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TESTIMONY

Statement of

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Chairman Davidson, Ranking Member Cleaver, and Members of the Subcommittee, thank you for the opportunity to testify before you today. My name is Baird Webel. I am a Specialist in Financial Economics at the Congressional Research Service (CRS) focusing on non-health insurance issues. CRS's role is to provide objective, nonpartisan research and analysis to Congress. CRS takes no position on the desirability of any specific policy or policy outcome. Any arguments presented in my written and oral testimony are for the purposes of informing Congress, not to advocate for a particular policy outcome.

My testimony today will begin with a brief introduction regarding the current issues in property and casualty insurance markets[1] and then address specific drivers of the rising insurance prices and reduced insurance availability that many people are experiencing. I look forward to answering any questions the committee members may have.

Introduction

Insurance consumers across the United States have been experiencing higher prices and gaps in coverage, which in many cases are affecting property and casualty insurance that is crucial for everyday life. The overall price of personal motor vehicle insurance has increased 18.9% in the past full year.[2] Homeowners insurance price increases are lower, at 8.8% for calendar year 2023 so far, but some states are seeing larger increases.[3] Possibly more distressing to consumers have been areas where insurers may be pulling out altogether, leaving people unable to find insurance at all except for state-created insurers of last resort (or *residual market mechanisms*), which may offer coverage that is more expensive or less complete than private coverage.[4] The rising prices of insurance extend as well to business coverage. Commercial property insurance has seen 23 consecutive quarters of increased premiums. The latest survey (2nd Quarter, 2023) showed the highest average increase among insurance lines—18.3%—for property insurance.[5]

Cycles in insurance prices and availability are not uncommon, particularly for property and casualty insurance.[6] Periods of high prices and reduced availability are termed *hard* markets, with *soft* markets referring to periods of relatively low prices and wider availability. Hard markets can occur when

[1] Property insurance is "coverage protecting the insured against loss or damage to real or personal property from a variety of perils, including but not limited to fire, lightening, business interruption, loss of rents, glass breakage, tornado, windstorm, hail, water damage, explosion, riot, civil commotion, rain, or damage from aircraft or vehicles," while casualty insurance is "a form of liability insurance providing coverage for negligent acts and omissions such as workers compensation, errors and omissions, fidelity, crime, glass, boiler, and various malpractice coverages." See National Association of Insurance Commissioners (NAIC), "Glossary of Insurance Terms," https://content.naic.org/consumer_glossary. In general, property and casualty insurance is one of the broadest categories into which insurance is divided, along with life insurance and health insurance.

[2] "Motor vehicle insurance" detailed expenditure category from U.S. Bureau of Labor Statistics, Table 2, Consumer Price Index for All Urban Consumers (CPI-U): U.S. city average, https://www.bls.gov/news.release/cpi.t02.htm.

[3] Jason Woleben, "Farmers, USAA Boost Homeowner Insurance Rates by Double Digits in 2023," S&P Global, October 3, 2023, https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/farmers-usaa-boost-homeowner-insurance-rates-by-double-digits-in-2023-77690424.

[4] Most of these insurers of last resort are known generally as Fair Access to Insurance Requirements (or FAIR) plans. For more information, see NAIC, "Fair Access to Insurance Requirements (FAIR) Plans," updated February 1, 2023, https://content.naic.org/cipr-topics/fair-access-insurance-requirements-fair-plans.

[5] Council of Insurance Agents and Brokers, "Commercial Property/Casualty Market Index Q2/2023," p. 2, downloadable at https://www.ciab.com/download/38548/?tmstv=1692214688.

[6] Life insurance, particularly on the claims side, tends to be much more stable than property and casualty insurance. In addition, most life insurers also have substantial annuity business, in which changes in death rates work in the opposite direction than in life insurance.

particularly unexpected events occur in claims payouts or in an insurer's asset/investment portfolio or when both sides of an insurer's balance sheet are affected.

High prices and unavailable insurance tend to draw policymakers' attention to insurance markets and possible solutions to these issues. Most such solutions, like insurance regulation generally, are enacted at the state level. States typically focus on lines of insurance such as auto, homeowners, or workers' compensation, where such insurance may be required by a third party. At the federal level, government interventions occur less frequently. Examples include:

- The Terrorism Risk Insurance Act, which provides a federal reinsurance backstop for the terrorism coverage following the 9/11 terrorist attacks;[7]
- The Liability Risk Retention Act, which aimed to increase insurance supply through reducing regulatory burden during a liability insurance crisis in the 1980s;[8] and
- The National Flood Insurance Program, which provides flood insurance directly to individuals and businesses following the pullout of private insurance from the flood market in the 1960s.[9]

Insurance prices generally react to a wide variety of factors at both the systemic and the individual levels. The current rising prices and limited availability in property and casualty insurance markets can largely be traced to the interplay between two different factors: (1) a macroeconomic environment marked by sharply rising inflation and interest rates and lower investment returns and (2) increasing losses from natural catastrophes. In addition, particular aspects of the insurance regulatory system in two large states, Florida and California, have generally been seen as contributing to market issues in those states.

Inflation, Interest Rates, and Investments

Insurance at its most basic level is a relatively simple economic proposition—a premium is paid for an insurer to take on a risk and then pay out a claim for future loss if the negative outcome occurs. The obvious focus in such an equation is estimating the probability of loss and the size of the claim. Nearly as important, however, can be the fact that the premium is paid in dollars today, while claim is paid out in dollars in the future. If inflation and interest rates or other investment returns remain relatively constant, or at least as expected, over the time period, then this can be relatively easily incorporated into the calculation of premiums. If these variables change dramatically and unexpectedly, however, the insurance equation can become highly uncertain, and insurers may struggle to price correctly, with swings in pricing as a result.

Inflation through the 2010s remained unusually low compared to the previous decades, typically around or below the 2% threshold used by the Federal Reserve. Insurers, along with the rest of the financial system, had become quite accustomed to the situation. The COVID-19 pandemic dramatically changed the situation, with annual inflation spiking to 7% in 2021 and 6.5% in 2022. Beyond the headline number, even higher price spikes and supply chain difficulties in particular sectors had spillovers into particular lines of insurance. Inflation increases in building materials and costs fed particularly into homeowners and commercial property insurance rates, as a large percentage of claims in these insurance lines involve rebuilding and repairing structures. The supply chain issues involving computer chips had an unexpected impact on new car supply due to the increased technological features in new cars. This resulted in higher costs for used cars and car repairs that fed back into auto insurance rates. In addition, the pandemic seems

[7] For more information, see CRS In Focus IF11090, *The Terrorism Risk Insurance Act (TRIA)*, by Baird Webel.

[8] For more information, see CRS Report RL32176, *The Liability Risk Retention Act: Background, Issues, and Current Legislation*, by Baird Webel.

[9] For more information, see CRS In Focus IF10988, *A Brief Introduction to the National Flood Insurance Program*, by Diane P. Horn.

to have had a significant impact on driving behavior, with increased traffic fatalities and increase insurance claim severity.[10]

Increases in underlying prices have a fairly direct and obvious effect on insurance pricing, while increases in interest rates are not as straightforward. Investments in bonds make up approximately 50% of insurer assets.[11] For the decade or more that interest rates, along with inflation, were very low, investing in bonds resulted in relatively low income for insurers, thus squeezing profitability. Increasing interest rates will increase this income for newly purchased bonds or variable rate bonds. But for the large stock of existing fixed rate bonds, increasing interest rates reduce the value of these bonds, and the steeper the increase, the greater the drop in value. This effect on insurers' capital levels is essentially immediate, compared to the increase in interest income, which occurs over time. Drops in the value of other investments, such as the approximately 33% that general property and casualty insurers held in equities in 2022, have a straightforward effect, decreasing insurer capital and surplus levels.[12]

In 2022, the Federal Reserve hiked interest rates to fight inflation, and equity markets reacted negatively to both rising inflation and interest rates. For the overall property and casualty industry, the effects can be seen in, for example, a 90.8% fall in overall realized capital gains, with a $9.9 billion realized loss on bonds. Overall surplus fell 7.1%, the first decline since 2017.[13] In another example, one report by a reinsurance broker found that reinsurer capital levels among larger reinsurers dropped by 12% in 2022, the first decline since at least 2015.[14] Drops in insurance capital result in reduced capacity and supply of insurance unless insurers are able to raise additional capital, which will be an additional expense. In either case, this is likely to feed through to higher insurance prices.

Increasing Catastrophe Losses

Large-scale losses from natural events—primarily tropical and other severe storms but also events such as wildfires, floods, and droughts—have been increasing over the past decades. These increasing losses have been largely attributed to population growth in disaster-prone areas, rising property values in hazardous areas, inadequate building codes, and climatological changes in weather patterns and storm intensities.[15] The National Oceanic and Atmospheric Administration (NOAA) tracks "weather and climate disasters" causing more than a billion dollars (inflation-adjusted) in overall damages/costs since 1980. Such events have increased in number from 33 in the 1980s to 131 in the 2010s and 84 in the 2020s so far. The

[10] National Highway Traffic Safety Administration, "NHTSA Estimates for 2022 Show Roadway Fatalities Remain Flat After Two Years of Dramatic Increases," press release, April 20, 2023, https://www.nhtsa.gov/press-releases/traffic-crash-death-estimates-2022; and Insurance Research Council, "IRC: U.S. Auto Claim Severity Surged During Pandemic," press release, July 18, 2023, https://www.insurance-research.org/sites/default/files/downloads/IRC%20News%20Release%20Trends%20in%20Personal%20Auto%20Insurance%20July%2018.pdf.

[11] NAIC, "U.S. Property and Casualty and Title Insurance Industries—2022 Full Year Results," p. 8, https://content.naic.org/sites/default/files/inline-files/2022%20Annual%20Property%20%26%20Casualty%20%26%20Title%20Insurance%20Industries%20Analysis%20Report.pdf.

[12] Capital and surplus are "a company's assets minus its liabilities." See NAIC, "Glossary of Insurance Terms."

[13] NAIC, "U.S. Property and Casualty and Title Insurance Industries—2022 Full Year Results," p. 9.

[14] Gallagher Re, "Reinsurance Market Report, Results for Full-Year 2022," April 2023, p. 4, https://www.ajg.com/gallagherre/-/media/files/gallagher/gallagherre/reinsurance-market-report-for-full-year-2022.pdf.

[15] See, for example, W. J. Wouter Botzen, Olivier Deschenes, and Mark Sanders, "The Economic Impacts of Natural Disasters: A Review of Models and Empirical Studies," *Review of Environmental Economics and Policy*, vol. 13, no. 2 (2019), pp. 167-188, https://www.journals.uchicago.edu/doi/epdf/10.1093/reep/rez004; Adam B. Smith, "2022 U.S. Billion-Dollar Weather and Climate Disasters in Historical Context," *Climate.gov*, January 10, 2023, https://www.climate.gov/news-features/blogs/beyond-data/2022-us-billion-dollar-weather-and-climate-disasters-historical; MunichRe, "Climate Change and Its Consequences," https://www.munichre.com/en/risks/climate-change.html; and Chandan Banerjee et al., "A Perfect Storm: Natural Catastrophes and Inflation in 2022," Swiss Re Institute, p. 4, https://www.swissre.com/institute/research/sigma-research/sigma-2023-01.html.

inflation-adjusted costs have increased along with the frequency, from $21.4 billion per year in the 1980s to $130.8 billion per year in the 2020s. **Table 1** below reproduces the NOAA findings.

Table 1. NOAA Comparisons of U.S. Billion-Dollar Disaster Statistics

CPI-Adjusted, as of October 10, 2023

Time Period	Billion-Dollar Disasters	Events/Year	Cost	Percent of Total Cost	Cost/Year
1980-1989	33	3.3	$213.6B	8.1%	$21.4B
1990-1999	57	5.7	$326.8B	12.4%	$32.7B
2000-2009	67	6.7	$604.2B	22.9%	$60.4B
2010-2019	131	13.1	$967.4B	36.7%	$96.7B
2020-2023	84	21.0	$523.1B	19.9%	$130.8B
All Years (1980-2023)	372	8.5	$2,635.1B	100.0%	$59.9B

Source: NOAA, "Billion-Dollar Weather and Climate Disasters: United States Summary," https://www.ncei.noaa.gov/access/billions/state-summary/US.

Note: Cost statistics not included for Hurricane Idalia (August 2023).

These NOAA findings cover overall losses, not just those losses covered by insurance. However, U.S. insurance markets are highly developed, and a larger percentage of economic losses tends to be covered by insurance in the United States compared to the rest of the world. For example, in 2022, U.S. economic losses due to catastrophes was 53% of the global total, but the insured losses were 74% of the global total.[16] The most destructive single event in 2022 was Hurricane Ian, which caused over $100 billion in damages with $60 billion insured.[17]

Increasing disaster losses are occurring across the globe, and the global experience matters particularly in catastrophe insurance, as losses in almost any country are significantly borne by global reinsurers. Thus, a catastrophe on the other side of the world can result in a decreasing amount of insurance capacity—and likely higher prices—in the United States. According to Swiss Re, 2022 global insured losses totaled $125 billion, following $121 billion in 2021. With $173 billion in losses in 2017, three of the five largest loss years have occurred in relatively short succession. (The other two years were 2011 and 2005.) The average yearly loss for the three decades from 1992 to 2021 was less than $60 billion.[18]

Large hurricanes, such as Ian, cause outsized losses, but so-called secondary perils—lower cost but higher frequency events—caused higher combined losses in 2022 and have become a substantial source of concern.[19] Through the third quarter of 2023, nine of the 10 costliest global insured loss events in the year were secondary peril events in the United States—the wildfires in Hawaii and eight different severe convective storms, with losses from $2.3 billion to $5 billion per event.[20] In the western United States,

[16] Gallagher Re, "Natural Catastrophe Report of 2022," p. 10, https://www.ajg.com/gallagherre/-/media/files/gallagher/gallagherre/gallagher-re-nat-cat-review-2022.pdf.

[17] Munich Re, "Climate Change and La Niña Driving Losses: The Natural Disaster Figures for 2022," January 10, 2023, https://www.munichre.com/en/company/media-relations/media-information-and-corporate-news/media-information/2023/natural-disaster-figures-2022.html.

[18] Banerjee et al., "A Perfect Storm," pp. 5-6.

[19] Gallagher Re, "Natural Catastrophe Report of 2022," p. 10.

[20] Aon, "Q3 Global Catastrophe Recap," October 2023, p. 7, https://www.aon.com/getmedia/7107985e-43d8-412b-a674-7722112cc2b0/20231018-q3-2023-catastrophe-recap.pdf. The single most costly event was an earthquake in Turkey and Syria at $5.7 billion in insured losses.

wildfire has become a particular concern, with insurers in California citing increased wildfire risks as a particular reason for limiting insurance offered there.[21]

Insurance Regulation and Market Disruption

In general, insurance is a highly regulated industry with complex products, many of which span long time frames. Insurers generally face solvency regulation (which focuses on making sure they have sufficient resources to fulfill the promises of future payments made in their products) as well as regulation of both the content and the pricing of their products. (Illinois is the only state that does not have widespread regulation of insurance rates.) Product regulation is heavily focused on the insurance products most widely purchased by individual consumers, such as homeowners insurance. Each state government has a department or other entity charged with licensing and regulating insurance companies and those individuals and companies selling insurance products. The National Association of Insurance Commissioners, comprised of each state's insurance regulator, fosters some uniformity in insurance regulation, particularly in insurer solvency regulation. Substantial differences, however, do remain, particularly in insurance rate regulation.

In a highly regulated environment, it is possible for regulation to become in some way out of step with the market and potentially contribute to market disruptions rather than solving market issues—the usual goal of regulation. This was seen, for example, in the Michigan automobile insurance market in the past, and the State of Michigan enacted reforms in 2019 intended to address issues in this market.[22] Recently, California and Florida, two large states already buffeted by exposures to the increasing catastrophe losses discussed above, have both undertaken regulatory changes in response to recent insurance market disruptions. California's regulatory issues have generally been seen to largely revolve around how insurance rates are set, while Florida's have revolved more around how insurance claims are resolved.

California's system of rate regulation in particular has drawn critics who see it as "restrictive price controls so disruptive that many insurers are curtailing their business operations."[23] Others, however, see this system as being "protective of insurance policyholders through laws and policies aimed at limiting rate increases."[24] The California rate regulatory process is more complex than in many states, involving both prior approval of rates by the insurance regulator and a process whereby consumers can independently intervene in the rate approval process if a proposed rate increase is higher than 7% and be compensated if they provide valuable technical input.[25] In addition to this regulation of the size of rate increases, regulations allowed only *historical* data to be used in setting homeowners insurance rates (not forward-looking models) and also disallowed reinsurance expenses as legitimate costs that can be built

[21] See, for example, Christopher Flavelle, Jill Cowan, and Ivan Penn, "Climate Shocks Are Making Parts of America Uninsurable. It Just Got Worse," *New York Times*, May 31, 2023, https://www.nytimes.com/2023/05/31/climate/climate-change-insurance-wildfires-california.html.

[22] For a discussion of issues in Michigan auto insurance reforms and arguments for further actions, see Amanda Nothaft and Patrick Cooney, "Building on Michigan's Auto Insurance Reform Law," University of Michigan, December 2021, https://sites.fordschool.umich.edu/poverty2021/files/2021/12/PovertySolutions-Auto-Insurance-Reform-PolicyBrief-December2021.pdf.

[23] Testimony of Jerry Theodorou, before U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Perspectives on Challenges in the Property Insurance Market and the Impact on Consumers*, 118th Cong., 1st sess., September 7, 2023, https://www.banking.senate.gov/hearings/perspectives-on-challenges-in-the-property-insurance-market-and-the-impact-on-consumers.

[24] Thomas Frank, "California Scared Off Its Biggest Insurer. More Could Follow," *Climatewire*, May 31, 2023, https://www.eenews.net/articles/calif-scared-off-its-biggest-insurer-more-could-follow/.

[25] California Department of Insurance, "Information Sheet: Proposition 103 Intervenor Process," https://www.insurance.ca.gov/01-consumers/150-other-prog/01-intervenor/info.cfm.

into the rate base.[26] Rather than reducing regulations, a representative for the Consumer Federation of America has argued that such models need additional regulatory scrutiny and that the reinsurance industry needs more regulation before such costs should be accepted in primary insurance rates.[27]

The California Insurance Commissioner recently announced a number of regulatory changes aimed at improving conditions in the insurance market. With regard particularly to the criticisms of the regulatory process, the changes will allow usage of "catastrophe modeling and California-only net reinsurance costs in rates"[28] while requiring companies to increase the number of policies offered in high-risk areas. With regard to rate regulation, the new rules are aimed at improving the timeliness and transparency of rate review. The rulemaking process for this initiative has just begun, and the target for implementation is December 2024, so the actual impact on California's market will likely not be known for some time.

Florida's exposure to hurricanes has long been a stress on the insurance market. A primary recent challenge, however, according to the Florida Office of Insurance Regulation (OIR) has been "an increase in the frequency and severity of litigated claims."[29] While insurance claims rules may seem an unlikely source of high insurance prices, aspects of the Florida system—particularly provisions on attorneys' fees and assignment of benefits—have resulted in numbers of claims litigation that are higher than in other states.[30] For example, according to the latest OIR figures for 2021, insurance claims in the state amounted to 6.9% of all claims nationwide, but 76% of the nationwide claims lawsuits were opened in the state. Somewhat similarly, the insurance rating agency A. M. Best has calculated that Florida's share of homeowners insurance premiums is approximately 10%, while the share of "defense and cost containment" (DCC)[31] expenses paid out of those premiums is over 30% of the nationwide DCC expenses. According to OIR, the DCC expenses totaled approximately $3 billion in the state.[32] The state enacted reforms to this system in late 2022 and 2023, primarily in Florida Senate Bill 2A and House Bill 837.[33] As this legislation is proactive, affecting claims going forward, it will be some time before results are clear as to the effects of the changes. However, some insurers are reporting benefits of the reforms, with Florida Citizens United (the state FAIR plan) saying that it was receiving fewer lawsuits.[34]

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[26] See California State Assembly Committee on Insurance, *Informational Hearing, The California FAIR Plan, Background*, March 8, 2023, pp. 6-7, https://ains.assembly.ca.gov/sites/ains.assembly.ca.gov/files/FAIR%20Plan%20hearing%20background.pdf.

[27] Testimony of Doug Heller, before U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Perspectives on Challenges in the Property Insurance Market and the Impact on Consumers*, 118th Cong., 1st sess., September 7, 2023, https://www.banking.senate.gov/hearings/perspectives-on-challenges-in-the-property-insurance-market-and-the-impact-on-consumers.

[28] California Department of Insurance, "Sustainable Insurance Strategy," https://www.insurance.ca.gov/01-consumers/180-climate-change/SustainableInsuranceStrategy.cfm.

[29] Florida OIR, "Property Insurance Stability Report," July 1, 2023, p. 3, https://floir.com/docs-sf/default-source/property-and-casualty/stability-unit-reports/july-2023-isu-report.pdf.

[30] For a discussion of, and viewpoint on, assignment of benefits and attorneys' fees, see Fred Karlinsky et al, "Florida Assignment of Benefit Abuse: Recent Developments," Federation of Regulatory Counsel, July 12, 2019, https://www.forc.org/Public/Journals/2019/Articles/Summer/Vol30Ed2Article1.aspx.

[31] A. M. Best, "US Homeowners Line Well Capitalized, but Weather Events Pose Significant Uncertainty," September 29,2022, p. 8, downloadable at https://news.ambest.com/newscontent.aspx?refnum=245263. DCC expenses include court fees, fees for lawyers, fees for expert witnesses, preparing for trial, etc.

[32] Florida OIR, "Property Insurance Stability Report," p. 3.

[33] For summaries of the legislation by the Florida Insurance Consumer Advocate, see Florida Department of Financial Services, "Recent Property Insurance Changes," https://www.myfloridacfo.com/division/ica/propertyinsurancechanges.

[34] Jean Eaglesham, "As Storm Damages Mount, States Try to Make It Harder to Sue Insurers," *Wall Street Journal*, October 19, 2023, https://www.wsj.com/finance/as-storm-damages-mount-states-try-to-make-it-harder-to-sue-insurers-e7f88720.