TESTIMONY OF THE

AMERICAN PROPERTY CASUALTY INSURANCE ASSOCIATION (APCIA)

HOUSE FINANCIAL SERVICES COMMITTEE

Factors Influencing the High Cost of Insurance for Consumers

Tuesday, October 24, 2023

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Chairman Davidson, Ranking Member Cleaver, and members of the Subcommittee, the American Property Casualty Insurance Association (APCIA) appreciates the opportunity to testify on the "Factors Influencing the High Cost of Insurance for Consumers." APCIA is the primary trade association for home, auto, and business insurers. For 150 years, we have promoted private competition for the benefit of consumers and insurers. APCIA members represent all sizes, structures, and regions – protecting families, communities, and businesses in the U.S. and across the globe.

OVERVIEW

The property casualty insurance industry is solvent but facing rapidly escalating loss costs, particularly in the property and auto lines of insurance. The root causes of the growing losses are increased asset values in regions exposed to higher risk of natural catastrophes, economic inflation, increases in extreme weather (e.g., wildfires, hurricanes, and convective storms), climate change, legal system abuse, and regulatory coverage mandates.

Particularly where states suppress or delay insurance rate increases, there is a growing gap between expected insured losses and premiums. Last year, insurers absorbed the worst underwriting losses in over a decade, contributing to a contraction of more than $73 billion in insurers' capital. In the first half of 2023, insurers spent 104.3 cents in claims and expenses for 100 cents of premium collected – and that's before the Maui wildfire and Hurricane Idalia catastrophes this fall.

The top driver of losses is the increase in exposure values and replacement costs, represented both by continued construction in high-hazard areas and by high levels of inflation that are driving up repair and rebuild costs. The number of people living in high wildfire risk areas doubled over the past two decades and the top hurricane-exposed states had double digit population growth between 2010-2020[1], trends that accelerated after the pandemic.

While insurance capital contracted last year, home values and building replacement costs spiked to record levels. Over the last 5 years, home values have increased 50% and building replacement values 44%[2], far more than the average increase in homeowners insurance. In the first half of this year, homeowners and commercial property claims costs increased by 36 and 30 percent respectively, elevating the loss ratios (claims payments versus premiums) to the highest first-half level in over a decade.[3] Used cars and trucks, which are the basis for auto insurance total loss settlements, increased nearly 40% over the last 5 years[4], also far more than the increase in auto insurance rates, with combined ratios (claims payments and expenses versus premiums) last year the highest since at least 1975.[5]

The frequency of severe weather events is increasing, even discounting for inflation. Average global natural catastrophe insured losses have nearly doubled over the last decade, a majority of which occurred in the United States. In just the first nine months of this year, there have already been 24 weather events causing over a billion dollars in losses — a new record. According to the National Oceanic and Atmospheric Administration (NOAA), the annual average of such events was 8.1 in 1980-2022, increasing to 18 from 2018-2022 (adjusted for CPI).[6]

Legal system abuse is further exacerbating insurance affordability pressures. U.S. liability claims costs rose 16 percent on average for the last five years, far exceeding economic claims drivers.[7] Regulatory mandates and massive data calls, such as the climate reporting requirements currently contemplated by the Securities and Exchange Commission, Federal Insurance Office, and the NAIC, add further significant cost pressures.

1 https://www.iii.org/press-release/triple-i-population-growth-drives-hurricane-loss-trends-071422
2 Bureau of Economic Analysis
3 https://www.swissre.com/institute/research/sigma-research/Insurance-Monitoring/us-property-casualty-outlook-september-2023.html
4 Bureau of Labor Statistics.
5 Swiss Re Institute, Ibid.
6 https://www.ncei.noaa.gov/access/billions/
7 https://www.swissre.com/institute/research/sigma-research/Economic-Insights/us-liability-claims.html#:~:text=US%20liability%20claims%20costs%20rose,not%20changed%20by%20COVID%2D19. ("Claims severity" refers to a proxy calculated as liability claims growth (claims incurred on a calendar-year basis) minus real GDP growth (as a proxy for exposure growth)).

The rapid escalation of losses and expenses well beyond insurance premiums collected caused a contraction in the industry's capital last year, while the lack of profitability is hindering ability to attract sufficient additional investment capital to meet increased coverage demands. Prudent risk management requires insurers to hold adequate capital to fund the volatility associated with insurance against rising auto accident and repair costs, natural catastrophes, and other potential losses. Insurers and reinsurers are only able to attract additional investment capital if they can offer investors an adequate rate of return. Unfortunately, insurers' ability to manage their risk in some states has been constrained by government underwriting mandates and delays in the review and approval of adequate rates, triggering severe market disruptions and reductions in coverage availability.

Insurance pricing also is a mechanism for conveying the consequences of decisions about road safety, where and how we build, and where people choose to live. Actuarially sound rates help with better recognition of climate-related impacts and increasing climate-risk exposures, encourage adoption of mitigation and resiliency strategies, and maintain insurance availability and private competitive markets. Where regulators suppress or delay adjustment in insurance rates, it masks socially beneficial climate-change risk signals, forcing policyholders and taxpayers residing in safer areas to subsidize those living in high-climate-risk regions.

To the extent insurers are able to charge actuarially justified rates, there is sufficient long-term capital and capacity available to insure against most natural catastrophes. But providing long-term affordable coverage for increasingly expensive buildings in areas at the highest risk of natural catastrophes will require significant improvements in mitigation and resiliency. Insurers and reinsurers have historically been leaders in understanding, quantifying, and mitigating weather risk, including increasing climate change risk and exposures. Earlier this year, APCIA helped develop a report by the Global Federation of Insurance Associations[8] (GFIA) entitled: "Global protection gaps and recommendations for bridging them." Natural catastrophes were recognized as creating one of the four most significant protection gaps. The GFIA report notes that the average share of insured natural catastrophe losses has increased over time globally; however, this has not resulted in a decrease in the natural catastrophe protection gap in absolute numbers, which stands at roughly US$139 billion per annum.[9] The report emphasized the critical role of (re)insurance and the urgent need for government and the private sector to work together to address the rising global natural catastrophe losses.

APCIA has identified dozens of state and federal programs that would help reduce catastrophe losses and generate significant long-term savings for consumers and governments, and we have been proactively supporting government programs to encourage improvements in building codes, improved land use planning to reduce the accumulation of assets in high-risk areas, retrofitting existing homes and infrastructure for greater resiliency, and improved land use management to reduce risk for wildfires.

8 Global Federation of Insurance Associations represents insurance associations that account for around 89% of total insurance premiums worldwide, amounting to more than $4 trillion.

9 Ibid. (between 1990 and 2000, the global average share of insured losses was approximately 22%, compared with 33% between 2010 and 2020; in Europe and North America, roughly 60-70% of catastrophic losses are insured).

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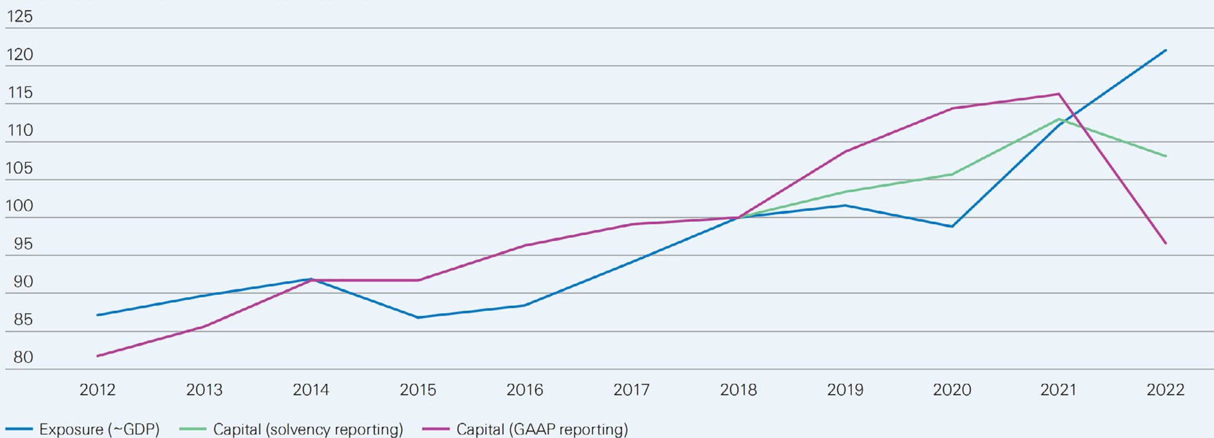
INSURANCE MARKET FINANCIAL OVERVIEW[10]

Solvency: The U.S. property and casualty[11] (P&C) insurance surplus is currently slightly over a trillion dollars.[12] Insurers require additional surplus to meet the ever-increasing risks and exposures, ranging from cyber threats in just about all insurance products to the devastating impact of extreme weather events and climate change. However, the aggregate net worth of the U.S. P&C insurance industry – the financial cushion to absorb unexpectedly high claims costs, investment losses, and catastrophe and weather events – fell by $73.1 billion in 2022.[13] The 6.9 percent drop from year-end 2021 was the largest percentage decline since the "Great Recession" year of 2008. The deterioration in industry financial strength was driven by underwriting losses (defined as claims paid and incurred versus premium revenue) of $25.6 billion (the largest loss since 2011) and record unrealized investment losses of $97.2 billion. Relative to the aggregate value of goods and services produced in the economy, insurance industry capital and surplus has shrunk. In the last three quarters, growth in capital and surplus failed to keep pace with growth in GDP – and the gap appears to be widening. This mismatch between insurance capital supply and consumer coverage demand is triggering market friction and availability concerns.

Global reinsurance capital vs exposure growth: a mismatch that looks set to stay

Demand for coverage for natural disasters had risen on evidence of increased catastrophe activity, and because of higher insurable values of buildings and other fixed assets. At the same time, catastrophe claims pay outs have reduced the supply of re/insurance capital. Rising interest rates and lower financial asset values have also contributed to supply constraints. Risk appetite has further decreased due to poor property re/insurance underwriting results in recent years, and widely held perceptions that risk assessments are underestimating actual loss experience. This is leading to hesitation on the part of capital providers to commit new funds to re/insurance risks and replenish the industry capacity.



Source: AM Best, Swiss Re Institute

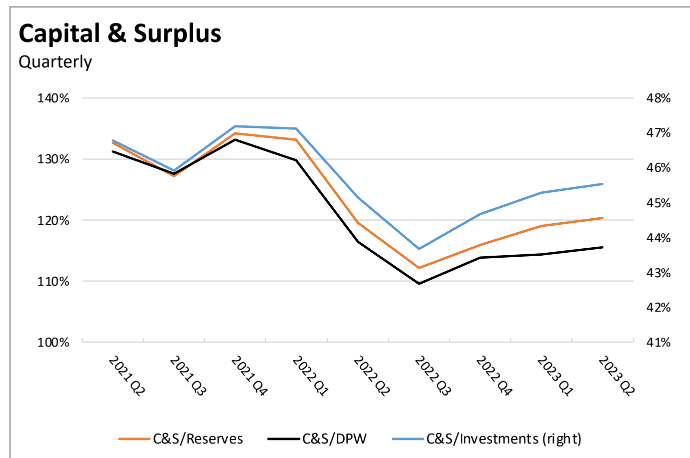
10 APCIA's Analysis of Financial Operating Results and Trends Impacting 2023 (May 2023) is available at **https://www.apci.org/attachment/static/8125/**

11 Property and casualty insurance provides coverage for personal and commercial property and assets (e.g., house, car, etc.) and liability for accidents, injuries, and damage to other people or their belongings.

12 S&P Global Market Intelligence based on NAIC June 2023 data for property casualty insurers ($1.039 trillion).

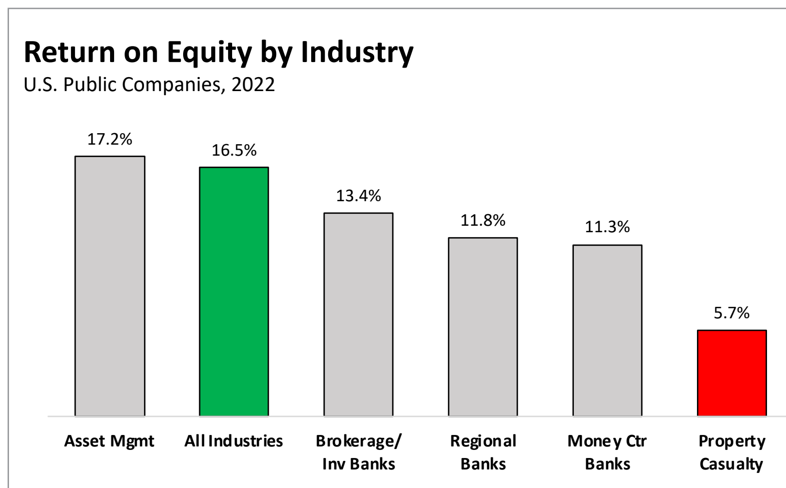
13 APCIA Analysis of Financial Operating Results and Trends Impacting 2023 (Spring 2023).

While overall policyholder surplus for the industry ticked up in the first half of 2023, it continued to contract for half of the top 10 and 20 P&C underwriters, even before Hurricane Idalia and the Maui wildfires.[14] Despite the surplus growth, the June 30 aggregate value of $1.04 trillion remains below the high-water mark of $1.05 trillion set at the end of 2021, while risk exposures have continued to dramatically escalate.[15]



Profitability: The profitability of the P&C insurance industry has been extremely low and has worsened recently, as shown in the accompanying graph comparing return on net worth against the rates for all industry, calculated by the National Association of Insurance Commissioners (NAIC).

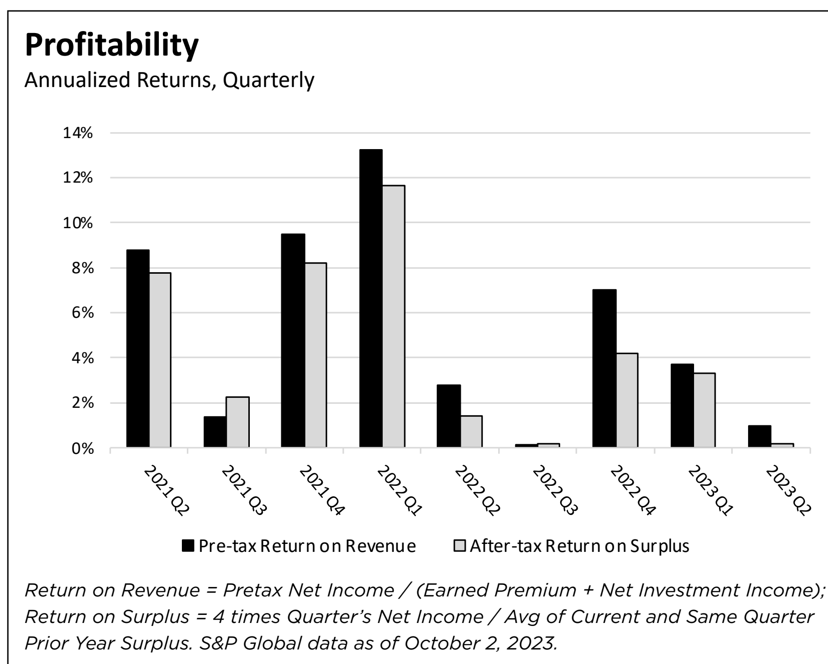
The deficient returns on insurance investments further worsened last year, with P&C insurers almost two-thirds less profitable as measured by return on equity. As interest rates have climbed, providing alternative investment options, and the industry's profitability and return on investment have decreased, this has created financial headwinds for insurers and reinsurers seeking to attract enough new investment capital.



Return on equity is after-tax net income divided by book value equity for publicly traded companies only. Calculations for 2022 are for the most recent four quarters for each company as available on January 5, 2023. 10-year averages are calculated in the same way and averaged over the period 2013 to 2022.
Source: Aswath Damodaran, NYU Stern School of Business. Data as of April 10, 2023.

14 AM Best Co "Best's Rankings", September 1, 2023.
15 APCIA based on S&P Global Market Intelligence data.

Mounting underwriting losses pushed P&C insurers' second quarter 2023 after-tax net income to the lowest level since 2011, with the industry eking out just $0.4 billion in earnings. Net income for the first half was $8.9 billion, representing a pre-tax return on revenue of just 2.3 percent and a very low after-tax return on statutory surplus of 1.8 percent (annualized).



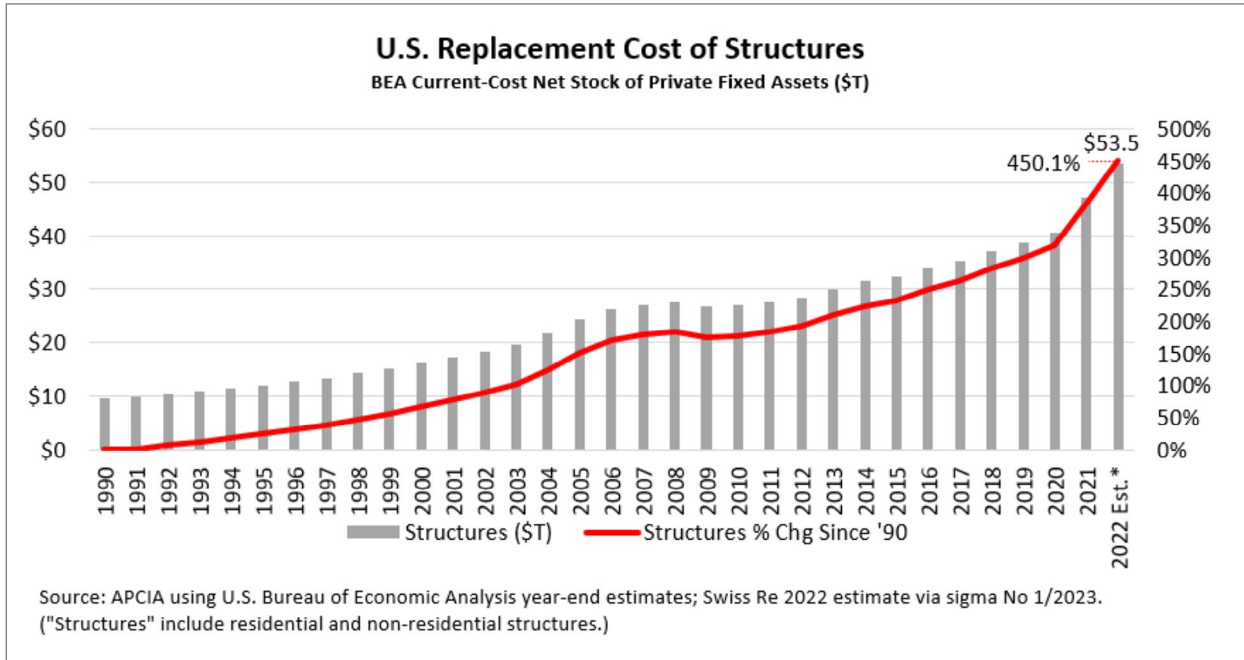
Return on Revenue = Pretax Net Income / (Earned Premium + Net Investment Income); Return on Surplus = 4 times Quarter's Net Income / Avg of Current and Same Quarter Prior Year Surplus. S&P Global data as of October 2, 2023.

Personal Lines: Personal lines insurance has become particularly unprofitable in recent years. In 2022, the U.S. inflation rate accelerated to a 41-year high of eight percent, reaching a peak in June of nine percent. In the first half of 2023, direct losses on home and farm insurance rose 24.5 percent over the first half of 2022, while personal auto losses rose 12.3 percent, with property losses up 10.7 percent and liability losses up 13.4 percent.

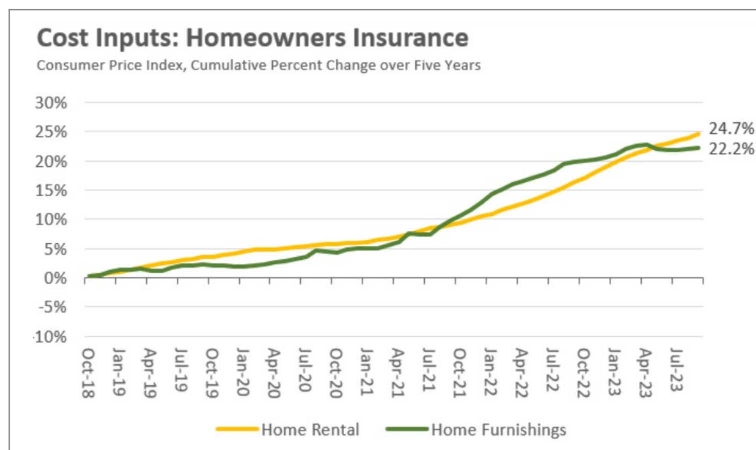
Homeowners: Homeowners insurance input costs (e.g., cost of home goods and services) have increased faster than the underlying rate of consumer inflation. The U.S. net stock of private structures (residential and non-residential) "replacement value" estimated by the U.S. Bureau of Economic Analysis (BEA) data rose more than 450 percent between 1990 and 2022.[16] This upward trend accelerated with the pandemic. In the five years from 2018 to 2022E (Swiss Re estimate[17]) alone, the replacement value increased 44 percent (from 2018 $37.2T to 2022E $53.5T). Principal drivers of cost inflation for home insurers have far outpaced the growth in home insurance prices over the past five years.

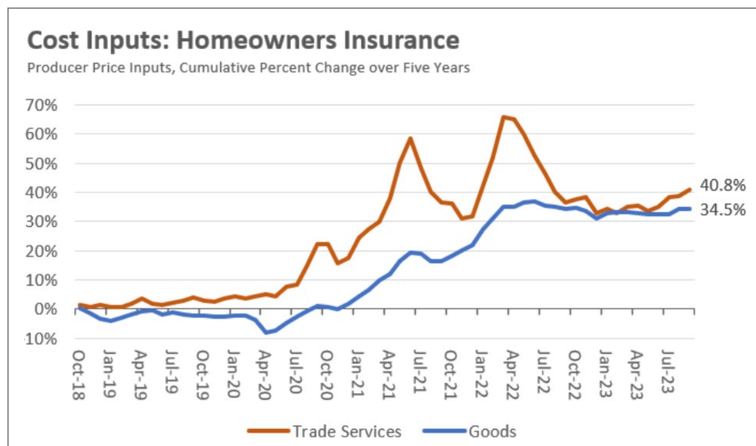
16 U.S. Bureau of Economic Analysis, Current-Cost Net Stock of Private Fixed Assets, Equipment, Structures, and Intellectual Property Products by Type, 1990 – 2021, available at: **https://apps.bea.gov/iTable/?ReqID=10&step=2#eyJhcHBpZCI6MTAsInN0ZXBzIjpbMiwzLDNdLCJkYXRhIjpbWyJUYWJsZ-V9MaXN0IiwiMTgiXSxbIlNjYWxlIiwiLTkiXSxbIkZpcnN0X1llYXIiLCIyMDExIl0sWyJMYXN0X1llYXIiLCIyMDIxIl0sWyJTZXJpZXMiLCJBIl1dfQ==**

17 Swiss Re Institute, "Natural catastrophes and inflation in 2022: a perfect storm", p.23 (2023).

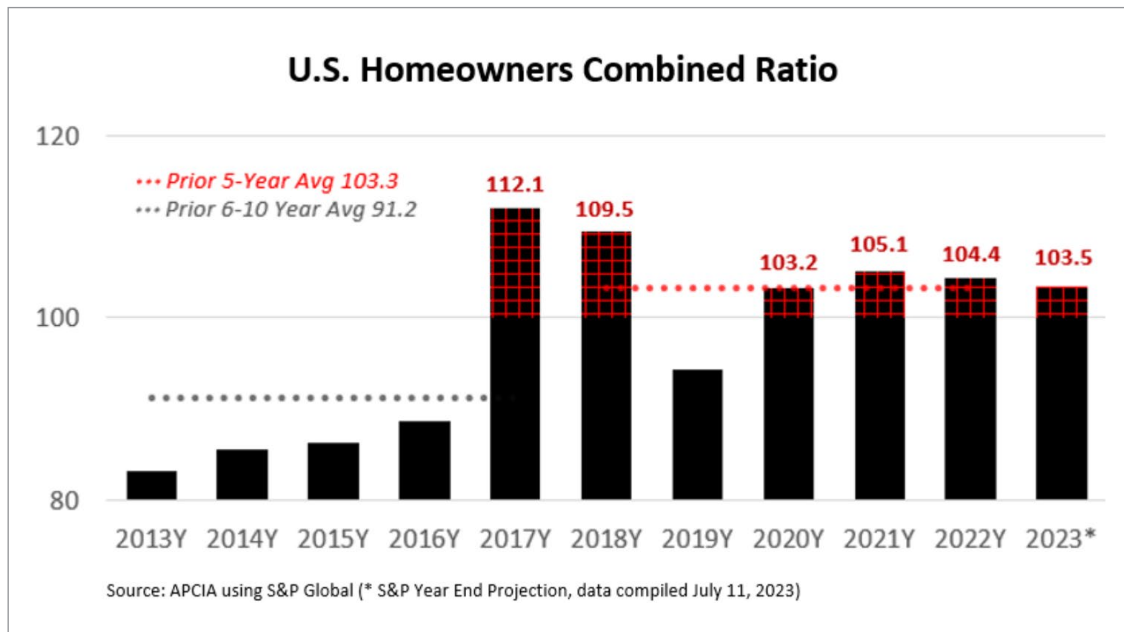


According to data from S&P Global Market Intelligence, the U.S. combined ratio (defined as claims paid and incurred plus administrative expenses) for the homeowners line has exceeded 100 for five out of the last six years, meaning insurers have spent more in claims payments and expenses than they have collected in premiums. The combined ratio is projected to exceed 100 again in 2023 – meaning another net underwriting loss.





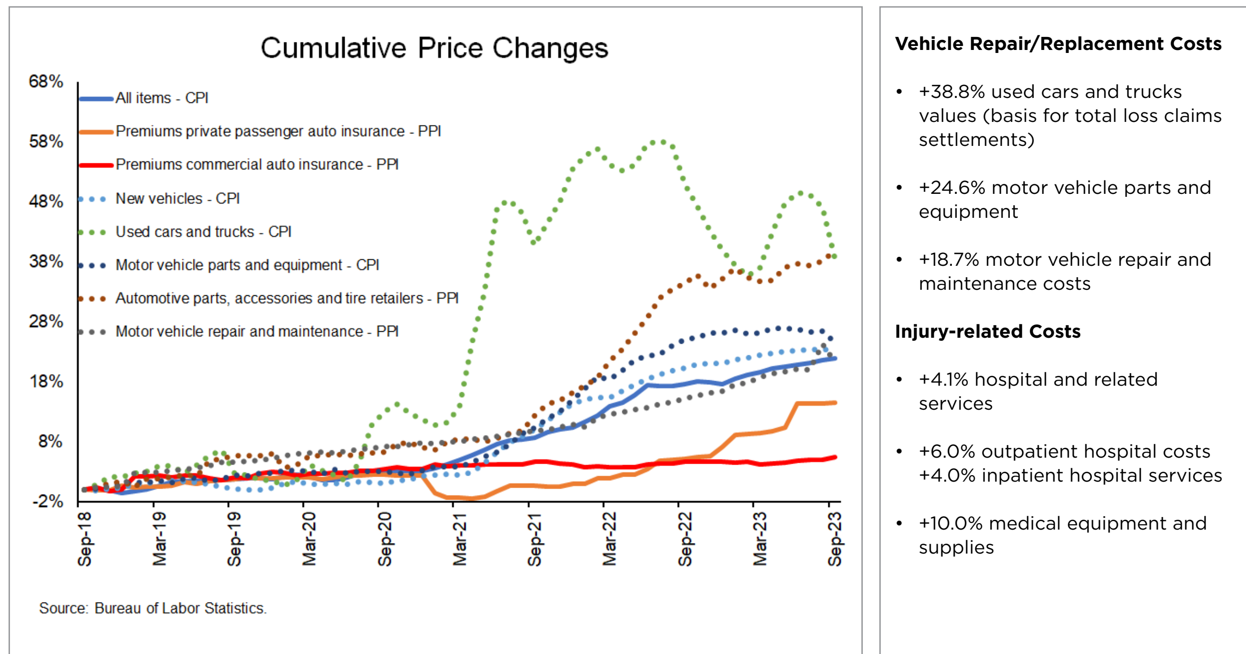
Consumer Price Index for All Urban Consumers: Rent of Shelter; Household Furnishings & Operations. Producer Price Index: Inputs to Single Family Residential Construction, Trade Services; Goods; Source: Bureau of Labor Statistics. Monthly data as of October 11, 2023.



Automobile: Rapid increases in inflation over the last year have spiked auto insurance losses. Insurance claims inflation has been rising even faster than the underlying consumer price index, far outpacing increases in premiums. As the chart below illustrates, during the five-year period ending in September 2023, private passenger auto insurance premiums have increased by 14.6 percent and commercial auto insurance premiums by 5.5 percent.[18]

Though the overall rate of increase has slowed from its peak, the cost of things that auto insurance pays for has increased significantly over the last five years and continues to do so. The government's most recent inflation data show the rate of growth in auto body repair prices above the general rate of inflation for 27 consecutive months.

18 The U.S. Bureau of Labor Statistics (BLS) generates both a Consumer Price Index (CPI) and a Producer Price Index (PPI) for personal auto insurance premiums and homeowners insurance premiums, as well as a Producer Price Index for several other commercial lines of insurance. CPI and PPI are calculated using different methods and are used for different purposes. According to the BLS web site's "Frequently Asked Questions: How does the Producer Price Index differ from the Consumer Price Index?", the PPI reflects the revenue received by its producer whereas the CPI reflects the out-of-pocket expenditure by a consumer. APCIA support a reference to the PPI as a more relevant measure of underlying insurance price changes because they allow direct comparability between personal and commercial insurance lines, and PPI calculations have fewer "moving parts" than the CPI which displays greater volatility caused by factors other than the pure cost of underwriting insurance risk. For example, because the CPI focuses on "out of pocket expenses", it includes agency commissions, taxes and fees, none of which relate to the pure cost of the risk of loss. The CPI also reduces the premium by the amount of any policyholder dividends paid by the insurer to the policyholder. In 2020, U.S. property casualty insurers returned a record $7.7 billion to policyholders in the form of dividends, much of which as compensation for reduced exposure to accidents accompanying significantly reduced driving miles during the COVID shutdowns. Phasing out those dividends in 2021 ($4.6 billion) and 2022 ($3.3 billion) caused upward pressure on the CPI for auto insurance premiums that would not be reflected in the comparable PPI measure. Another important difference between CPI and PPI measures is that the CPI includes data for "urban consumers" only whereas the PPI surveys a U.S. insurer's entire book of business without geographic restrictions.



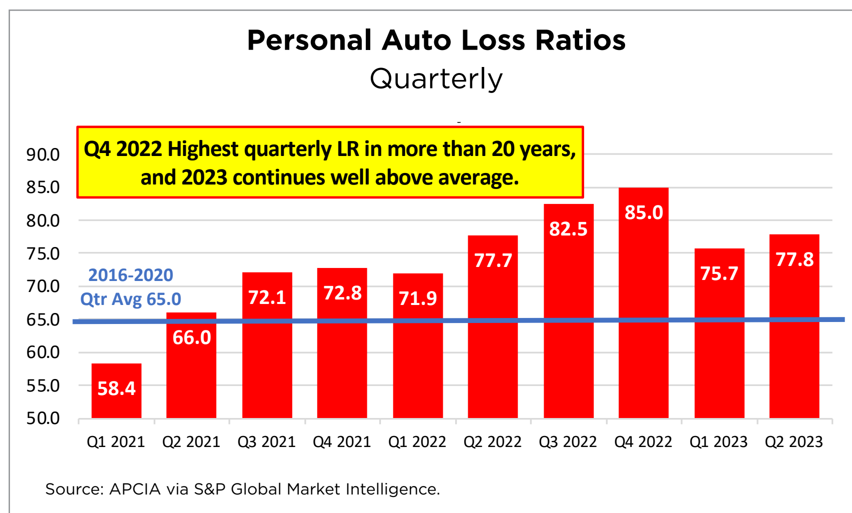
Vehicle Repair/Replacement Costs

- +38.8% used cars and trucks values (basis for total loss claims settlements)
- +24.6% motor vehicle parts and equipment
- +18.7% motor vehicle repair and maintenance costs

Injury-related Costs

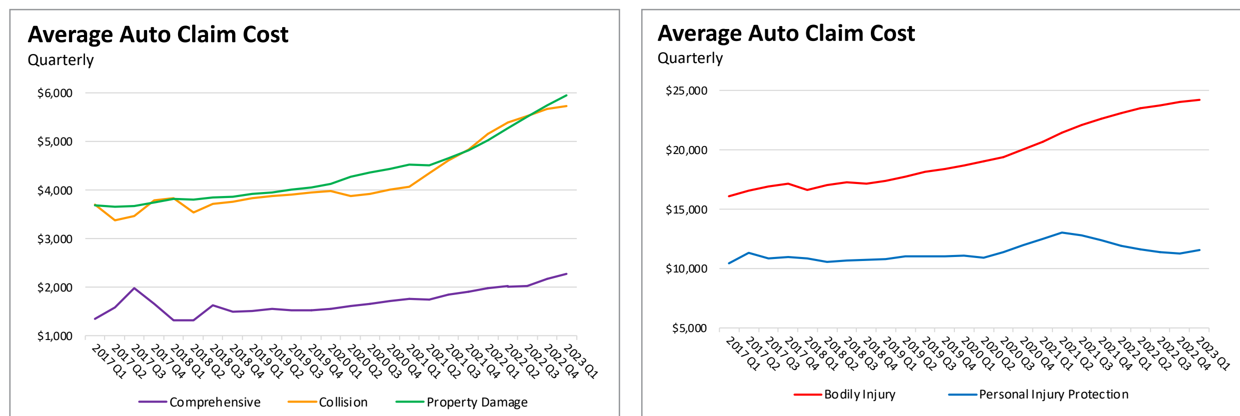
- +4.1% hospital and related services
- +6.0% outpatient hospital costs +4.0% inpatient hospital services
- +10.0% medical equipment and supplies

For personal automobile insurance, loss ratios for each of the last five quarters have exceeded any single quarter in the last 87 on record (going back to the fourth quarter of 2001).



Both auto claim frequency and costs per claim have risen precipitously over the last five years. According to quarterly survey data from ISS/ISO/NISS, average claim costs have risen to new highs for bodily injury ($24,234), property damage ($5,945), collision ($5,731), and comprehensive ($2,274) coverages.[19] Average comprehensive claims size has risen 15.1 percent from the first quarter of 2022 to the first quarter of 2023 (latest period available), while average claims rose 11 percent and 18.2 percent for collision and property damage, respectively. The main driver of double-digit annual increases in average claim size is persistently high inflation for the goods and services that insurers pay for following auto accidents.

19 Independent Statistical Service, Inc., Insurance Service Office, Inc., and National Independent Statistical Service's Fast Track Report. Data through the first quarter of 2023.



Personal Auto Average Claim Costs, Independent Statistical Service, Inc., Insurance Service Office, Inc., and National Independent Statistical Service's Fast Track Report. Data as of October 2, 2023.

Record-breaking vehicle theft is an additional factor contributing to rising losses. Nearly 500,000 vehicles were reported stolen nationwide in the first half of 2023. From the first half of 2022 to the first half of 2023, states with the largest increase in vehicle thefts include Illinois (38 percent), New York (20 percent) and Ohio (15 percent).[20] Also, heavier electric vehicles and batteries are extremely costly to replace when damaged (and susceptible to combustion), and advanced technology on newer cars that is embedded in parts (e.g., bumpers and taillights) has made replacement of parts more expensive.

Commercial Lines

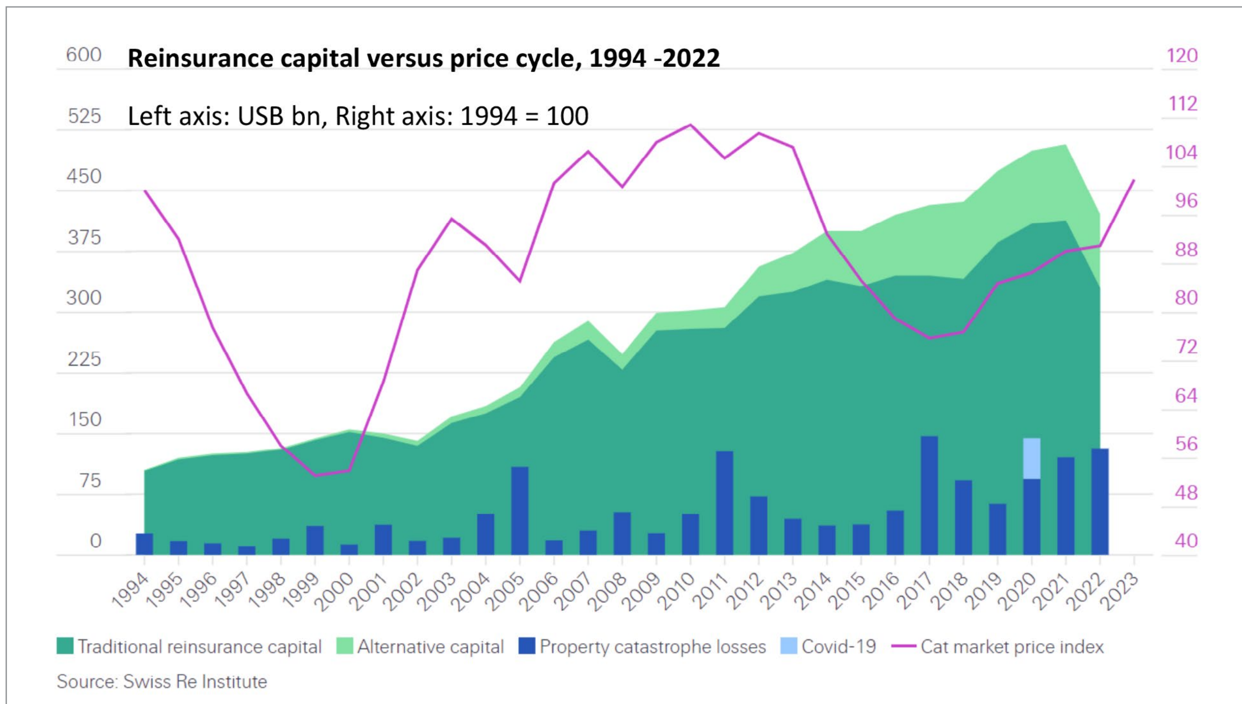
The commercial insurance market is experiencing similar challenges to those in personal lines due to inflation and other cost drivers. The combined ratio for the commercial multi-peril line has exceeded 100 for the last 7 years in a row and is projected to exceed 100 again in 2023. From an underwriting standpoint, commercial auto is the least profitable of the major commercial business lines by a wide margin. Since 2012, commercial auto has been one of the worst-performing lines of business, with a higher combined ratio in each year than the aggregate commercial lines combined ratio.[21]

Reinsurance/Alternative Capital Markets

The global reinsurance markets are also highly solvent but facing profitability challenges. Global reinsurers have had to manage the cover they provide against catastrophic property insurance risks after several years of large catastrophe losses, particularly as prices have failed to keep pace with weather-related losses. However, according to Fitch Ratings, reinsurers are still offering ample cover for severe catastrophes, albeit at a higher cost to primary insurers.[22]

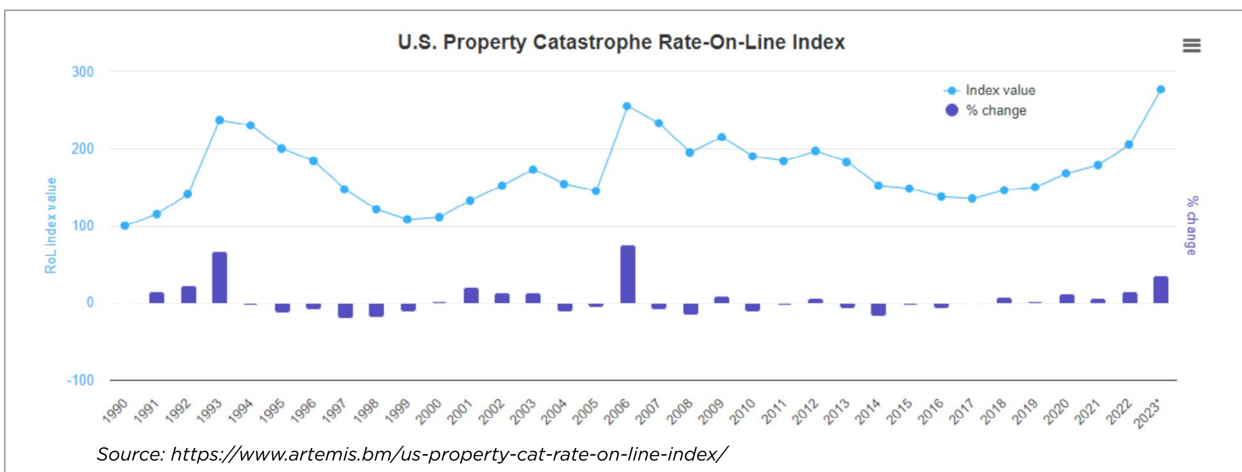
Global reinsurance capital in 2022 contracted by $87 billion – 12 percent of the total. By the first quarter of 2023, global reinsurer capital increased by five percent ($30 billion) to $605 billion.[23] By the end of the first half of this year, reinsurance capital grew 13 percent to $709 billion (close to the $725 billion peak in 2021). Non-life alternative capital (defined as financial products offered outside the traditional insurance sector and often financing natural catastrophe risk) increased by 4 percent in the first half to $99 billion, driven by an increase in catastrophe bonds.[24]

20 National Insurance Crime Bureau: "Vehicle Thefts Continue to Increase to Near-Record Highs in 2023", October 11, 2023
21 AM Best: "Pre-Pandemic Woes Return to Commercial Auto", October 3, 2023.
22 https://www.fitchratings.com/research/insurance/global-reinsurers-pull-back-from-natural-catastrophe-cover-24-08-2023.
23 https://www.aon.com/getmedia/5bd28313-9c37-461c-b665-69a910bf0a6a/20230628-midyear-rmd.pdf
24 https://www.ajg.com/gallagherre/news-and-insights/2023/september/1h-2023-reinsurance-market-report/



Reinsurance costs in the U.S. have surged as a result of the poor returns on capital driven by elevated insured natural catastrophe losses and other factors. Since 2017, the cumulative rate index for reinsurance has risen 97 percent (after a long soft market). According to Swiss Re:[25]

> With more risk and more exposure to leveraged capital from outside of their own balance sheets, reinsurers retained earnings have been insufficient to bear their cost of capital, let alone build stronger balance sheets to cater for an increasing risk landscape.
>
> Since 2017, the re/insurance industry has paid out USD 650 billion (in 2022 prices) for weather-related natural catastrophes claims. However, premium income has not kept pace with events or exposure growth – whether measured by GDP or other more targeted measures – the result being steadily declining profits… Perceptions about whether risks are priced adequately is key in determining the supply of capital and capacity available for underwriting. The historically elevated catastrophe and claims activity since 2017 has created doubts on the part of re/insurers and investors, which slowed the capital supply response.

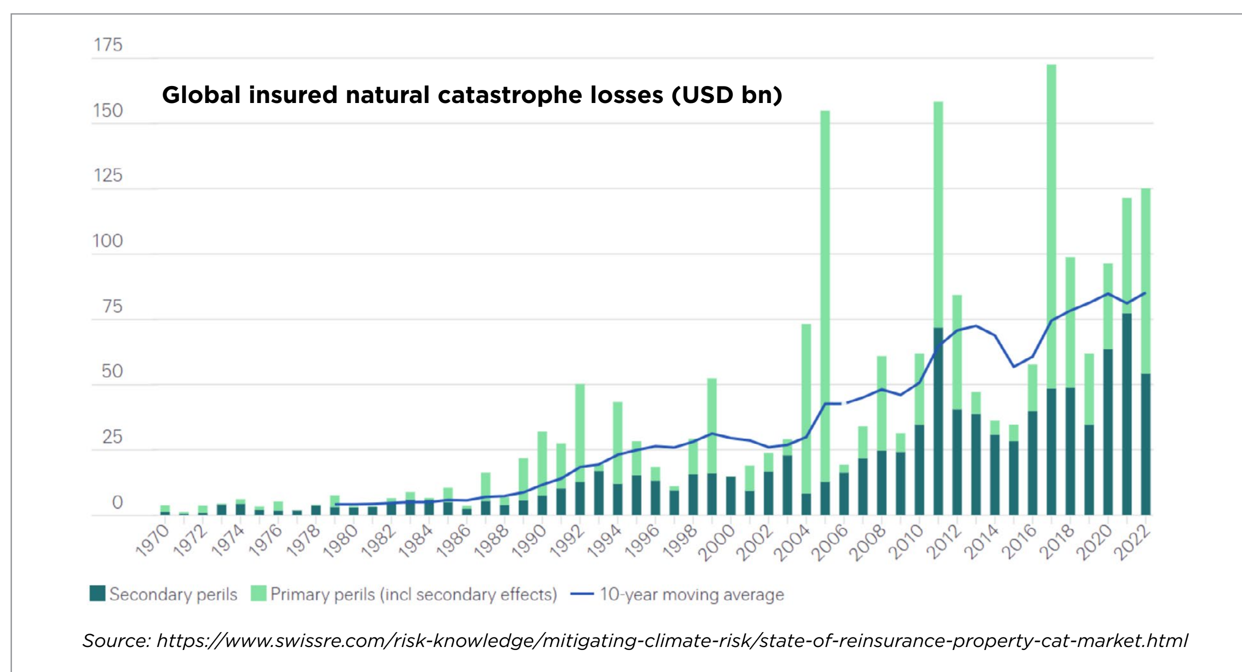


Source: https://www.artemis.bm/us-property-cat-rate-on-line-index/

25 **https://www.swissre.com/risk-knowledge/mitigating-climate-risk/state-of-reinsurance-property-cat-market.html.**

INCREASING NATURAL CATASTROPHE LOSSES

Weather-related disasters are becoming increasingly common across the globe, causing significant economic damage and societal losses. Insurers also continue to be concerned with the increasing volume of so-called "secondary peril" events, which are generally smaller to mid-sized events or secondary effects that follow a primary peril. These include severe storms, wildfires, flooding, drought, and snow and ice storms. Such secondary peril events are generating increasing insured losses, affecting the bottom lines of personal and commercial lines property underwriters.



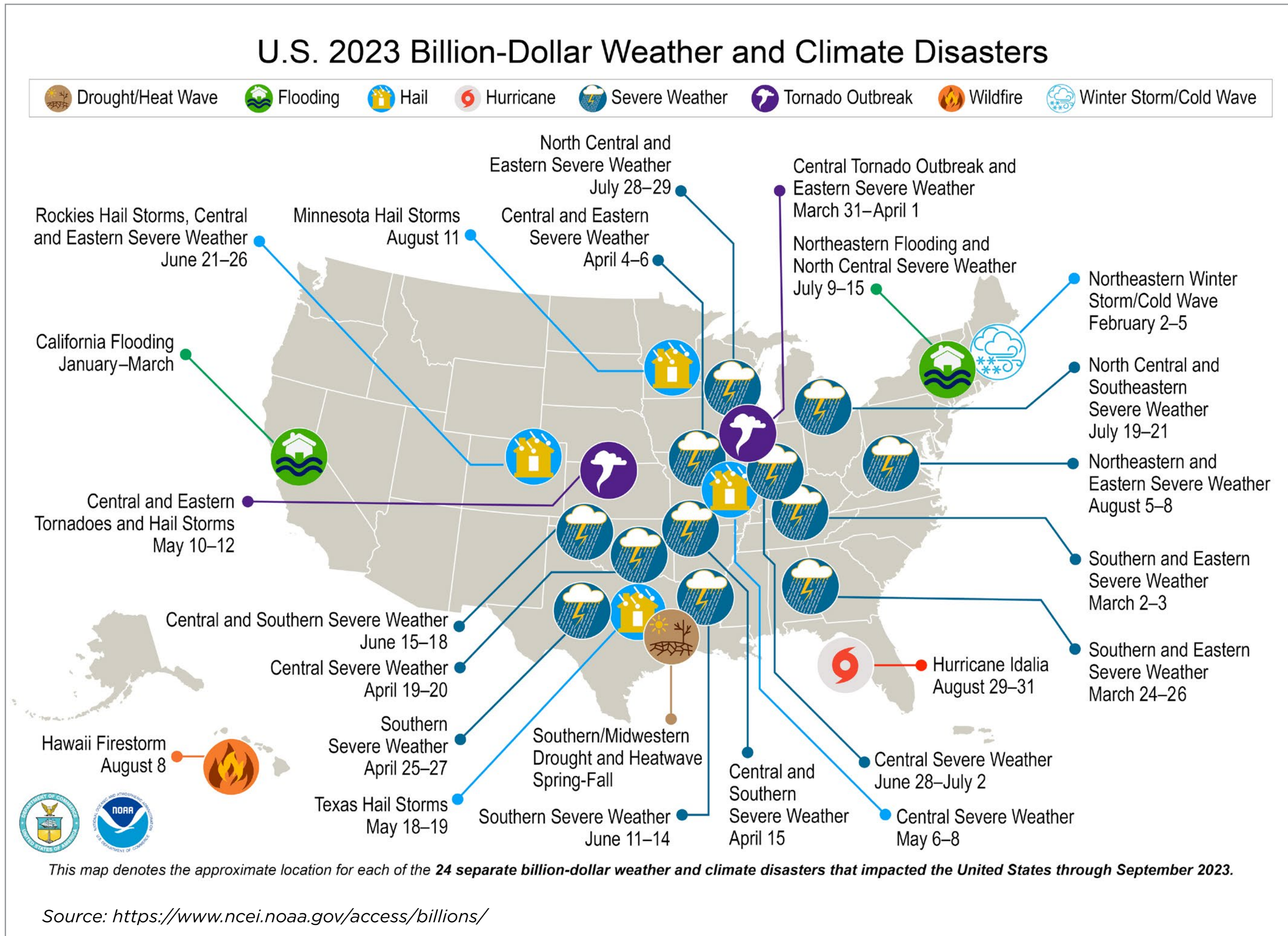
Source: https://www.swissre.com/risk-knowledge/mitigating-climate-risk/state-of-reinsurance-property-cat-market.html

Aon, one of the largest global insurance brokers, reported that global natural catastrophes reached $313 billion in economic losses in 2022, while global insured losses reached $132 billion, well above short- and long-term averages.[26] Global economic and insured losses from natural disasters in the first half of 2023 are estimated to be $194 billion and $53 billion, respectively[27], well above their 20-year averages.[28] 2023 is projected to become the sixth year since 2017 to exceed $100 billion in global insured losses.[29]

In the U.S., economic losses from natural catastrophes reached $165 billion in 2022, 65 percent above the average since 2000 (adjusted to 2022 dollars), while insured losses reached $99 billion.[30] The combined insured losses of 2020 through 2022 in the U.S. reached $287 billion (adjusted to 2022 dollars) for natural catastrophes, making this the costliest consecutive three-year period on record for U.S. insurers. So far in 2023, U.S. insured losses are continuing their above-average trend.

The annual number of billion-dollar weather and climate disasters in the U.S. has also been increasing. The average number from 1980 to 2021 was 7.7 per year, while the average was 17.8 events per year from 2017 to 2021.[31] In 2022, there were 18 weather or climate disaster events with losses exceeding $1 billion each. In the first nine months of 2023, the U.S. saw 24 separate billion-dollar events, breaking the previous annual record of 20 in 2020, with three months still left in the year.

26 Aon 2023 Weather, Climate and Catastrophe Insight, **https://www.aon.com/getmedia/f34ec133-3175-406c-9e0b-25cea768c5cf/20230125-weather-climate-catastrophe-insight.pdf**.
27 **https://assets.aon.com/-/media/files/aon/capabilities/reinsurance/global-catastrophe-recap-1h-2023.pdf**.
28 **https://www.fitchratings.com/research/insurance/global-reinsurers-pull-back-from-natural-catastrophe-cover-24-08-2023**.
29 Gallagher Re, Q3 2023 Natural Catastrophe Report, **https://www.ajg.com/gallagherre/news-and-insights/2023/october/natural-catastrophe-report-q3-2023/**
30 Aon 2023 Weather, Climate and Catastrophe Insight, **https://www.aon.com/weather-climate-catastrophe/index.aspx**.
31 NOAA National Centers for Environmental Information (NCEI), U.S. Billion-Dollar Weather and Climate Disasters (2022). **https://www.ncei.noaa.gov/access/billions/.**



Source: https://www.ncei.noaa.gov/access/billions/

COST DRIVERS

The primary factors driving increasing losses are demographic shifts leading to increased asset values in higher-climate-hazard areas, economic inflation, climate change, legal system abuse, claims fraud, government interference in the form of both new laws that expand policy coverage and overall exposure for insurers, and regulatory constraints that simultaneously limit the ability of insurers to manage growing exposure and costs.[32] Each of these problems increases system costs, which in turn has led directly to higher premiums for policyholders.

According to Swiss Re:[33]

> *Rather than the physical destructive force of natural catastrophes themselves, the main drivers of resulting high losses are economic growth, accumulation of asset values in exposed areas, urbanization and rising populations, often in regions susceptible to natural perils. We expect that these and the evolution of a range of present-day risk factors like climate change effects and, of late, inflation, will continue to drive losses higher.*

32 APCIA, the Association of Bermuda Insurers and Reinsurers (ABIR), and the Reinsurance Association of America (RAA) developed a white paper entitled It's Not Just the Weather: The Man-Made Crises Roiling Property Insurance Markets (August 2022) at **https://www.apci.org/attachment/static/6783/**

33 Swiss Re Institute, "Natural catastrophes and inflation in 2022: a perfect storm", p.2 (2023).

According to a 2022 study on Global Modeled Catastrophe Losses by the data analytics firm Verisk, the factors most impacting losses in order of importance are:[34]

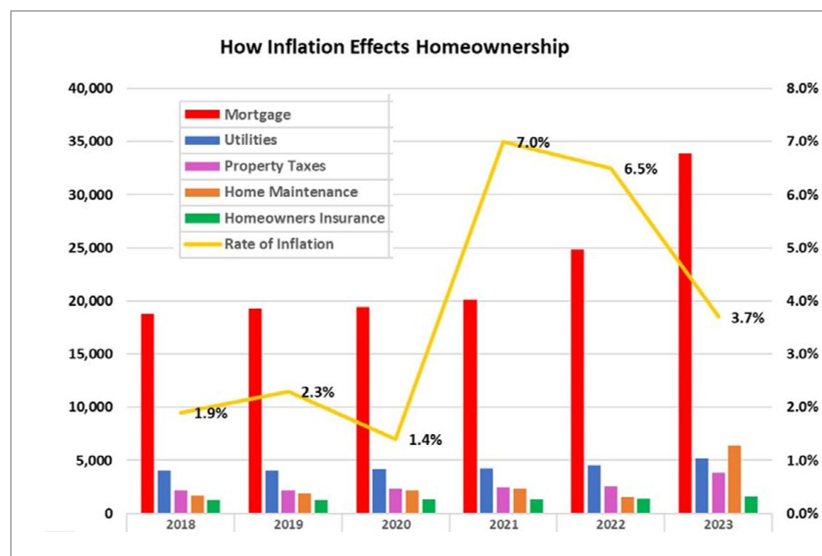
1. A rise in exposure values and replacement costs, represented both by continued construction in high-hazard areas and by high levels of inflation that are driving up repair and rebuild costs.
2. The natural variability that comes from selecting any five-year sample of natural catastrophe experience
3. The effects of climate change on different atmospheric perils
4. The impacts of man-made loss drivers, such as social inflation and legal and regulatory factors

Much of the increase in natural disaster costs can be attributed to rapid population growth in catastrophe-prone areas such as the wildland urban interface (WUI), where wildfire risk is high, and the Atlantic and Gulf of Mexico regions, which face the greatest risk from hurricanes. High value houses tend to be built in these areas susceptible to weather and climate-related events, further driving up the accumulation of assets in disaster-prone areas.

By some estimates, the number of Americans directly exposed to wildfire doubled over the past two decades[35] and approximately one in six Americans currently live in areas with significant wildfire risk.[36] The hurricane-exposed states of Florida, South Carolina, Georgia, and Delaware all experienced double-digit population growth between 2010 – 2020.[37] The Houston area added more than 1.3 million homes between 1980 and 2020, where Hurricane Harvey caused an estimated $149 billion in damages in 2017.[38] Ongoing development in coastal areas has also damaged natural areas such as wetlands that act as buffers by absorbing the physical effects of wind, waves, and storm surge.[39]

PUTTING THE IMPACTS ON CONSUMERS INTO PERSPECTIVE

The following charts show the typical payments made by homeowners from 2018-2023 compared to overall inflation.[40] Among homeowners' expenses for mortgage payments, costs of utilities, property taxes, and maintenance costs, homeowners insurance constitutes the lowest category in all years. While homeowners insurance has been getting more expensive, all other categories of homeowners' expenses have increased more rapidly.



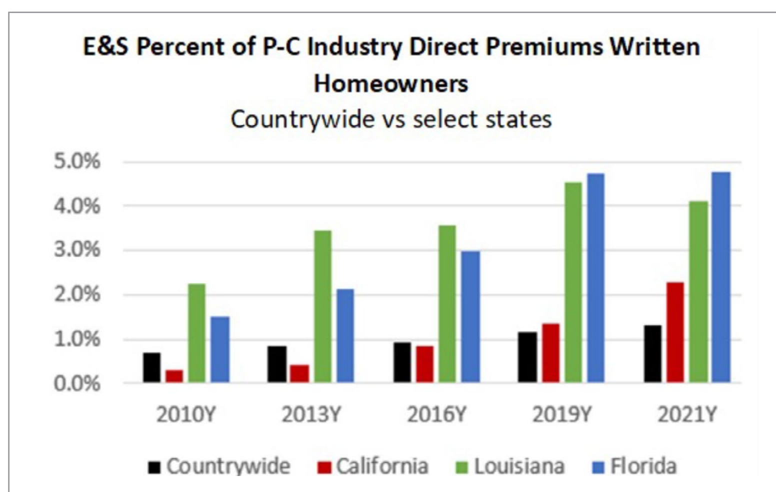
34 https://www.air-worldwide.com/siteassets/Publications/White-Papers/documents/2022_Global_Modeled_Catastrophe_Losses.pdf, p.4 (2022).
35 https://www.cbsnews.com/news/risk-of-wildfires-near-homes-doubled-why/.
36 https://www.washingtonpost.com/climate-environment/interactive/2022/wildfire-risk-map-us/.
37 https://www.iii.org/press-release/triple-i-population-growth-drives-hurricane-loss-trends-071422.
38 https://www.nytimes.com/2022/12/02/briefing/why-hurricanes-cost-more.html.
39 See GFIA report on "Global protection gaps and recommendations for bridging them", March 2023 ("A driver contributing to the acceleration of the protection gap is the movement of populations and their valuable assets to high-risk areas.")
40 Data drawn from multiple sources including the BLS, NAIC, Insurance Information Institute, Forbes, NY Times, Business Insider, and Home Buying Institute. Data is intended to show directional and proportional differences, but the varying sources makes the data somewhat less precise.

CONSEQUENCES OF RATE SUPPRESSION – CONSUMER SHIFT TO SURPLUS LINES AND RESIDUAL MARKETS

A critical element of properly functioning insurance markets for consumers is maintaining the ability for insurers to charge an adequate rate for the risk covered. As insurers continue to face increasing pressure in catastrophe-prone states, and especially in the states with regulatory constraints that have made it more challenging for insurers to manage growing exposure and costs, there are a variety of risk mitigation steps insurers may choose to take based on their business models, capital needs, and risk appetite, among other factors. Additionally, the non-admitted market and residual market plans are increasingly serving as a relief valve.

Some insurers choose to do business on a surplus lines (or "non-admitted") basis, which means they are generally not subject to rate or policy regulation by the state insurance regulator. Instead, U.S. domiciled surplus lines insurers are subject to regulatory requirements and are overseen by their domiciliary state; they then operate on a non-admitted basis in the other states in which the insurer offers policies. As a result, surplus lines carriers experience freedom of rate and form, which enables a surplus lines carrier to be innovative, creative, and responsive in developing a product that provides the level of coverage a consumer is seeking, while pricing the product in a financially responsible manner commensurate with the risk.

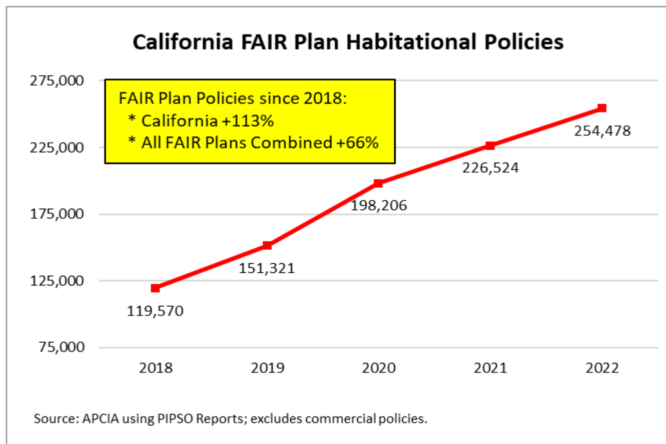
A.M. Best's Surplus Lines Market Report of 2022 noted there have been no surplus lines carrier financial impairments since 2004, suggesting surplus lines carriers continue to operate as a beneficial "safety valve for the admitted market". According to an analysis by S&P Global Market Intelligence, the U.S. excess and surplus (E&S) market constituted 8.7 percent of the country's total property and casualty industry during the first half of 2022, as direct written premiums surged to $37.6 billion in the first six months of 2022. This represents an E&S premium growth of 27.6 percent versus the same prior-year period, a substantially larger rate of growth than the total U.S. P&C market (excluding E&S premiums), which grew by only 8.4 percent in the same period.[41]



Residual market plans have similarly experienced significant growth. However, the expansion of policies in residual market plans weighs heavily on admitted insurance companies, as the concentration of high-risk properties could result in substantial losses in any given year. Should losses exceed a residual market plan's claims paying capacity, assessments might be made against admitted market insurers, forcing those insurers (and ultimately their policyholders) to pay the shortfall.

A growing number of residual market plans are now experiencing increasing financial stress. For example, a Louisiana Legislative Auditor report noted that Louisiana Citizens, the state's residual market plan, may not have adequate reinsurance to pay claims if a major hurricane occurs, due to the higher number of policies and problems in the reinsurance market.[42] Florida Citizens, Florida's property residual market, has grown from 486,773 policies in July 2020 to 1.3 million at the end of June 2023, with an insured value approaching

41 S&P Global Market Intelligence (Nov 30, 2022), "E&S premiums accounting for larger share of US property and casualty market".
42 **https://app.lla.state.la.us/publicreports.nsf/0/9d5c25a709f476a3862588da005c6930/$file/000283c0.pdf**



a record $562 billion.[43] California's property residual market, the FAIR plan, is smaller but similarly growing at a very rapid pace (see chart to the left). Similar challenges are emerging in residual market plans in other catastrophe-exposed states.[44]

SOLUTIONS TO MARKET DISRUPTIONS

The insurance market disruptions seen in some states can be alleviated by regulators allowing rates to adequately and accurately reflect risk in a timely manner. Beyond helping assure a stable insurance market, accurate risk-based pricing is reflective of comparative exposure to risk. Accurate insurance pricing of risks helps society recognize and address the true costs.

Longer-term solutions are also essential to effectively address the underlying cost drivers for losses. The deteriorating loss situation is felt most directly by impacted communities and households, but its financial impacts are also borne by insurers and government. And we all share the urgent need to reduce those losses by working together to mitigate risk and increase resiliency, address legal system abuse through meaningful tort reform, and resolve regulatory constraints that contribute to insurance market dysfunction.

To help make communities more resilient, insurers advocate for stronger and better enforced building codes, improved land use planning to reduce the accumulation of assets in high-risk areas, retrofitting existing homes and infrastructure, and improved land use management to reduce risk for wildfires.[45]

Building Codes and Land Use Planning

While individual owners can take important steps to mitigate risk at their property, widespread adoption of community-level mitigation measures, including stronger building codes and better land use planning, is needed to reduce the increasing risks from natural disasters.

There is tremendous opportunity to better support risk reduction and climate resilience in both new and existing buildings. The National Institute of Building Sciences (NIBS) has shown that every $1 spent on natural hazard mitigation in new code construction can save up to $11 in disaster repair and recovery costs. FEMA's report "Building Codes Save: A National Study" shows that compliance with modern building codes leads to major reductions in property losses from natural disasters. NIBS' and Fannie Mae's Resilience and Incentivization Roadmap 2.0 explores investment opportunities by lenders, insurers, developers, owners, and government entities that will help Americans prepare for and respond to natural disasters by making the business case for resilience.

The insurance industry-funded Insurance Institute for Business & Home Safety (IBHS) performs science-based building safety research that leads to real-world solutions for home and business owners, helping to create

43 https://www.citizensfla.com/documents/20702/93064/20230630+Business+Overview.pdf/115af816-1ba7-a5e4-acda-9eaad0895449?t=1694458730480
44 https://www.eenews.net/articles/growing-storms-push-shrinking-la-insurers-into-failure/
45 See also, the GFIA report on "Global protection gaps and recommendations for bridging them", March 2023 (recommending disaster prevention and adaptation measures such as land-use or building codes and not incentivizing rebuilding in high-risk areas).

more resilient communities. Based on decades of research, IBHS developed FORTIFIED, a voluntary program that certifies homes, commercial buildings, and multifamily housing to enhanced construction standards that provide additional protection from severe weather. As more communities are built or renovated to higher standards, this should result in a meaningful decrease in losses, which should translate to more affordable and available coverage for consumers.

Wildfire Resiliency and Mitigation

In 2022, IBHS launched Wildfire Prepared Home™, a voluntary certification program designed to reduce wildfire risk. Like IBHS' FORTIFIED program, Wildfire Prepared Home helps homeowners protect their homes through evidence-based home hardening and defensible space techniques. These actions can help reduce vulnerabilities to heat, flames, and embers that often lead to a total loss when a home ignites. Launched initially in California, Wildfire Prepared Home plans to expand to additional states, though homeowners in any state can still benefit from following the program requirements.

The Wildland Fire Mitigation and Management Commission's recent report to Congress[46] highlights changes needed in the Federal Government's approach to reducing catastrophic wildfire risk. The report includes recommendations organized around seven key themes: urgent new approaches, supporting collaboration, shifting from reactive to proactive, enabling beneficial wildfire, supporting and expanding the workforce, modernizing tools for informed decision-making, and investing in resilience. The insurance industry was represented on the Commission and looks forward to working with Congress to help advance legislation geared toward implementing the Commission's findings.

Supporting Resilient Communities and Infrastructure

In addition to helping to mitigate the risks of wildfire, the Federal Government plays a key role in supporting community resilience. FEMA's Hazard Mitigation Assistance (HMA) Grants program includes three key hazard mitigation funding programs that are intended to help break the cycle of disaster damage, reconstruction, and repeated damage. The Building Resilient Infrastructure and Communities (BRIC) and Flood Mitigation Assistance Program (FMA) are designed as pre-disaster mitigation programs, while the Hazard Mitigation Grant Program (HMGP) provides post-disaster funding assistance.

In addition to these and similar programs, NOAA's Community-Based Restoration Program and National Coastal Resilience Fund, a public-private partnership, offer funding for natural infrastructure in coastal communities. And HUD's Community Development Block Grant (CDBG), CDBG-Disaster Recovery, and CDBG-Mitigation programs offer support for vulnerable communities and disaster areas.

The American Society of Civil Engineers (ASCE) assigned a grade of C- to the physical condition and performance of U.S. infrastructure in 2021 and estimates an investment gap of $2.59 trillion over the next ten years. In addition to old age and poor physical condition of U.S. infrastructure, urban population growth is stressing some systems beyond their intended capacities. To help solve some of these infrastructure challenges, ASCE highlights the importance of using new approaches, materials, and technologies to increase our nation's resilience to natural disasters, including the combination of gray, green, and natural infrastructure. Insurers support a comprehensive risk mitigation strategy that incorporates many different approaches.

Insurers have also supported dozens of federal bills introduced in Congress that would increase resiliency and help reduce losses. For example, APCIA has been strongly supporting bills such as The Community Disaster Resilience Zones Act (CDRZ) of 2022, The Strengthening Homes and Eliminating Liabilities Through Encouraging Readiness (SHELTER) Act, and The Disaster Mitigation and Tax Parity Act. We call on Congress to prioritize the passage of legislation to help build the resiliency of communities and property owners.

46 https://www.usda.gov/sites/default/files/documents/wfmmc-final-report-09-2023.pdf

Financial Literacy and Empowerment

Insurance plays an essential role in protecting consumers and communities from catastrophic loss as well as sending societally beneficial market-based risk signals. Accurate risk-price signals promote economically viable decisions across the economy, especially when building in areas prone to catastrophic weather. Unfortunately, insurance products are sometimes misunderstood by consumers, potentially leaving them vulnerable to a major loss. Insurance companies continue to work hard to educate consumers about the importance of maintaining proper insurance and ways to mitigate risk. This includes providing dedicated insurance professionals to help explain insurance products and coverages, science-informed mitigation strategies, and the claims process. It also involves forging partnerships with government agencies, regulators, and other stakeholders. Organizations such as the Insurance Information Institute (III) also provide extensive information and resources on insurance. The industry is also helping to raise awareness of the negative impacts of legal system abuse and advocating for meaningful tort reform in the U.S.

Insurers' Innovation

Insurers have long adapted to changing market conditions by developing innovative risk transfer mechanisms. Insurers strongly support technology-enabled forecasting, including the use of artificial intelligence (AI) and machine learning (ML), data collection, analysis, and hazard warning and notification systems. To respond to increasing natural disaster losses, insurers must be allowed to use forward-looking models to project evolving risks in a changing climate. Catastrophe (cat) models are updated using data from recent events and are fairly accurate in predicting risks over the period most property contracts are written (12 months). In some states, insurers are prohibited from using cat models to set rates, and are required by law to use historical averages, which masks recent loss trends.

Newer product offerings such as parametric (or index-based) insurance provide risk transfer beyond traditional insurance. Parametric insurance provides coverage against a predefined event happening that meets certain parameters or an objective index value, regardless of the actual loss sustained. While technology is affording new opportunities for parametric-style insurance products at the consumer level, parametric contracts are meant to supplement rather than replace traditional insurance coverage or to provide limited risk protection in instances where traditional insurance is unavailable. Insurers also offer products that support the energy transition, including policies for renewable energy projects and technologies, sustainable buildings and infrastructure, and fuel-efficient cars and electric vehicles.[47]

47 APCIA developed a white paper entitled Energy Resource and Insurer Roles During the Energy Transition (August 2022) at **https://www.apci.org/attachment/static/6731/**

REGULATORY CONCERNS

Insurance in the U.S. is heavily regulated at the state level, with insurance departments responsible for reviewing and approving rates and terms to ensure they are fair for consumers and support a healthy insurance market. Insurers are also increasingly subject to a complicated array of international and federal mandates, such as climate-related risk disclosures, which create confidentiality and materiality concerns and restrict insurers' ability to conduct normal business operations.

Federal Insurance Office (FIO)

In late 2022, the Federal Insurance Office (FIO) solicited feedback on a proposed data call that would collect insurers' historical underwriting data on homeowners insurance. FIO intends to use the data in its efforts to assess climate-related financial risk and the potential impacts of climate on insurance availability and affordability. APCIA expressed concerns with FIO's approach of imposing a potentially duplicative and costly data call on insurers directly. FIO is expected to conduct its data call in late 2023 or early 2024. Prior to releasing a data call, FIO is required to consult with state regulators to see if they already have the needed data and if it can be collected within a reasonable timeframe.

In June 2023, FIO released a report titled "Insurance Supervision and Regulation of Climate-Related Risks", describing how state insurance regulators are addressing climate risk. The report contains 20 recommendations for enhancements to solvency, corporate governance, macroprudential oversight, market conduct, and reporting requirements. Some of the recommendations are already being implemented across states, but FIO believes the efforts are fragmented and limited in several ways. These findings are not surprising given that insurance is regulated at the state level to account for unique and important differences in insurance-related issues at the individual state level.

National Association of Insurance Commissioners (NAIC) / States

Last year, through the NAIC, a group of 15 participating states revised the annual climate risk disclosure survey to require more detailed disclosures consistent with the international framework of the Taskforce on Climate-related Financial Disclosures (TCFD). The NAIC recently announced that a state regulator drafting group is working to develop a new data call to collect homeowners insurance data to meet the Property and Casualty (C) Committee's charge to better understand property insurance markets and insurance protection gaps. The goal will be to develop a long-term, robust data collection strategy to help regulators more nimbly respond to inquiries related to their property markets. The data call is expected to be far-reaching and present significant costs and complications for insurers to comply.

The NAIC's action is considered to be a response to FIO's proposed data collection, and the scope of NAIC's data call, expected to be finalized in late November, will likely inform FIO's data collection effort. APCIA is working with both parties to try and prevent dueling data calls from the NAIC and FIO, as well as urging the NAIC to collect data in the most efficient way possible and focus on data that can be gathered by statistical agents and data aggregators. APCIA has continuously raised with the regulatory community a longstanding concern about the plethora of data calls and lack of coordination on data calls among various bodies.

SPECIFIC STATE ISSUES

California

Over the last decade (2012-2021), NAIC data shows that the claims costs and expenses for total property casualty insurance in California were $100.60 for every $100 of premium collected to cover all claims costs and expenses across all lines of business.[48] This translates into an overall underwriting loss of -0.6 percent over the last decade, compared to a profit of 2.0 percent for property insurance countrywide. In simple terms, it costs more to cover a claim in California than insurers collected in premium.

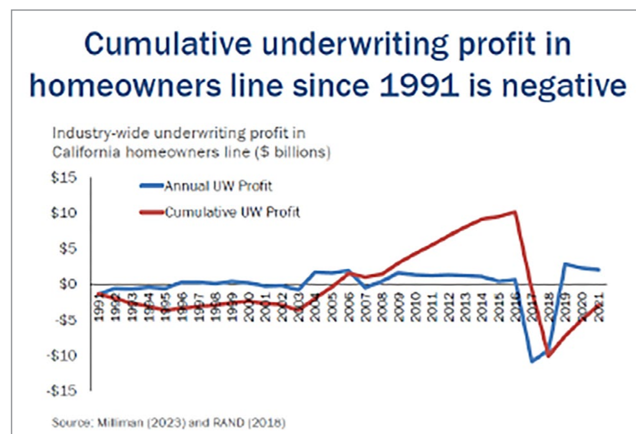
The same NAIC report shows that homeowners insurance claims costs and expenses in California for the same decade were $113.10 for every $100 collected in premium, resulting in an underwriting loss of -13.1 percent, versus a 3.6 percent profit countrywide. While insurers have managed an underwriting profit in California during some individual years with no severe weather events, insurance rates need to include a catastrophe load based on actuarial analysis and catastrophe modeling to collect enough premium for the periodic extreme loss events, including wildfires and floods. California experienced multiple catastrophic wildfires in 2017 and 2018 that caused record insured losses, wiping out underwriting gains from the remainder of the decade. The following table lists the underwriting profits (in black) and losses (in red) for homeowners, commercial multi-peril, and total property casualty insurance over the last decade for California and countrywide. To avoid confusion with other references to "CW" in this letter, "CW" as used in the table below stands for "countrywide":

Underwriting Profit/Loss
California vs. Countrywide

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	10-Yr Avg
CA Private Passenger Auto	(1.3)	(1.8)	(0.7)	(5.4)	(10.0)	(5.7)	(0.7)	0.8	10.3	(1.3)	(1.6)
CW Private Passenger Auto	(3.9)	(3.4)	(3.0)	(5.1)	(7.8)	(3.1)	1.8	1.5	7.6	(1.5)	(1.7)
CA Commercial Auto	(8.2)	(9.6)	(10.3)	(15.2)	(20.2)	(18.9)	(13.8)	(15.9)	(12.2)	(8.7)	(13.3)
CW Commercial Auto	(6.2)	(5.6)	(5.8)	(7.9)	(10.5)	(10.4)	(8.3)	(8.7)	(2.7)	(0.5)	(6.7)
CA Homeowners	19.7	17.6	15.4	3.3	7.5	(155.5)	(124.9)	35.4	27.4	22.7	(13.1)
CW Homeowners	4.1	16.8	14.4	13.7	11.2	(12.2)	(9.5)	5.7	(3.3)	(5.2)	3.6
CA Commercial Multi-Peril	10.0	11.5	7.1	4.7	(2.2)	(18.7)	(21.8)	3.0	(3.4)	4.1	(0.5)
CW Commercial Multi-Peril	(0.0)	9.2	6.6	10.0	3.5	(12.4)	(5.9)	(1.3)	(6.2)	(3.8)	(0.0)
CA Total Property Casualty	0.9	2.5	3.6	0.3	(0.3)	(20.4)	(12.9)	8.0	6.6	5.7	(0.6)
CW Total Property Casualty	(2.4)	5.7	5.9	4.7	1.6	(4.7)	1.3	3.6	2.4	1.8	2.0

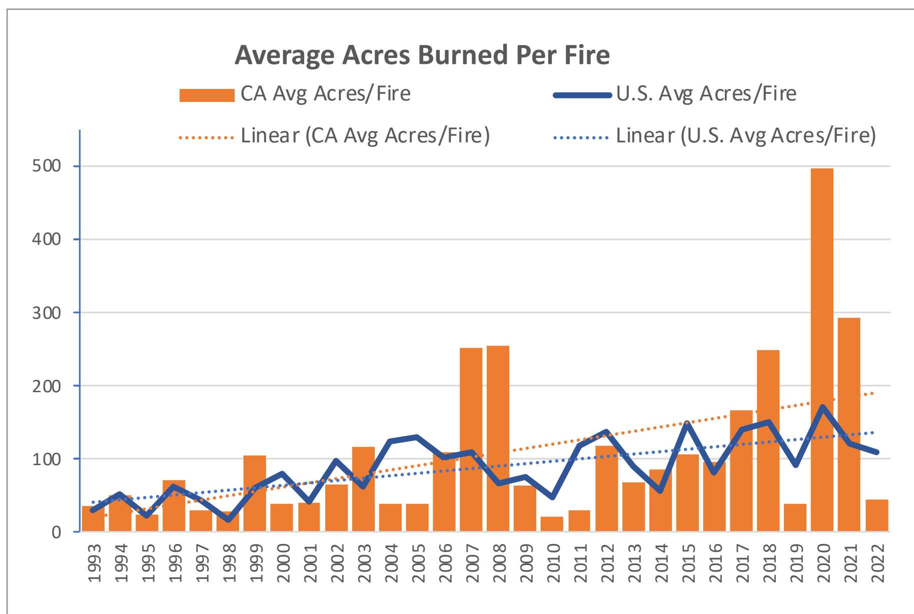
Source: NAIC Report on Profitability by Line by State in 2021, January 2023 edition.

The following graph was part of the September legislative briefing by the Rand Corporation entitled "Challenges Facing California's Residential Insurance Market" (August 29, 2023). The graph shows in red the impact of the 2017 and 2018 catastrophic wildfires and related losses on the cumulative underwriting of California homeowners insurers, wiping out more than 30 years of underwriting profits.



48 *Report on Profitability by Line by State* in 2021, National Association of Insurance Commissioners 162 (Jan. 2023), (January 2023) at **https://content.naic.org/sites/default/files/publication-pbl-pb-profitability-line-state.pdf**.

While California has not suffered catastrophic wildfire insured losses in the last three years, wildfires burned a record number of acres in 2020, the average acres burned per fire has been increasing significantly, and Governor Newsom's executive order references the expectation that climate change will result in more frequent wildfires of greater intensity in the future.



Long-term underwriting losses in California, and the expectation of future escalating losses from increasing natural disaster severity, inflation, and other cost drivers, present a dilemma for insurers that the California Department of Insurance (CDI) Commissioner Lara aptly describes in his press statement: "[I]nsurance companies will not write insurance, especially in high-risk areas, unless they are able to ensure they have the capital and reserves to fully meet all insurance claims submitted by consumers, cover their expenses, and earn a fair return."[49]

Following the pandemic, during a time of record inflation, insurers experienced a period of more than 30 months with no private passenger auto rate increase approvals by the CDI. The 2022 California personal auto loss ratio was the highest over the last decade at about 80 percent. That is prior to all expenses, ranging from commissions and overhead expenses to claims adjustment expenses (which combined were approximately 35 percent for 2021 according to the 2023 NAIC Profitability Report). While the CDI resumed auto rate approvals in late 2022, rate and filing reviews continue to show delay. "Requested rates" are often negotiated with the CDI, but approvals often come long after initial filings and typically well below the indicated rate need.

California Auto
2022 Estimated Combined Ratio

115.0% - Personal Auto
($115 spent on every $100 collected)
117.6% - Commercial Auto
($117.60 spent on every $100 collected)

All this is taking place when the impact of climate change continues to hammer the state's consumers and businesses. After years of severe drought, the probability of significant floods is increasing from the unusually heavy rain in early 2023 and the likelihood of melting snowpacks to follow. This in turn may exacerbate the risks of catastrophic fires as flood debris and newly fertilized weeds dry out in the summer heat. CDI strongly encouraged and reached an agreement with the FAIR plan to increase its commercial insured limits. However, the FAIR plan already has a large deficit, and the additional exposure increases the chance of significant assessments on private insurers. Any shortfall generated by the FAIR plan will ultimately be paid for by all consumers and businesses in the state.

49 *See supra* n.6.

California insurance regulation is currently constrained by an antiquated 35-year-old regulatory system imposed by Proposition 103, predating the dramatically changing insurance landscape. An effort to enact significant insurance reforms by Governor Newsom, California's legislative leadership, and CDI Commissioner Lara during the brief legislative session that adjourned sine die on September 14, 2023, failed. On September 21, 2023, Governor Newsom issued a press statement in which he "urge[d] Insurance Commissioner Lara to take swift action to address issues with the insurance market and expand coverage options . . . ."[50] His related executive order identified more frequent and severe wildfires and more severe winter storms due to climate change and their related costs as primary contributors to California's failing market.[51] It states that the increased exposure to catastrophic weather events, high construction repair costs, and global inflation are primary drivers of insurers' decisions to pull back from the California market. The Governor recognized the regulatory reform efforts of Commissioner Lara but said that "even more must be done to maintain access to insurance for consumers."[52]

That same day, Commissioner Lara announced his intention to "address problems fueled by climate change" and inflation, which over the years had brought California's insurance market to a "crossroads"[53]:

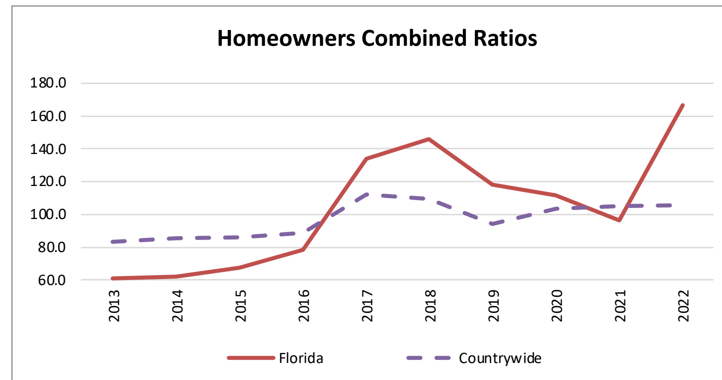
> The actions [of the Commissioner's office] announced today are aimed at addressing problems fueled by climate change and being experienced by states across the nation including global inflation and increased costs for rebuilding that have led to several insurance companies pausing coverage for writing new homeowners and commercial insurance policies, non-renewing existing consumers, and increasing rates to maintain their financial stability. Unlike public utilities, which are required by law to cover all consumers, insurance companies will not write insurance, especially in high-risk areas, unless they are able to ensure they have the capital and reserves to fully meet all insurance claims submitted by consumers, cover their expenses, and earn a fair return.[54]

The remainder of Commissioner Lara's press statement outlines the related regulatory steps he is undertaking to stabilize the property and casualty insurance market so that coverage is widely available and affordable. Importantly, he concludes with the following: "The current system is not working for all Californians, and we must change course. I will continue to partner with all those who want to work toward real solutions."[55] APCIA is committed to working with the CDI and Commissioner Lara on those solutions.

Florida

Even prior to the second largest insured hurricane loss caused by hurricane Ian, the Florida market was challenged by increasing inflation, litigation, and the impact of climate change. Despite having fewer than 7 percent of homeowners' claims in 2021, Florida had 76 percent of the countrywide homeowners' lawsuits.[56] A new 1 percent emergency assessment request from the Florida Insurance Guaranty association was approved and will start on October 1.[57] This will be the fourth surcharge in the last two years. "The charge follows assessments of 0.7 percent, 1.3 percent, and 0.7 percent as the Florida market has seen 10 property insurer insolvencies in the last two years."[58] The property market challenges have resulted in only 15 insurance companies writing over 60 percent of the direct premium.[59] At the same time, the premiums of Florida's residual market, Citizens, have almost quadrupled since 2020 to $3.2 billion in 2022.[60] Due to some of the large national companies not writing new business or cutting back their book of business, the state's personal property specialty companies account for a growing share of the market, at 37 percent in 2022.[61]

50 *See Governor Newsom Signs Executive Order to Strengthen Property Insurance Market*, Office of Governor Gavin Newsom (Sept. 21, 2023), **https://www.gov.ca.gov/2023/09/21/governor-newsom-signs-executive-order-to-strengthen-property-insurance-market/**.
51 Exec. Order N-13-23 (Sept. 21, 2023), **https://www.gov.ca.gov/wp-content/uploads/2023/09/9.21.23-Homeowners-Insurance-EO.pdf**.
52 *See* n. 44.
53 *See* Press Release, *Commissioner Lara announces Sustainable Insurance Strategy to improve state's market conditions for consumers*, Cal. Dept. of Insurance (Sept. 21, 2023), **https://www.insurance.ca.gov/0400-news/0100-press-releases/2023/release051-2023.cfm**.
54 *Ibid.*
55 *Ibid.*
56 **https://floir.com/docs-sf/default-source/property-and-casualty/stability-unit-reports/july-2023-isu-report.pdf** (p.5)
57 **https://figafacts.com/assessments/**
58 AM Best: "Short-term pain to precede long-term gain for Florida auto insurers"; April 14, 2023.
59 AM Best: Florida Losses from Hurricane Idalia Are Unlikely To Match Hurricane Ian's, September 1, 2023.
60 *Ibid.*
61 *Ibid.*



The Florida auto insurance market has also been challenging. The ratio of defense and cost containment expenses ("DCCE") incurred to direct premiums earned in the combination of the no-fault and other private auto liability lines was 6.4 percent in 2022, the highest in any state. Florida's DCCE ratio has exceeded that from all other states in each of the past 25 years, with a 2.8-percentage gap in 2022.

Florida passed extensive property insurance reforms in December 2022 and broader insurance and tort reforms in March 2023, including limiting one-way attorney fees and bad faith awards. Those reforms have regenerated significant insurer interest in the Florida marketplace. However, reflecting the litigation environment in the state, almost 300,000 claims were filed right before the effective date of the reforms in an effort to avoid having the lawsuits proceed under the new law.[62]

Louisiana

Louisiana is exposed to significant natural catastrophe risk and has one of the worst legal system abuse environments in the country. A 2022 report on America's "judicial hellholes" ranked Louisiana seventh, citing litigation, staged accidents, COVID-19 lawsuits, and judicial misconduct as top concerns.[63] Ongoing coastal litigation against more than 200 energy companies is a major source of legal system abuse in Louisiana with detrimental effects on the state's economy which include loss of 2,000 jobs worth an estimated $70 million per year in earnings.[64]

Louisiana has only ***1.5% of U.S. population*** but ranked ***5th among states*** with increasing jury verdicts against corporations above $10 million and over $9.5 billion in nuclear verdicts (2009-2022).

Louisiana Record (April 10, 2023, study)
Property Insurance Stability Report, Jan 1, 2023

These lawsuits have led to bankruptcies and reduced the state's tax revenue from energy production. Staged accidents involving big rigs in New Orleans and other areas are driving up the cost of auto insurance in the state. Judicial misconduct is also a challenge, with only seven hearing dispositions out of 526 complaints filed against judges and justices of the peace in 2021. Studies have shown that lawsuit abuse and excessive tort claims cost billions of dollars in annual economic activity, costing each resident over $1,000 and the state about 46,000 jobs per year.[65]

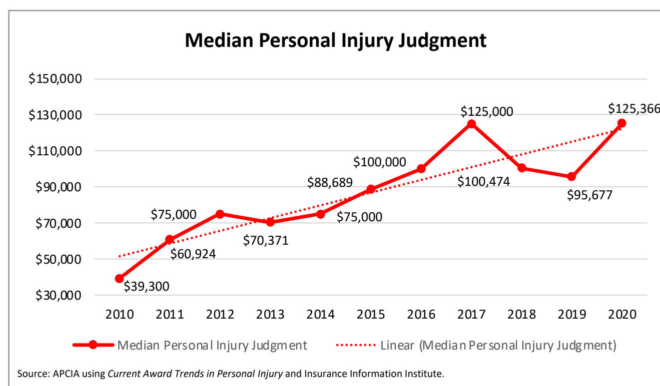
The incoming Louisiana Insurance Commissioner Tim Temple has stated that he supports efforts to amend the state's "bad faith" law that makes it easier for property owners to sue their insurance companies when they encounter problems with their claims.[66] The existing law is overly broad and contains harsh penalty provisions. Successful litigants can receive up to 50 percent more money in legal damages than the actual value of their insurance claim, in addition to their attorneys' fees.[67] "The Louisiana Association of Business and Industry has also pushed for an overhaul, saying the bad faith clause makes it too expensive to do business in the state, and [Commissioner-Elect] Temple agrees that it deters insurance companies from writing policies in Louisiana."[68] The incoming Commissioner also wants to reform Louisiana's unique "three-year rule", which restricts an insurer's ability to non-renew a policy if the insurer has written that insurance policy for three years.[69] Legislative attempts to change the three-year rule and the bad faith clause failed earlier in 2023.

62 The Florida Bar: "Comprehensive Tort Reform Spurs Record Filings"; April 6, 2023.
63 **https://www.thecentersquare.com/louisiana/report-ranks-louisiana-as-a-judicial-hellhole/article_57877542-7703-11ed-b670-0bc5aa60549d.html**.
64 *Ibid.*
65 *Ibid.*
66 Louisiana Illuminator: "How incoming Insurance Commissioner Tim Temple wants to change the industry", October 10, 2023.
67 *Ibid.*
68 *Ibid.*
69 *Ibid.*

OTHER OPPORTUNITIES AND CHALLENGES

Legal System Abuse

Legal system abuse is a significant factor increasing rates in many lines of insurance. Over the five-year period of 2014-2018, the annualized increase in insured losses of commercial auto, product liability, and other commercial liability lines were 10.9, 17.4, and 9.3 percent, respectively.[70] These values vastly outpaced an annualized increase in CPI of 1.5 percent and an increase in GDP of 4.1 percent.



Source: APCIA using *Current Award Trends in Personal Injury* and Insurance Information Institute.

There are many drivers of legal system abuse. For example, lawsuits have become increasingly likely to result in "nuclear" verdicts (verdicts over $10 million dollars), and these exceptionally high jury verdicts — often exceeding what would be considered reasonable damages — can threaten a company's viability, causing some organizations to go bankrupt. According to a recent study, the median nuclear verdict increased 27.5 percent over the ten-year study period, far outpacing inflation.[71]

Nonetheless, the impact of legal system abuse is not limited to nuclear verdicts. Even average verdicts are seeing outsized growth, with a significant increase in ten years. In 2010, average personal injury verdicts were $39,300, and by 2020 they were $125,366. This increase represents a 319% increase in these judgments even accounting for a dip at the beginning of the pandemic.

The many drivers of these adverse changes and legal system abuse include: third party litigation financing (TPLF), a deeply opaque and burgeoning $13.5 billion industry in the U.S.; the significant increase in attorney advertising nationwide; the acceleration of phantom damages and medical financing; the ubiquitous use of "reptile" tactics by the plaintiff's bar such as "jury anchoring"; the expansion of statutory damages, such as under wrongful death statutes; and the elimination or inflation of damages caps, among others. The growing crisis has grown so acute that some are drawing unfavorable comparisons to the liability crisis of the 1980s.[72]

TPLF is a particularly challenging aspect of legal system abuse, as it involves unknown, dark money investments and can be found in consumer, medical financing, as well as business to business (B2B) litigation. Financers are unabashed about what they do. Allison Chock, then with litigation financer Bentham IMF (now known as Omni Bridgeway), stated it plainly – litigation financing makes "it harder and more expensive to settle cases."[73]

We are also seeing the challenging growth of foreign investment in civil litigation in the U.S. Many leading U.S. litigation financers now have sizeable foreign government investment, including Burford Capital, Fortress Investment, and Therium. This is presenting a growing national security concern as, according to the Wall Street Journal, foreign actors, including foreign governments, are increasingly taking advantage of the flaws in the patent system to target critical U.S. industries.[74] A leading TPLF expert has warned "that the China Investment Corporation (CIC), China's Sovereign Wealth Fund, [could] fund a suit against an American company in a sensitive industry such as military technology" and, in the process, "obtain[ ] highly confidential documents containing proprietary information regarding sensitive technologies from the American defendant-corporation." APCIA is encouraging policymakers to consider adopting increased transparency for TPLF in civil litigation.

70 Insurance Research Council, Social Inflation: Evidence and Impact on Property-Casualty Insurance (June 2020) at **https://www.insurance-research.org/sites/default/files/news_releases/IRCSocialInflation2020.pdf**
71 US Chamber of Commerce, Institute for Legal Reform, Nuclear Verdicts: Trends, Causes and Solutions, (2022) at **https://instituteforlegalreform.com/research/nuclear-verdicts-trends-causes-and-solutions/**
72 Forbes, Today's Liability Crisis and Your Risk Management Options (Dec. 1, 2021) at **https://www.forbes.com/sites/forbesbusinesscouncil/2021/12/01/todays-liability-crisis-and-your-risk-management-options/?sh=68fe84521078**.
73 Wall Street Journal, Lawsuit Funding, Long Hidden in the Shadows, Faces Calls for More Sunlight (March 21, 2018).
74 Wall Street Journal, Patent Litigation is a Matter of National Security (Sept. 11, 2022) at **https://www.wsj.com/articles/patent-litigation-is-a-matter-of-national-security-chips-and-science-act-intellectual-property-theft-lawsuit-technology-scammers-manufacturing-11662912581**.

CONCLUSION

The property casualty industry is solvent but facing rapidly escalating loss costs, particularly in the property and auto insurance lines. Losses are being driven by the increasing accumulation of asset values in regions vulnerable to higher risk of natural catastrophes, economic inflation, climate change, legal system abuse, and regulatory delays in approving rate filings , and coverage mandates. Particularly in states where challenges persist with rate filing approvals, rates have lagged far behind losses, resulting in record loss ratios and causing severe net underwriting losses.

The consequence of the rapid escalation of losses beyond insurance premiums collected caused a contraction in the industry's capital last year, while the lack of profitability has made it extremely difficult for insurers to attract sufficient additional investment capital to meet increased coverage demands. Many insurers have had to pull back from coverage exposures, resulting in availability challenges for consumers. Some states have reacted by expanding significantly underpriced residual markets or trying to mandate subsidized coverages. Those actions can create a further death spiral in the markets while creating subsidies that mask socially beneficial driving-risk and environmentally friendly climate-risk signals.

Insurance availability can be best improved by allowing competitive private markets to actuarially price risk according to expected costs, while reducing government rate suppression and policy form constraints. Insurance affordability is best addressed through improved mitigation and resiliency programs. APCIA has identified dozens of such state and federal programs that would help consumers and make their insurance more affordable.

Insurers' core business is protecting people and helping them recover from catastrophic losses to their homes, cars, and businesses. Insurers remain committed to our policyholders and American consumers. But insurance markets are facing very strong challenges that will require strong leadership to overcome. APCIA is ready and willing to work with state and federal regulators and policymakers on reforms.

American Property Casualty Insurance Association[SM]

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APCIA CONTACT:

Robert Gordon
Senior Vice President, Policy, Research, and International
American Property Casualty Insurance Association
robert.gordon@apci.org