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Comments of the Center or Economic Justice

To the Climate and Resiliency (EX) Task Force

In Support of the Proposal to Create a NAIC CAT Model Regulatory Resource

October 27, 2021

The Center for Economic Justice supports the proposal to establish a regulatory support resource for natural catastrophe modeling issues at the NAIC and offers some additional suggestions.

CEJ is indifferent to how the NAIC names the regulatory support resource or how the NAIC organizes its resources to provide these services. We suggest that instead of focusing on grandiose titles or identifying a location within the NAIC, the proposal focus on identifying the goals, strategies, specific activities and resources necessary to provide these activities, similar to what the NAIC has done with regulatory support for principles based reserving and review of complex pricing models. We fear that a focus on the title and location may detract from the important substance of the proposal.

The September 20, 2021 proposal states:

> *(S)tate insurance regulators need to improve their understanding of the CAT modeling technologies used by insurers and reinsurers. This means having access to the same knowledge, insights, and tools used by insurers. In doing so, state insurance regulators can more effectively engage with insurers and state and federal policymakers when discussing how best to maintain critical insurance coverages for their states' economies and developing new regulatory policy. The NAIC can play an instrumental role fulfilling these needs.*

This problem statement assumes and focuses on a problem defined as regulatory understanding of CAT modeling technologies. The problem statement seems to assume that regulatory oversight of insurers' use of CAT model would improve if regulators better understood how CAT models were developed and how they operate,

We suggest that equally important, if not more important, for regulatory oversight is regulatory understanding of how insurers utilize CAT models for specific purposes (rating agency ratings, rate filings, reinsurance, investments, risk management) and how the market for CAT models operates – whether market forces promote or distort CAT model outputs for various purposes. An insurer may, for example, be seeking a higher expected cost of catastrophes in support of a rate increase, but a lower expected cost to present to a ratings agency.

In addition, we offer the obvious conflict of interest created by the credit rating agency Moody's purchase of one of the four major CAT modelers – RMS. Most insurers rely upon Moody's for a financial rating to present to investors as well as ratings on debt offerings. By owning RMS, Moody's has a financial interest in insurers utilizing RMS for their (insurers') cat modeling needs and, by virtue of providing credit and debt ratings to the insurers, Moody's has both a conflict of interest in and a mechanism to distort an insurer's choice of CAT Modelers.

Consequently, there is a regulatory need to understand and monitor insurers' and CAT Modelers governance of CAT Models and whether conflicts of interest or market failures may distort the use of CAT Models. We suggest a fourth support service that is particularly suited to CIPR:

(4) Conducting research and analysis into the markets for CAT Models and identify any issues of unfair discrimination or conflicts of interest that might compromise insurer or regulator use of CAT Models.

Finally, we suggest that purpose (3) does not accurately describe the intended activities. Purpose (3) states:

> Conducting applied research analysis utilizing various model platforms to proactively answer the regulatory "so what" questions that may need to be addressed for regulatory resilience priorities.

But, the description states:

> CAT Models. . . are tools for CAT risk assessment. State insurance regulators can apply these tools in much the same way as the industry, albeit for regulatory resilience priorities (e.g., how to increase the uptake and proliferation of home hardening activities related to hurricane and wildfire risk). Such mitigation activities are critical to reduce expected losses and improve the availability and affordability of coverage currently and in a future warming climate. Applied research utilizing CAT models can demonstrate the economic value of such mitigation activities, laying the proper foundation for policy discussions to address increasing property owner mitigation implementation.

We strongly support this effort and suggest a clearer description of this Purpose (3) would be:

> (3) Conducting applied research analysis that utilize or analyze the potential to utilize CAT Models to further public and private risk mitigation and resiliency efforts, benefits and opportunities at the individual consumer or business or public agency or at the community, regional, state or national level.