Written Testimony of

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On Behalf of the National Association of Insurance Commissioners

Before the United States House of Representatives

Financial Services Committee,
Subcommittee on Housing and Insurance

Regarding:

The Factors Influencing the High Cost of Insurance for Consumers

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Chairman Davidson, Ranking Member Cleaver, and members of the Subcommittee, thank you for the invitation to testify today. My name is Grace Arnold and I serve as the Commissioner of the Minnesota Department of Commerce, which is the state's insurance regulator. As such, I am a member of the National Association of Insurance Commissioners (NAIC).[1, 2] On behalf of my department, my fellow state and territory insurance regulators, and the NAIC, I appreciate the opportunity to testify today.

The United States insurance market is the single largest and most competitive in the world. State insurance regulators supervise more than one-third of global premium. As of 2022, property and casualty insurance companies reported over $874 billion in direct written premium.[3] The U.S. property and casualty insurance industry's cash and invested assets surpassed $2.4 trillion at year-end of 2022[4]

State regulators share a mission to ensure a stable, competitive, and fair marketplace where U.S. consumers are well-informed and well-protected. States work hard to strike an appropriate balance between insurer solvency and product availability and affordability. We oversee risk financing that allows individuals and businesses to thrive, while preserving the ability of the sector to pay claims and otherwise meet obligations that result from financing risk.

As a national system of state-based regulators, we collaborate closely on a regular basis and have long been committed to providing leadership across the entire spectrum of global and domestic insurance issues and activities. For more than 150 years, state insurance regulators have developed extensive experience and insight into the macroeconomic forces shaping property insurance markets, and how those factors impact each unique insurance market in each state or territory. We have strived to develop tools and rules to balance industry solvency with fair treatment for policyholders.

The Property & Casualty Market

There are many factors and forces that impact property insurance market availability and affordability, from reinsurance costs to inflationary pressures, to labor and material supply, to

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

[2] *See* NAIC, *2023 Committee List* (Oct. 12, 2023), https://content.naic.org/sites/default/files/documents/committee-list.pdf

[3] NAIC, *U.S. Property & Casualty and Title Insurance Industries – 2022 Full Year Results*, https://content.naic.org/sites/default/files/inline-files/2022%20Annual%20Property%20%26%20Casualty%20%26%20Title%20Insurance%20Industries%20Analysis%20Report.pdf

[4] NAIC, *Capital Markets Special Report*, https://content.naic.org/sites/default/files/capital-markets-special-reports-asset-mix-ye2022.pdf

litigation and broader macroeconomic conditions. However, what is dominating the news and national attention is the impact of recent natural disaster losses in creating property insurance availability and affordability challenges for a number of regions across the United States. These dynamics can vary within a relatively small geographic area, so while a state's property insurance market may be generally healthy overall, there can be localized protection gaps that challenge certain communities or that impact some insurers more than others.

This is not the first-time state regulators have seen such cyclical growth and contraction in property insurance markets, and we have taken action to address the particular challenges we see nationally and locally. For example, in response to increased weather frequency and severity, state insurance regulators have pursued customized initiatives to promote market stability and increase access to insurance. State regulators have the capacity to respond swiftly and nimbly to the market conditions in each of our markets. Through the NAIC, we are able to coordinate nationally to share insights and market dynamics, gather data, and promote best practices, however, the most effective solutions to a particular market challenge can vary from state to state.

For example, Florida focused legislative reforms on excessive claims litigation, which was driving up costs, while California is using wildfire mitigation tools and incentives and has proposed modifying regulations to better account for the rising cost of reinsurance and incorporate catastrophe modeling into rates. Alabama has worked to elevate its state-wide building code and created grants for homeowners to fortify their roofs, making them more resistant to windstorm damage. Minnesota has borrowed from Alabama's model and adapted it to the natural disaster perils we see such as strong convective windstorms, hail, and ice damage. We are working across state agencies including our housing, labor and industry, pollution control, natural resources and agriculture to promote the resilience of communities through land use, improved structures and personal resilience.

The strength of the state based regulatory system lies in its flexibility, speed, and on the ground knowledge of each individual state's insurance market and consumer needs. For example, the increase in the severity and frequency of storms has made it challenging for some of our smaller, regional companies to secure reinsurance. We have been able to react quickly to these companies' ongoing regulatory needs as they make business changes. The states also harness the power of coordinating through the NAIC to share their experience and promote solutions. While regulators can move quickly to adapt with their markets to promote coverage and access, the underlying risks that insurers are being asked to cover in some areas are growing, and insurance rates will rise to reflect that increased risk and expense.

Climate Risk, Natural Catastrophes, and Resiliency

Moving from state specific solutions to more national efforts, state insurance regulators, through the NAIC, have had a climate-risk working group for more than a decade, which in 2020 evolved into our Climate and Resiliency Task Force. The Task Force serves as the coordinating NAIC body for discussion and engagement on climate-related risk and resiliency issues. This Task Force builds on existing efforts to address the economic consequences of natural disasters, including efforts to mitigate their toll. While the role of the climate in influencing the frequency and severity of natural disasters has received more specific attention over the last decade, our work is built on decades of expertise and experience in managing the economic fallout of these disasters.[5]

Climate risk and the impact of extreme weather will remain an evolving risk, forcing us to adapt – something state regulation has and will continue to do – but we have laid the proper foundation to address it throughout our state-based regulatory system focusing on: (1) climate financial risk analysis; (2) the availability and affordability of insurance; and (3) stakeholder risk awareness and engagement. We also continue to advocate for resiliency and mitigation efforts that can reduce the risk of property loss, keeping people in their homes and businesses open. Building on that foundation, the Climate Risk and Resiliency Task Force has taken several important steps that we would draw your attention to.[6]

First, a bipartisan and growing group of state insurance regulators adopted a new standard for insurance companies to report their climate-related risks, in alignment with the international Task Force on Climate-Related Financial Disclosures (TCFD). The TCFD standard is the international benchmark for climate risk disclosures and will help insurance regulators and the public to better understand the climate-related risks to the U.S. insurance market. As of August 2023, 27 states and territories utilize the survey, which represents nearly 85% of direct written premium nationwide, giving us a national perspective on how insurers see climate-related risks impacting their businesses.

Second, state insurance regulators have updated the NAIC's Risk Based Capital (RBC) formula to include specific charges for hurricane, earthquake, and most recently wildfire risks. State insurance regulators use the RBC formula to monitor the capital adequacy of insurers to ensure their ability to pay claims following catastrophic events. The NAIC is currently considering adding severe convective storms as a modeled loss for insurers to report as a separate peril. We are also considering updates to the NAIC's financial examination materials and guidance manuals to reflect climate related risk within financial solvency tools as well as exploring how insurers are using scenario analysis to assess climate related risk internally. Ensuring that insurance carriers remain solvent and have sufficient claims paying capacity is the critical foundation to fostering a healthy marketplace.

Third, state regulators and the NAIC, in coordination with FEMA, continue to build consumer awareness and support risk reduction measures to create more resilient and sustainable communities. The NAIC has also partnered with the Institute for Business and Home Safety (IBHS), which publishes experimental research, identifying and describing home hardening

[5] *See* NAIC November 11, 2021, Comment Letter https://content.naic.org/sites/default/files/testimony-letterresponse-fio-rfi-climate-financial-risk-211111.pdf

[6] *See* NAIC, *Executive Committee Task Force on Climate and Resiliency National Association of Insurance Commissioners June 2023 Progress Report*, https://content.naic.org/sites/default/files/draft-annual-progress-reportsummary-2022.pdf

actions that reduce losses. Building on the IBHS' work, several states, including Alabama, Florida, Louisiana, Minnesota, North Carolina, South Carolina, Oregon, and California, have successfully implemented state-level mitigation programs to provide financial assistance to homeowners for reducing risks to their home or business. To help facilitate access and establishment of such mitigation programs, the NAIC has established a dashboard of risk mitigation programs.[7]

Fourth, last year the NAIC established a Catastrophe Model Center of Excellence within the NAIC's Center for Insurance Policy and Research (CIPR) to provide resources for state insurance regulators, including access to catastrophe model documentation, technical education and training, and applied research, to proactively address regulatory climate risk and resilience priorities. The Center of Excellence works with catastrophe modeling providers to understand how climate risk and changing weather patterns are or are not incorporated into their models and provides this information to state insurance regulators. By doing so, it enables state insurance regulators—including the Department of Commerce—to better comprehend the use of these models in projecting risks and losses and identifying factors that could either increase or reduce risks. For example, Minnesota has been working with CIPR to think through what a CAT model would look like in Minnesota in order to strengthen the Minnesota Homes Program.

Fifth, at the 2023 NAIC Summer National Meeting, state regulators announced a plan to issue a data call aimed at helping state insurance regulators collect data from insurers to better understand property markets and coverages as well as protection gaps.[8] We are also aware that the Federal Insurance Office has proposed gathering data from insurers to answer similar questions, and we have been in discussions with them to try to minimize the reporting burden on the sector while still meeting our respective objectives.

Overall, our state-based insurance regulatory system has developed an extensive set of tools to assess and analyze insurer solvency and liquidity as well as protect insurance consumers, and it is accustomed to adapting to an evolving risk landscape both today and in the future. However, while our regulatory system is well equipped to oversee the sector, and efforts to mitigate property insurance risk are impactful, there are no easy answers or silver bullets to address rising costs to protect what is, for many, our largest investment – our homes. Insurance costs reflect a host of local and global factors, from inflation, rising building costs, global reinsurance pricing, state and local land use decisions on where to build, and building codes that govern how well we build. The cost and availability of property insurance reflects the inherent risks facing our property and are a clear indication that the true cost of homeownership is not just the cost to obtain a home, but the cost to protect it as well.

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[7] *See* NAIC, *State Mitigation Programs Dashboard*, https://content.naic.org/sites/default/files/inline-files/State%20Mitigation%20Programs.pdf

[8] *See* NAIC, *NAIC to Issue Data Call to Help Regulators Better Understand Property Markets*, https://content.naic.org/article/naic-issue-data-call-help-regulators-better-understand-property-markets

Cyber Insurance

Turning from property insurance, state insurance regulators also continue to be engaged in innovation, cybersecurity, and emerging technologies on a number of fronts. As part of that engagement, the NAIC has developed a Cybersecurity Supplement for insurers' annual financial statements to gather information about insurers writing cyber coverage in the United States. Through the NAIC, state insurance regulators utilize the data captured within the cyber supplement to monitor risks in the cyber insurance market.[9]

Additionally, the NAIC Innovation, Cybersecurity, and Technology (H) Committee is considering adding new 2024 charges to the Cybersecurity (H) Working Group in order to assist state regulators in better understanding cyber insurance and reinsurance trends, related state regulatory data needs, cyber insurance availability and affordability, the pricing of cyber insurance, the limits of cyber insurance coverages, cyber insurance disclosures, cyber insurance policy content requirements, and underwriting practices, among other related insights.

The cyber insurance market is relatively young and still evolving, but it is also growing quickly due to increased demand and availability of capital. Since 2018, the number of cyber insurance claims has increased by 110% while the number of policies in force have increased by approximately 31%. Between 2020 and 2021, direct written cyber insurance premium increased approximately 75%, while the number of claims increased by approximately 17%. Most of that growth was due to pricing increases for existing coverage, rather than additional coverages. However, more recently, state regulators are seeing a lower increase in premiums, in the 15-20% range. State regulators are also seeing an increase in the frequency and severity of cyberattacks as well as an increase in cyber claims.

The market has responded with stricter underwriting requirements, reduced limits, higher deductibles, and more restrictive terms to manage exposure. For example, insurers are beginning to exclude infrastructure attacks. Insurers are also introducing endorsements aimed at incentivizing patches to known vulnerabilities, which is leading to increased resiliency in the insured businesses. Additionally, with the rise in ransomware attacks, we are seeing ransomware sublimits to cyber policies and a trend towards terrorism exclusions. These are all signs of an evolving insurance market that is functioning to understand and price risks appropriately as well as incentivize cyber resilience that redounds to the benefit of policyholders, their customers and suppliers, and the broader economy.

We understand that the Federal Insurance Office recently released a Request for Information regarding a potential federal insurance response for catastrophic cyber incidents. Historically, federal insurance initiatives have been limited to areas where an insurance market either evaporates or doesn't exist for a risk that becomes effectively uninsurable, such as flood coverage (though

[9] *See* NAIC, Cybersecurity Supplement Instructions, https://content.naic.org/sites/default/files/825-property-2023-cybersecurity-supplement.doc

that is changing with better mapping and modeling), or terrorism coverage. That is not the current state of cyber insurance, which is a healthy and growing property casualty coverage with a number of insurers and reinsurers actively participating in the market. We would urge caution before moving forward with any federal program, which could displace the private sector, undermine cyber hygiene incentives created through pricing and underwriting, and lead to adverse selection.

The Role Congress Can Play

Certainly, there are a number of ways Congress can play an important role in helping improve the resilience of our housing stock and drive down the cost of insurance, but we would direct your attention to two in particular.

First, recent hurricanes and inland flooding have illustrated the critical importance of flood insurance as many of the losses are caused by water, not wind, and flooding is a peril experienced in every state. We remain in an active hurricane season, so the NAIC urges action on a long-term reauthorization of the National Flood Insurance Program (NFIP) before it expires on November 17, 2023. A long-term extension will help provide certainty for policyholders in their efforts to prepare for flood disasters. A continuation of temporary extensions will only impair consumers' ability to plan, particularly when considering that most flood insurance policies do not take effect until 30 days after purchase.

We would also encourage Congress to utilize NFIP reauthorization as an opportunity to facilitate greater growth in the private flood insurance market to help provide consumers with additional choices for flood insurance products.[10] Over time, this additional competition and shift of risk from a federal program to the private market could help lessen the exposure of U.S. taxpayers to the types of catastrophic flood losses that now reside as unpaid debt on the NFIP's books.

It is critical to ensure that private flood insurance meets the continuous coverage requirement, so policyholders have a choice to return to the NFIP without penalty, including not losing any subsidy they previously had with the NFIP. It is also imperative that reauthorization legislation include measures to encourage investment in prevention and preparedness to help minimize the impact of flood damage and economic loss. It is estimated that for every dollar we invest in mitigating future natural hazards, like flooding, we save six dollars.[11] We support the inclusion of mitigation discounts, such as premium discounts or insurance rate reductions to persons who build, rebuild, or retrofit their properties to better resist flood events, and allowing individuals to set aside funds in a tax-preferred savings account for disaster mitigation and recovery expenses.

Significant investment in preparation and mitigation could result in substantial savings in federal disaster relief. As discussed above, states are leading resiliency initiatives throughout the country

[10] *See* NAIC, *NAIC Principles for National Flood Insurance Program (NFIP) Reauthorization*, https://content.naic.org/sites/default/files/inline-files/government_relations_161019_nfip_guiding_principles_0.pdf
[11] National Institute of Building Sciences, *Natural Hazard Mitigation Saves: 2019 Report* (December 2019), https://www.nibs.org/files/pdfs/NIBS_MMC_MitigationSaves_2019.pdf

and establishing mitigation grant programs to support homeowners' efforts to retrofit their homes. Encouraging mitigation not only reduces risks to homeowners, but to the insurance companies who provide them coverage.

Secondly, while promoting mitigation planning is a shared state and federal goal, there is inconsistent tax treatment of state and federal disaster mitigation grants. Congress has excluded grants provided through the Federal Emergency Management Agency (FEMA) from federal income tax, but state grants, including those offered by state established residual market mechanisms for the same purpose are, in many cases, subject to federal income tax even if they are exempt from state income tax. This reduces both the impact of the grant and the incentive to pursue them. The bicameral bipartisan Disaster Mitigation and Tax Parity Act of 2023 (S. 1953 / H.R. 4070) would fix the inconsistency and provide parity for residential mitigation grants provided by state public entities. As we continue to experience the devastating effects of natural disasters, it is more important than ever to encourage residents and homeowners to utilize pre-disaster mitigation programs.

Conclusion

In conclusion, as state officials, we are perhaps closer to the consumers and businesses impacted by natural catastrophes than any other primary financial regulator. We are on the front lines assisting consumers with policy questions and talking to businesses about their concerns. We are committed to doing all that we can to support our communities and continuing to work with our federal, state, and local partners to help our country address the devastating personal and economic impacts of natural disasters. State regulation has a strong 150-year plus track record of evolving to meet the challenges posed by dynamic markets, and we continue to believe that well-regulated markets make for well-protected policyholders.

Thank you again for the opportunity to be here on behalf of my fellow Commissioners who make up the NAIC. I look forward to your questions.