



Testimony of Joanna Syroka

Senior Underwriter and Director of New Markets, Fermat Capital Management, LLC

Before the Select Committee on the Climate Crisis

“Creating a Climate Resilient America: Strengthening the U.S. Financial System and Expanding Economic Opportunity”

October 1, 2020

Good afternoon, Chair Castor, Ranking Member Graves, and members of the Select Committee, my name is Joanna Syroka, and I am a senior underwriter and director of new markets at Fermat Capital Management. Based in Westport, Connecticut, Fermat is one of the largest and most experienced investment managers in Insurance-Linked Securities, or ILS for short.

ILS are financial investments whose losses are directly linked to insured loss events such as wildfires, floods, hurricanes and earthquakes. To be clear: investors lose money when these events occur. ILS are most often used by insurers and reinsurers to transfer catastrophic risks that stress their balance sheets the most directly to the capital markets where capacity for such risks is greater.[1] This frees up capital, allowing insurers to provide more coverage to the areas that demand it and to support homeowners, businesses and vital economic activity in all geographies in the United States. As governments act as the “insurer of last resort”, many governments and public entities around the world – including the U.S. federal government – are also issuing ILS to manage their obligations in times of disaster. ILS effectively convert the global bond market into the largest de facto insurance company ever seen. By doing so, they have the potential to absorb catastrophe risks far better than the traditional insurance industry. The current ILS market stands at over US\$90 billion in size, but as climate and other risks outpace insurance supply, we foresee substantial market growth ahead.[2]

Some of the largest institutional investors in the world invest in ILS, usually through specialists like my company. Our portfolios, like the ILS market, are predominantly U.S. focused and primarily exposed to U.S. weather risks, such as hurricanes, floods, tornadoes and wildfires, as well as earthquakes and other catastrophe risks. As such, the ILS market – like the insurance and reinsurance markets it supports – is at the forefront of monitoring changes in weather extremes and their impact on economies. Unlike long-duration investments like equities, traditional bonds and real estate, ILS are more short-term in nature (maturities typically range from one to five years) and can, therefore, reprice their returns in the relative near term as new information about the frequency and severity of weather events becomes available. As a leading manager in this space, we

continually monitor events and check our models and benchmarks for any potential changes in extreme weather activity, seeking to detect and integrate emerging climate trends into our investment processes. This ongoing feedback loop is critical to the functioning of the ILS market, creating a “climate linker” market architecture within which ILS can be thought of as “climate-indexed floating rate” investments. In this way, investors and ILS issuers alike are provided with a forward-looking, market-based indication – or price – of the costs of weather risks and, consequently, climate change. The insurance and ILS markets are uniquely placed to provide this essential price discovery function to society.

The United States is the cradle of the ILS market. It was born in the late 1990s after two events – Hurricane Andrew in 1992 in suburban Miami and the Northridge Earthquake in 1994 in suburban Los Angeles – caused a near-collapse of the insurance markets in Florida and California. These disasters created an opportunity for capital market investors to provide new capital to the insurance sector. Since then, ILS have had an increasingly important role in helping stabilize the U.S. insurance market through the sharing of risks across a broader and deeper capital pool and in narrowing the insurance protection gap by increasing the available insurance capacity for catastrophe risks. By providing multi-year protection against events so large that any traditional reinsurer’s solvency would be called into question, ILS have reduced insurance costs for U.S. homeowners and businesses and have helped ensure that coverage remains stable *nationwide* in the aftermath of a major catastrophe.[3] However, as society responds to risks such as climate change – by shifting towards to a low-carbon economy, investing in risk mitigation and adaptation measures, and as new regulations are introduced to enforce climate-related guidelines – we believe ILS will have an even greater role to play in building a more climate and disaster-resilient future.

ILS are already helping emerging economies rebound from disasters quicker and enjoy significant governmental support abroad. They enable governments and other public entities to manage systemic catastrophe risks with an efficient, pre-event approach – rather than an inefficient, post-event approach to disaster response. Pre-arranged financing with timely, reliable and transparent triggers for funding flows, when embedded within broader disaster risk management programs aimed at reducing the impact of disasters on local economies and that include contingency plans for how communities build back better, can significantly increase the efficacy of disaster financing and planning, while promoting resilience for the long-run. For example, the World Bank has been enabling client countries, such as Chile, Columbia, Mexico, Peru and the Philippines, to manage their natural catastrophe risks with catastrophe bonds, the best-known type of ILS, since 2009.[4] These bonds use triggers based upon transparent and objective parameters of an event, such as the central pressure of a hurricane, that can unlock capital quickly and efficiently when disaster strikes to respond to areas in need. The U.K.’s terrorism insurance pool issued a terrorism risk catastrophe bond in 2019, with the aim of further distancing Her Majesty’s Treasury and the U.K. taxpayer from any liability in the event of a major claim due to a large terrorism attack (or attacks).[5]

In the U.S., ILS are already a core component of residual homeowner insurance programs in states like Florida, Louisiana, North Carolina and Texas, ensuring they can pay claims after hurricanes and

remain solvent to provide coverage for the next year.[6] They are helping utility companies in California better manage their wildfire risk and reduce the risk for the communities they serve.[7] The Metropolitan Transportation Authority (MTA) uses catastrophe bonds to cover storm surge losses to the New York City subway system.[8] Catastrophe bonds are helping the National Flood Insurance Program (NFIP) ensure it can pay claims after flood disasters without additional supplemental appropriations from Congress.[9] A hallmark of our market has been innovation, and there is no reason why ILS could not be used more broadly in public-private partnerships to help communities across the nation recover and rebound more quickly from weather catastrophes and reduce the need for post-disaster federal outlays.

As an ILS investment manager, we see first-hand that global investors are actively seeking positive Environmental, Social and Governance (ESG) investment opportunities that support the United Nations Sustainable Development Goals and we believe that ILS are inherently aligned with such positive principles. As outlined above, on the **environmental** front, ILS provide a market-based pricing mechanism giving an essential signal of the relative benefits of climate risk mitigation and adaptation measures to communities, creating a powerful feedback loop that aligns incentives for better risk management in the long term. On the **social** front, ILS are already helping to stabilize insurance markets, allowing them to support sustainable economic activity and reduce the economic impact of disasters on citizens. With respect to **governance**, ILS enable companies and governmental entities to manage systemic catastrophe risks with a rational, forward-looking approach—rather than an inefficient, after-the-fact approach—with significant multiplier effects for economies and society. For these reasons, our asset class has received significant attention from investors who are increasingly considering these qualities in their investments. In short, while the need for insurance capacity is great and growing, the capital required to set against this country’s most pressing extreme weather risks is on stand-by to be deployed.

To facilitate this, we have the following recommendations to the Select Committee:

1. Congress can take measures to help bring the ILS market onshore, which would make it more accessible to private and public entities who lack the resources or find it operationally difficult to do business offshore yet desire to tap the market. Currently, all catastrophe bonds and ILS are issued offshore in jurisdictions that have favorable regulatory and tax treatments for the special purpose insurers (SPIs) that are used to create and issue these securities. In the U.S., these SPIs are classified and therefore taxed at the federal level as corporations, making it prohibitively expensive to securitize catastrophe risks onshore. Allowing a so-called “pass-through tax status” for ILS SPIs would remove this impediment and enable ILS to be issued onshore. If implemented correctly, such pass-through legislation would result in a pure gain in revenue to the federal government. Bringing the market onshore would mean municipalities, states and other public entities would be freer to cede their risk to the capital markets and create programs to manage that risk with an efficient, pre-event approach. Moreover, such a step would also create jobs in the U.S. with valuable know-how in a new and expanding area of financial resilience, and generate

opportunities in data, science and cutting-edge technologies in disaster risk mitigation as on-the-ground programs are created.

2. The Federal Emergency Management Agency (FEMA), through the NFIP, is already a pioneer in catastrophe bonds. Congress should adopt key recommendations on technical assistance from the Select Committee's majority staff report, "Solving the Climate Crisis: The Congressional Action Plan for a Clean Energy Economy and a Healthy, Resilient, and Just America", so that entities seeking to access the ILS market – such as communities, municipalities and states – can optimally leverage existing experience and programs and have access to the expertise they need to follow in FEMA's footsteps.
3. Congress should also adopt pertinent recommendations on insurance and innovative risk transfer from the Select Committee's majority staff report, "Solving the Climate Crisis: The Congressional Action Plan for a Clean Energy Economy and a Healthy, Resilient, and Just America", including:
 - Increasing the role of insurance and innovative finance to support rapid and resilient recovery from disasters.
 - Strengthening the NFIP by, among other things, providing community-wide flood insurance.
 - Directing FEMA to evaluate and report on the use of innovative risk transfer mechanisms such as parametric insurance and catastrophe bonds to cover assets that are eligible for Stafford Act Category E funds.
4. Congress should consider legislation to encourage federal agencies to work with the private sector to better manage and transfer climate risk.

We believe these steps would significantly reduce the burden of catastrophe costs on taxpayers and help accelerate resilient recovery in times of disaster, while creating the insurance tools required to manage the climate, and other, risks ahead in the 21st century and ensuring the nation can finance and support continued economic growth in all geographies.

Thank you for the opportunity to testify today to the House Select Committee on the Climate Crisis and I look forward to answering any questions you may have.

References:

[1] Reinsurers are companies that insure insurance companies.

[2] *ILS Annual Report 2020*, Aon, September 28, 2020. Available at: http://thoughtleadership.aonbenfield.com//Documents/280920_aon_securities_ils_annual_2020_update.pdf

[3] *Alternative Capital and Its Impact on Insurance and Reinsurance Markets*, Robert P. Hartwig and James Lynch, Insurance Information Institute, March 2015. Available online at: https://www.iii.org/sites/default/files/docs/pdf/paper_alternativecapital_final.pdf. See also: *ILS*:

"Taller" Than You Might Think, John Seo, presented to the Federal Insurance Office, U.S. Department of the Treasury, November 4, 2015. Available online at: https://home.treasury.gov/system/files/311/Fermat_Capital_Presentation.pdf

[4] E.g. see *World Bank Catastrophe Bond Provides Financial Protection to Mexico for Earthquakes and Named Storms*, World Bank, March 9, 2020. Available online at: <https://www.worldbank.org/en/news/press-release/2020/03/09/world-bank-catastrophe-bond-provides-financial-protection-to-mexico-for-earthquakes-and-named-storms>

[5] *Placed World's First Terrorism Insurance-Linked Security (ILS) of £75m*, Pool Re, 2019. Available online at: <https://www.poolre.co.uk/history/placed-worlds-first-terrorism-insurance-linked-security-ils-of-75m/>

[6] The most recent transaction of this kind was by the Texas Windstorm Insurance Association in June 2020, see *TWIA's New Alamo Re 2020 Cat Bond Doubles in Size to \$400m*, Artemis, June 1, 2020. Available at: <https://www.artemis.bm/news/twias-new-alamo-re-2020-cat-bond-doubles-in-size-to-400m/>

[7] E.g. Sempra Energy, see *Sempra Energy's SD Re 2020-1 Wildfire Cat Bond May Upsize to \$90m*, Artemis, July 2, 2020. Available at: <https://www.artemis.bm/news/sempra-energy-sd-re-2020-1-wildfire-cat-bond-may-upsize-to-90m/>

[8] See *New York's MTA Sells Storm Bond: Agency Gets Creative in Disaster Planning as Usual Sources of Insurance Dry Up*, Wall Street Journal, July 31, 2013. Available at: <https://www.wsj.com/articles/SB10001424127887323681904578640401075075198>

[9] More information on NFIP's reinsurance program and catastrophe bond issuances can be found online at: <https://www.fema.gov/flood-insurance/work-with-nfip/reinsurance>