[10] For example: S. 3606 the National Earthquake Hazards Reduction Program Reauthorization Act of 2024; S. 4143 The Flood Insurance Relief Act; H.R. 7070 the Wildfire Response Improvement Act; and S. 2132 the Catastrophic Wildfire Prevention Act of 2023.

Sincerely,

Andrew N. Mais *(He/Him/His)*
NAIC President
Commissioner
Connecticut Insurance Department

Jon Godfread
NAIC President-Elect
Commissioner
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Scott White
NAIC Vice President
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Elizabeth Kelleher Dwyer
NAIC Secretary-Treasurer
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Chief Executive Officer
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cc: The Honorable Patrick McHenry, Chair,
House Committee on Financial Services