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Statement

of the

National Association of Mutual Insurance Companies

to the

United States Senate

Committee on Banking, Housing, and Urban Development

Hearing on

Perspectives on Challenges in the Property Insurance Market and the Impact on Consumers

September 7, 2023

Introduction

The National Association of Mutual Insurance Companies (NAMIC) is pleased with the opportunity to provide testimony for the Senate Banking Committee's hearing on "Perspectives on Challenges in the Property Insurance Market and the Impact on Consumers."

NAMIC is the largest property/casualty insurance trade group with a diverse membership of more than 1,500 local, regional, and national member companies, including seven of the top 10 property/casualty insurers in the United States. NAMIC member companies represent a cross-section of the property/casualty insurance industry ranging in size from a one-person farm mutual operating in a single county to local and regional insurers on main streets across America to national insurers operating throughout the country and around the globe.

NAMIC members write $391 billion in annual premiums, accounting for 69 percent of the homeowner's insurance market, 56 percent of the auto market and 31 percent of business insurance markets. Through our advocacy programs, we promote public policy solutions that benefit NAMIC member companies and the policyholders they serve, and we foster greater understanding and recognition of the unique alignment of interests between management and policyholders of mutual companies.[1]

A New Era of Risk

As the world grows increasingly populated and climate change looms, we have seen a confluence of factors affect not only the insurance industry, but the country as a whole and, most importantly, everyday consumers. Some of these factors we will discuss in more detail below, ranging from inflation and the reinsurance market to regulatory hurdles and legal system abuse, to the need for strengthening our built environment – all of which have increased costs across the board.

Current insurance industry dynamics are unprecedented, and the phrase "everything, everywhere, all at once," may best describe the dimensions of the challenges insurance companies face. With major risk-events occurring at the same time, significant disruptions are affecting all lines of business, all types of policyholders, in virtually every part of the country, with certain regions more impacted than others.

According to AM Best, the insurance industry recorded a net underwriting loss of $5 billion in 2021. In 2022, that number skyrocketed to $26.5 billion.[2] Already in 2023, severe convective storms have caused $34 billion in insured losses in the United States, and that was only at the half-way point in the year.[3] While in aggregate increasing severity and frequency of climate/weather events is a contributor to these developments, it is in addition to the mix of other factors – including rising materials and labor costs, reinsurance rate hikes, regulatory hurdles, legal system abuse, and people moving en masse to riskier areas of the country.

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[1] https://www.namic.org/aboutnamic/overview

[2] https://news.ambest.com/newscontent.aspx?refnum=248590&altsrc=177

[3] https://www.swissre.com/press-release/Severe-thunderstorms-account-for-up-to-70-of-all-insured-natural-catastrophe-losses-in-first-half-of-2023-Swiss-Re-Institute-estimates/cea79f3c-6486-41a8-9c6e-09df260efe30

Climate + Weather

This is an unparalleled time for engaging on climate-related matters. Extreme weather is reaching a new level of attention in the national spotlight, and rightly so. When tracking billion-dollar weather and climate disasters, as done by the National Oceanic and Atmospheric Administration, it is clear these costly events are on the rise. The 1980–2022 annual average of such events is 8.1 (CPI-adjusted), while the annual average for the most recent five years (2018–2022) is 18 (CPI-adjusted).[4] Looking at 2023, as of Aug. 8, the U.S. has experienced 15 confirmed weather/climate disaster events with losses exceeding $1 billion each, resulting in the deaths of 113 people, with significant economic effects on the areas impacted.[5] And the year is not over; these figures do not include the recent Hawaii wildfires or Hurricane Idalia that hit Florida, South Carolina, North Carolina, and Georgia just last week.

The changes in damage costs are yielding sweeping concerns about availability/affordability challenges on a large scale, but this does not necessarily need to be a foregone conclusion. This is not a new issue for property/casualty insurance. Since its inception, the property/casualty industry has concentrated on extreme weather and focused on seeking ways to minimize and mitigate the physical and financial effects of climate events on policyholders.

A concerning pattern insurers have noticed is the uptick in consumers moving more frequently into areas with some of the highest risks of natural disasters. Since 2010, Florida has added close to 3 million people. Fort Myers – an area that was severely impacted by Hurricane Ian's deadly storm surge in September 2022 – was recently named the sixth fastest-growing city in the country by the US Census Bureau.[6] According to Redfin, counties with the highest risks of wildfires and flood have enjoyed a post-pandemic net bump in population.[7] While resiliency and mitigation are vital pieces of the puzzle, there is only so much these two pieces can address when more people are moving into areas with heightened and growing risks. While a difficult political feat, land use and controlling how much development is allowed in environmentally sensitive areas is a key part of the discussion. After all, if we continue to expand building in areas most vulnerable to weather events, then we cannot be surprised to find losses and devastation also on the rise.

Annual contracts allow insurers to regularly evaluate changes to many risks, including climate risk, and to react quickly and incrementally to changing conditions. Insurers play a critical role in the time leading up to, in the midst of, and in the aftermath of natural catastrophes, they often communicate with policyholders to share information about extreme weather and prepare for such events. Insurers also help policyholders put their lives back together after disasters strike.

Inflation

Further complicating the current insurance marketplace are the increased costs associated with rebuilding in the wake of more frequent disasters. Consumer inflation in the U.S. in 2022 reached a four-decade high, bringing along rising interest rates. This turbulence has led to inflationary pressures on materials and labor costs and exacerbated climate change impacts on the industry. When a home or business is damaged, insurance companies look at the valuation of a property,

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[4] https://www.ncei.noaa.gov/access/billions/
[5] https://www.ncei.noaa.gov/access/billions/
[6] https://www.census.gov/newsroom/press-releases/2022/fastest-growing-cities-population-estimates.html
[7] https://www.wsj.com/real-estate/rising-insurance-costs-start-to-hit-home-sales-d8787f0f?mod=hp_lead_pos2

and any repair or construction is valued at a certain number. Increased construction costs due to labor shortages, rising materials costs, and well-documented supply chain issues in some cases have resulted in insurance companies spending more to rebuild than they have collected in premiums.

According to an analysis by the Insurance Information Institute, home replacement costs jumped by a cumulative 55 percent from 2019 to 2022.[8] More severe and frequent weather events continue to wreak havoc on the country just as these prices continue to soar, with the backdrop of insured losses multiplying year over year. Construction material prices increased 24.4 percent in just two years from 2020 to 2022, per the National Roofing Contractors Association.[9] In general, construction costs hit their highest point in 50 years in early 2022.[10]

Turning to specific materials, the U.S. Forest Service reports that during the first year of the pandemic, "wood products such as softwood lumber and plywood nearly quadrupled. Wholesale prices for plywood increased from $400 to $1,500 per thousand square feet (roughly equivalent to retail prices of plywood increasing from about $12.80 to $48.00 per sheet)."[11] Since March 2020, copper prices have risen 125 percent and in 2021 broke an all-time high of $10,724.50 per metric ton, a record that was subsequently broken in March of 2022 when it hit $10,730. By August 2022, rates had dropped to around $8,000 due to recession fears, however, copper is back on the upswing and has risen to $9,300.[12] Copper is one of the top three most used materials, a vital component in the construction of homes.[13] When these and other prices go up so drastically, the prices of homes go up, in turn making them more costly to insure.

Layered onto this backdrop of inflation is the impact of natural catastrophes when there may be a localized surge in demand. When many consumers need repairs at the same time, access to supplies and to contractors may be even more limited and costly.

Social Inflation + Legal System Abuse

Social inflation is a dynamic phenomenon that is growing in volatility, scope, and public interest. There is no universal agreement about the causes, which are complex, or the solutions. Its damaging consequences are palpable, however, for businesses, consumers, and the rule of law. The U.S. Chamber of Commerce's Institute for Legal Reform finds that U.S. tort costs, which reached about $443 billion in 2020, were equivalent to 2.1 percent of GDP. Costs had steadily increased at an average annual rate of six percent from 2016 to 2020, outpacing the growth in inflation and GDP over the same

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[8] https://www.iii.org/insuranceindustryblog/category/industry-financials/#:~:text=%E2%80%9CA%20cumulative%20replacement%20cost%20increase,primarily%20due%20to%20rate%20increases.%E2%80%9D

[9] https://www.nrca.net/RoofingNews/construction-material-prices-are-24-4-higher-than-a-year-ago.4-14-2022.10422/details/story

[10] https://www.nbcdfw.com/news/local/construction-costs-hit-highest-spike-in-50-years/2891677/

[11] https://www.fs.usda.gov/features/how-pandemic-drove-cost-wood-products

[12] https://www.institutionalinvestor.com/article/2bsto5dwe3r3rdng0035s/innovation/five-reasons-copper-prices-have-risen

[13] https://www.usgs.gov/centers/national-minerals-information-center/copper-statistics-and-information

period.[14] The Institute for Legal Reform found that for jury verdicts of $10 million or more, the median verdicts increased by 27.5 percent from 2010 to 2019, far outstripping inflation of 17.2 percent over the same period.[15]

The insurance industry is not immune to this phenomenon. Class action lawsuits and nuclear verdicts force companies to absorb massive losses that have downstream effects on business operations and the prices of products. Some of the causes of social inflation are third-party litigation funding/financing, an increase in very large verdicts influenced by psychological factors, advertising that numbs potential jurors with respect to reasonable case values and business motives, anchoring, and scare tactics used by plaintiffs' attorneys. With legal system abuse driving up costs for insurers and consumers, some states recently have taken proactive corrective measures. Tennessee, for example, passed landmark reform to curb the abuses of third-party litigation funding – a major function source of legal system abuse. Louisiana also addressed tort reform in 2020, correcting some of the legal abuse that leveraged motor vehicle accidents.

Perhaps no state has been more focused on insurance issues – and specifically its litigation landscape – than Florida. Florida has 9 percent of homeowner property claims, but accounts for an astonishing 79 percent of lawsuits filed nationwide related to property claims.[16] Insurers spent more than $3 billion in 2019 alone fighting these lawsuits.[17] As insurers have been unable to survive the litigious environment paired with the climate disasters, the Florida Legislature held an emergency session to pass a comprehensive tort reform package earlier this year. This package included provisions covering third-party bad faith, comparative negligence, fee multipliers, one-way attorneys' fees, statute of limitations, transparency in damages, and premises liability. Since the tort reform was enacted, four new companies have entered the Florida market, according to the state's Office of Insurance Regulation.[18]

Regulatory Hurdles

With the heightened focus from the federal government and the various functional state regulators who oversee the insurance industry, we have seen far more proposals than in previous years to address some difficulties insurers are confronting. Yet, perhaps with the best intentions, many regulators have been proposing, and in some states, passing, new regulations that do more harm than good to consumers by creating a regulatory environment that exacerbates the challenges consumers face.

In addition to severe weather, inflationary pressures, and legal system abuse, state insurance markets are sometimes negatively impacted by their own regulators. For insurers, and regulators, there are essentially two vital operations, each with its own guiding principle – setting rates for coverage and paying claims. For the former, insurers strive for accuracy in

[14] https://instituteforlegalreform.com/wp-content/uploads/2022/11/Tort-Costs-in-America-An-Empirical-Assessment-of-Costs-and-Compensation-of-the-U.S.-Tort-System.pdf
[15] https://instituteforlegalreform.com/wp-content/uploads/2022/09/NuclearVerdicts_RGB_FINAL.pdf
[16] https://www.iii.org/press-release/triple-i-extreme-fraud-and-litigation-causing-floridas-homeowners-insurance-markets-demise-062322
[17] https://www.preventionweb.net/news/big-reason-florida-insurance-companies-are-failing-isnt-just-hurricane-risk-its-fraud-and
[18] https://floir.com/newsroom/archives/item-details/2023/08/14/florida-s-insurance-market-continues-growth-following-historic-reforms-to-property-casualty-market

evaluating the risk a would-be insured presents so that the rate offered is enough to cover the risk. For the latter, a major focus is on solvency, or ensuring that companies have the funds to fulfill their obligations to their policyholders, which is the most important principle for the industry.

More broadly, states can help insurance consumers by acting on the insurance axiom that rate follows risk. From an insurance regulatory standpoint, the states that do things right are those that do not impair insurers in assessing risk as accurately as possible, and provide swift, fair, and efficient action where regulatory approvals/actions are required. These insurance fundamentals have unfortunately been sidelined in California. Climate-change fueled events have laid bare the flaws in California's regulatory system, which was largely established through the voter-approved Proposition 103 in 1988. The current regulatory regime ignores decades of development in climate and actuarial science, requiring that wildfire risk be priced based upon an insurer's average wildfire losses over the past 20 years as opposed to allowing CAT modeling that looks forward into the future. This means rates in California also cannot reflect some of the most important shifting realities, such as the extensive housing growth in high-risk regions, or increased fuel load following years of drought and fire suppression strategies.

There is no doubt that risks facing California's consumers have grown considerably in recent years, but the California Department of Insurance has been slow to approve rates that would reflect that increase, perhaps given the reluctance of elected officials to increase costs for their constituents. Insurance differs from other businesses because its actual cost to the business is unknown at the time the product is sold. Rather, it is based on estimates and predictions about risks and potential future costs to enable the contractual transfer of a customer's specified and defined risk to the insurer. The issuance of a policy and collection of premium happens up front, which makes regulatory efficiency vital for companies. Slowed approvals or denials for rate increases required to keep pace with increasing risk profiles and costs are enormously damaging to the marketplace. News reports have highlighted that filing approaches are a factor behind the recent decisions by different insurers retreat from the state. Simply put, if the rates they are allowed to charge do not keep up with rising loss costs, then insurers may be forced making difficult decisions, which may include a "survival mode" approach in which they may determine that fulfilling their obligations to existing customers must be put ahead of growing business by attracting new policyholders.

Insurance is regulated at the state level for a very good reason, as localized risks and conditions require the oversight of a local authority. Some risks facing individual states are unique, may create unique problems, and may require unique solutions from those who understand those risks best. That being said, there are guiding principles for a healthy insurance marketplace, which should include flexibility on behalf of regulators and industry alike with swift and fair rate adjustments that align with the risk and costs, which ultimately ensures solvency and fosters consumer protection. A healthy marketplace is diverse and has a variety amongst its different competitors. Not all insurers are the same, so requirements must be proportional and recognize the nature, scale, and complexity of an insurer's business. Acting consistent with insurance fundamentals, state regulators are the best positioned to ensure that the principles stated above are appropriately in place in their markets.

Reinsurance

Just as insurers help spread the risks facing policyholders, reinsurers assume risk from insurers. As climate-related risks increase and contribute to more losses, this has also fueled increasing rates for reinsurance coverage. Reinsurance rates are not regulated or reviewed as stringently as those for primary coverage, and unlike market consumers, insurers have little recourse in challenging rate increases. According to a July report from reinsurance brokerage Guy Carpenter, reinsurance rates rose between 10 percent and 50 percent globally during July 1 renewals and between 20 percent and 50 percent for property catastrophe coverage in the U.S.[19] Another broker, Gallagher Re, said U.S. reinsurance rates for policies that had claims for natural catastrophes rose 30-50 percent during July renewals, while in Florida the increase was 30-40 percent.[20]

These stark increases, which followed similar changes in renewals earlier this year, only underscore the growing risk from climate change and other global events that affect insurers, particularly in California where these increases are not allowed in the rate setting process. With issues surrounding reinsurance compounded by various other factors, insurance companies have made the difficult decision to exit risky markets such as California and Florida or limit their business within the states.

Looking Forward

In looking at the confluence of multiple factors contributing to the current state of insurance markets, it is not only climate change that has backed insurers and consumers into this corner. From a public policy standpoint, the property/casualty insurance industry has been focused on climate issues for decades on Capitol Hill, working to advance mitigation and resiliency policies to reduce the effects of climate risk, particularly following Hurricane Katrina in 2005. Equally as important will be efforts to foster and improve state insurance marketplaces and get legal system abuse under control.

One of the most important things that states can do to improve markets is maintain a fair and efficient regulatory environment that appreciates and recognizes the importance of evaluating risk when setting rates. Limiting, or in some cases prohibiting, data that insurance companies use to appropriately tailor policies to the consumer puts insurers' obligations to consumers and the ability to maintain proper solvency levels at risk. Additionally, ensuring the judicial system is transparent with an emphasis on just and balanced outcomes is vital to the continued growth of a healthy marketplace.

As the industry and policymakers contemplate solutions to these growing problems, state, local, and federal governments can help their constituents by promoting policies that improve the built environment and ensure the nation's most vulnerable communities have the tools they need to build more resilient structures and homes. Stronger, more resilient communities that work to mitigate the growing risks of severe weather will also help reduce economic losses. Going further, state and local government should consider a more cautious approach to land use and fully assess the impact of development in environmentally sensitive or high-risk areas on the community as a whole.

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[19] https://www.guycarp.com/company/news-and-events/news/press-releases/july-2023-renewals.html

[20] https://www.reuters.com/world/us/us-property-catastrophe-reinsurance-rates-rise-up-50-july-1-report-2023-07-03/#:~:text=U.S.%20reinsurance%20rates%20for%20policies,the%20risk%20of%20heavy%20losses.

Along the lines of matching risk to rate, one of the most basic and important steps is the adoption of statewide building codes in addition to providing the funding necessary to enforce them. The federal government can help with resources (like the Building Resilient Infrastructure and Communities Program) dedicated to pre-disaster mitigation funding for vulnerable communities. Through cutting-edge research by the Insurance Institute for Business & Home Safety, it has been shown that small tweaks to building codes, such as using roof straps or ring-shank nails, can be the difference between a home standing or being destroyed during a natural catastrophe. The broader financial impact is equally impressive, according to research by the National Institute of Building Sciences, adopting model building codes saves $13 in losses per $1 spent.[21] Better still, it's worth remembering that stronger buildings help save lives.

NAMIC has always been a thought leader in Washington and across the country advocating for policies increasing investments in mitigation to draw down disaster costs and losses. As a founding member of the BuildStrong Coalition, NAMIC has been instrumental and steadfast in its support for climate resiliency and improving the built environment. In 2018, after years of the insurance industry working to advance policies designed to better shield communities in the face of severe extreme weather, the Disaster Recovery Reform Act (DRRA) was signed into law. The DRRA is a historically significant disaster reform law that contains a host of policies designed to significantly boost the nation's pre-disaster funding mechanism, which included the creation of the BRIC Program.

NAMIC was pleased recently to see Fiscal Year 2022 BRIC selections totaling nearly $3B announced by the Federal Emergency Management Agency, which cover projects across a diverse geographic scope in all 10 FEMA Regions.[22] As FEMA Director Deanne Criswell stated, "it is also paramount to build resilience before disasters strike," and these efforts go a long way towards lessening the financial burden of recovery efforts. NAMIC also continues to press Congress to fund more mitigation projects to reduce risk and better protect America's communities from future extreme weather events, which is why we urge Congress to reintroduce the Resilient AMERICA Act, H.R. 5689 in the 117th Congress, as the next wave of transformational disaster and climate reform efforts. This significant legislation would boost funding for the BRIC Program and create new resources and incentives for states and communities to adopt and enforce modern constructions standards and building codes.

Conclusion

There is no industry more affected by changes in severe weather and climate or more sympathetic to the victims of the increasing natural disasters than the property/casualty insurance industry. America's insurers have paid and continue to pay billions of dollars every year to help policyholders recover from extreme weather events. While increased natural disasters continue to contribute to more insured losses, other factors such as increasing prices for materials and labor, higher reinsurance costs, legal system abuse, population shifts to riskier areas, and other inflationary pressures are crucial to consider when getting the full picture.

[21] https://www.nibs.org/files/pdfs/ms_v4_overview.pdf
[22] FEMA Announces Nearly $3 Billion in Funding Selections to Drive Resilience to Climate Change and Extreme Weather Events

Property/casualty insurers exist to protect policyholders consistent with an agreement to be the financial first responders for homes and businesses. The mutual model provides a proven structure built on a foundational principle of serving policyholders.

When the current pressures and challenges are ignored, and at times made worse by some regulators, an insurer may decide it needs to reassess its business approach, and in some instances that decision may be that it feels forced to withdraw, either entirely or from specific lines of business. When this perfect storm of convergent events occurs, markets become unhealthy and competition diminishes, which provides fewer choices for consumers. We have seen the most success when regulatory regimes instead partner with the insurance industry to encourage innovation and provide tools such as advanced models and products, especially in light of elevated risk in the marketplace. This allows the industry to find new and better ways to serve existing consumers and take on new ones.

Businesses, including insurers, are not designed to sell products for less than what it costs to provide them. Insurance markets thrive when they can manage risk through adequate rates. Generally, when more insurers can operate and succeed in a given area, all consumers benefit from increased competition. However, insurers should not be expected to subject existing policyholders to greater risks by adding new policies when rates are insufficient rates to cover losses. Doing so puts all policyholders at risk, by jeopardizing company solvency.

With increasing risk profiles, especially in certain markets, it is critically important for accurate price signals to be sent to consumers. Further, rates must match risk to avoid larger increases that can stress consumers' budgets. Each year, rates must be adjusted to account for *all these factors* and risk must be acknowledged by all market participants.