Consumer Federation of America

Testimony of Douglas Heller[1]
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before the
United States Senate Committee on Banking, Housing, and Urban Affairs
"Perspectives on Challenges in the Property Insurance Market and the Impact on Consumers"
September 7, 2023

Summary of Testimony

As residents of Florida, Georgia, the Carolinas, California, Hawaii, and Vermont attempt to put their lives and neighborhoods back together after major, and some quite unexpected,[3] disasters this summer, a broader concern about the ability of homeowners, renters, and other property owners to sufficiently protect their assets is rightly in the spotlight. We appreciate the opportunity to share the research and perspective of Consumer Federation of America (CFA) with this Committee.

The failures we see in property insurance markets today are a result of several reinforcing factors. First, insurers ignored climate risk for decades. When a few state insurance commissioners started development of a climate risk assessment and disclosure for insurers in the early 2000s the property-casualty insurers and trade associations opposed the effort and continued to oppose climate risk assessment and disclosure until just a few years ago. Instead of preparing for climate risk by working with policyholders, businesses, and communities with loss prevention partnerships, the insurers hollowed out policies with exclusions and higher deductibles, shifting risk onto consumers.

Highlighting newly released data from the National Association of Insurance Commissioners (NAIC), *The Washington Post* reported this week that several insurers,

> have told regulators that extreme weather patterns caused by climate change have led them to stop writing coverages in some regions, exclude protections from various weather events and raise monthly premiums and deductibles….[saying] they will cut out damage caused by hurricanes, wind and hail from policies underwriting property along coastlines and in wildfire country…[4]

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[2] Consumer Federation of America is a nonprofit, nonpartisan association of more than 250 national, state, and local non-profit consumer organizations that was founded in 1968 to advance the consumer interest through advocacy, research, and education.

[3] The Maui, Hawaii fire was the deadliest in state history; the Vermont flooding was among the worst (though not as severe as the 1927 flood); and California saw highly unusual tropical storm damage this summer.

[4] Bogage, J., September 3, 2023. Home insurers cut natural disasters from policies as climate risks grow. *The Washington Post.*

As a starting point of any discussion on this issue, we must acknowledge that insurance companies reducing their exposure to property losses in order to protect their profitability does not address, and only worsens, the threats posed by climate change to American homeowners, renters, and other property owners. For decades, insurance companies have taken consumers' premiums and provided critical protections, giving people the comfort in knowing that their long-term investment in a home and community was reasonable, at least from an insurability perspective. So, it makes no sense to homeowners, and should raise deep skepticism among regulators and policymakers, that insurers are suddenly leaving or dramatically increasing premiums so as to make quality coverage effectively unavailable for far many Americans who long relied upon and trusted those insurers, which accepted the risk and collected the premiums.

If we want to effectively address the challenge brewing at the intersection of climate change and insurability, it cannot happen simply by transferring the increasing climate risk back to American homeowners, renters, and small businesses. Consumers, insurers, and government need to be allied in the effort to prevent or minimize losses, strengthen the sources of protection against catastrophic risk for both consumers and insurers, and work together to make smart and equitable decisions about where and how we build and rebuild communities in light of the consequences of climate change.

As an overarching summary of our testimony, we highlight the following points:

- Severe rate hikes by insurers and sudden announcements to limit sales in communities that companies have served for decades wreak havoc on homeowners and other property owners in Florida, Louisiana, California, Colorado, Texas, and a growing list of other states.
- Two primary drivers of premium increases and regional availability crises are the interacting effects of climate change and the exploding cost of risk transfer in the unregulated, global reinsurance market. Additionally, the increasing use of drone imagery, scoring algorithms, and predictive models are giving insurers a magnified and, in some cases, exaggerated picture of existing and prospective customers' risk profiles.
- To address affordability and availability, we must focus on providing and incentivizing more investments in risk reduction and loss mitigation.
- To stabilize the insurance market, we need to incorporate mechanisms that supplement the unregulated reinsurance market, such as a public mega-catastrophe reinsurance facility, to offload some of the extreme climate-change driven risk.
- Arguments that the problems stem from consumer protection laws that provide regulatory oversight or legal accountability for bad actors in the insurance industry are a distraction from the fundamental forces creating the availability and affordability problems.
- Rather than shifting more of the risk burden to consumers through much higher deductibles and hollowed out coverage, policymakers should be encouraging the sales of more comprehensive all-risk policies that will provide more protection for homeowners, will more effectively spread risk, and will result in less reliance on post-disaster emergency aid.
- The problems in the insurance market must be considered in a larger framework that also includes public policy related to climate change, land use, building codes, and housing affordability and equity.

Detailed Testimony of Douglas Heller, Director of Insurance, Consumer Federation of America

Property insurance provides an essential service and financial protection to its policyholders. In its best form, insurance allows people to transfer much of their risk of loss to an entity supported by a pool of others who also pay a premium so that when a risk becomes a reality, whether in the form of a family's kitchen fire or a catastrophic storm, there are financial resources available to support the repair and rebuilding process. This best version of an insurance market also helps communities and property owners better understand risk and supports, through investment and incentives, strategies for minimizing and preventing losses. This risk intelligence and harm reduction aspect of insurance lowers the long-term costs of home ownership and enhances community and personal safety. In short, insurance can be a tool that improves financial security and stability, increases neighborhood resilience, and leads to safer homes and communities.

For several reasons, though, the nation's homeowners, renters, and other property owners, including small businesses, farm owners, and nonprofits, find themselves facing an insurance market that is not achieving those goals or meeting consumers' needs. Beyond the fact that insurance is a financial necessity for most homeowners, it is a mandatory purchase for the vast majority of Americans, because their mortgage lenders require significant coverage in order to receive and maintain the loan. Since home insurance is – much like state-mandated auto insurance coverage – akin to a utility that homeowners cannot live without, the homeowners insurance product, the companies that sell it, and the market for it need to be well-regulated and, as this committee is doing by conducting this hearing, subject to oversight and review to determine critical and systemic problems and identify opportunities for improvement and reform.

With this testimony, CFA presents an overview of the home insurance crisis facing millions of Americans and threatening even more. We also identify and discuss some of the key factors driving the crisis, and we present opportunities for addressing these challenges as well as point to aspects of the issue for which continued research and discussion among all stakeholders are needed.

Affordability and Availability of Quality Property Insurance – a Bedrock of Modern Homeownership – Is in Jeopardy (or Worse) for Millions of Americans

Insurance rate increases are unsustainable for homeowners, renters, and other property owners

We begin with an important piece of data: In 2022, Americans paid $125 billion for homeowners Insurance, according to the National Association of Insurance Commissioners (NAIC). That is 9.6% more than 2021 and 35%, or $32.6 billion, more than just five years prior.[5] After accounting for the estimated increase to the number of insured houses in 2022 compared with 2017, the increase in home insurance premiums rose about 40% faster than inflation as measured by the Consumer Price Index. It is no surprise, then, that the premium increases showing up in consumers' renewal notices are so alarming and earning so much public attention.

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[5] 2022 industry total direct premiums earned for Homeowners Multiple Peril Insurance Line 04. National Association of Insurance Commissioners, March 1, 2023. Property/Casualty Market Share. Retrieved from https://content.naic.org/sites/default/files/research-actuarial-property-casualty-market-share.pdf. 2021 and 2017 calendar year data from respective years' NAIC Market Share Reports for Property/Casualty Groups and Companies By State and Countrywide.

The rate increase data, however, can be misleading. NAIC data show that the average premium for homeowners insurance[6] in 2017 was $1,211.[7] While granular 2022 data are not yet available, it is reasonable to estimate that, after accounting for increases in the number of insured homes, the average premium for home insurance in 2022 was in the range of $1,500 to $1,550. However, both the average premium charged to policyholders and the average rate increase imposed on customers are not evenly distributed around the country or even within states and counties. As one might expect, the premium increases for homeowners in more catastrophe prone areas are substantially above the average rate hikes we are seeing. The $1,500 annual homeowners insurance premium, while itself a burden for many Americans, would be financially transformative to those facing premium quotes in the range of $500 or more *per month* in communities with either a history of, or new predictions for, climate related disasters.

It is worth noting, as a reminder that the problem of high insurance rates is not just a coastal problem, that the most expensive states for homeowners insurance are inland – often with severe tornado and hail risk. Oklahoma, Kansas, Nebraska, Colorado, Arkansas, and Kentucky are the states with average premiums above $2,000 per year for $250,000 in coverage, according to a June 2023 Bankrate.com study.[8] A different study published on Insurance.com reported substantially higher average premiums using a different methodology but found similar results for highest priced states, except that it included Texas, South Dakota, and Mississippi in the group of the very highest home insurance premiums nationwide.[9] *The Wall Street Journal* further reports that since January 2022, "Arizona, Texas, North Carolina, Oregon, Illinois and Utah had the biggest total of approved increases, ranging from 20% to 30%."[10]

Beyond the geographic, topographic, and climate factors driving increasingly untenable annual premium quotes around the country, it is important to note that, in most states, homeowners insurance premiums often vary substantially based on a customer's credit history.[11] Similar to the doubling of premium that low-credit, but safe, automobile drivers see in the United States,[12] homeowners are charged higher premiums when they have lower credit, even if they have never filed a claim. According to the insurance website ValuePenguin.com, using data from three major insurers in Texas, homeowners with fair credit scores (this equates to a 710-740 FICO score, according to the

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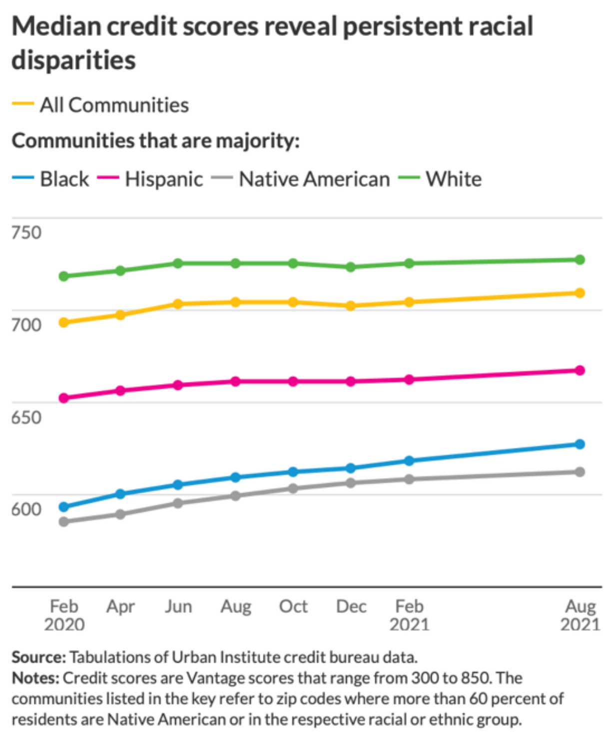
[6] These data reflect all types of home coverages, including dwelling, renters, condo, mobile homes, and owner-occupied.
[7] National Association of Insurance Commissioners, 2019. Dwelling Fire, Homeowners Owner-Occupied, and Homeowners Tenant and Condominium/Cooperative Unit Owner's Insurance Report: Data for 2017.
[8] Sham, June, June 29, 2023. Homeowners Insurance Rates by State for 2023. Bankrate. Retrieved from https://www.bankrate.com/insurance/homeowners-insurance/states/.
[9] Kasperowicz, Leslie, September 1, 2023. Average Homeowners Insurance Rates by State in 2023. Insurance.com. Retrived from https://www.insurance.com/home-and-renters-insurance/home-insurance-basics/average-homeowners-insurance-rates-by-state.
[10] Eaglesham, J., July 30, 2023. Home Insurers Are Charging More and Insuring Less. *The Wall Street Journal.* Retrieved from https://www.wsj.com/economy/housing/home-insurers-are-charging-more-and-insuring-less-9e948113.
[11] The use of credit for homeowners insurance underwriting and rating is prohibited in California, Maryland, and Massachusetts.
[12] Heller, D. & DeLong, M., July 31, 2023. The One Hundred Percent Penalty: How Auto Insurers' Use of Credit Information Increases Premiums for Safe Drivers and Perpetuates Racial Inequality. Consumer Federation of America, retrieved from https://consumerfed.org/reports/the-one-hundred-percent-penalty-how-auto-insurers-use-of-credit-information-increases-premiums-for-safe-drivers-and-perpetuates-racial-inequality/.

report) see a 46% increase on their premium over similar homeowners with excellent credit. For those with a FICO score in the low 600s, homeowners insurance premiums more than double.[13] This credit penalty amplifies the impact of the recent spate of rate hikes across the country.

While the use of credit to price homeowners insurance is itself worthy of further investigation – especially as insurers have no credit risk with their policyholders who will be canceled if they fail to make a payment – we highlight it here to point out that the homeowners insurance crisis is not spread evenly through our society. As Federal Reserve research has illustrated, “we find substantial overlap between the geography of subprime-scored households and racial segregation…[and] the creditworthiness of households is intertwined with economic adversity at the neighborhood level.”[14] In another report, Federal Reserve data show,

> Scores tended to be lower among LMI [low- and moderate-income] borrowers (those with incomes of less than 80 percent of area median family income) and those living in or moving into LMI neighborhoods (census tracts with median family income less than 80 percent of area median family income) or predominantly minority neighborhoods.[15]

Similarly, the Urban Institute shows the credit scoring disparities graphically,[16] and the implications are clear: Black, Latino, and Native American homeowners and renters will face higher insurance premiums irrespective of their claims or loss history because of the use of credit-based insurance scoring.



Notably, the intersection of credit scoring and insurance premiums is further amplified by the geography and demography of effects of climate change. Citing research on flood risk in particular, Carolyn Kousky and Karina French highlight, in *Inclusive Insurance for Climate Related Disasters*,

> “Research has found that some natural disaster risk — today and even more so in the future as the climate changes — is higher in neighborhoods with

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[13] Breiner, B., May 30, 2023. How Credit Scores Can Affect Home Insurance Premiums. Retrieved from https://www.valuepenguin.com/how-credit-scores-affect-homeowners-insurance-rates.

[14] George, T., Newberger, R., & O’Dell, M. (2019). The geography of subprime credit. Profitwise, (6), 1-11.

[15] Bhutta, N., & Canner, G. B. (2013). Mortgage market conditions and borrower outcomes: Evidence from the 2012 HMDA data and matched HMDA-credit record data. Federal Reserve Bulletin, 99(4). See, for example, Table 14.

[16] Urban Institute, February 25, 2021. Credit Health During the COVID-19 Pandemic. Retrieved from https://apps.urban.org/features/credit-health-during-pandemic/.

populations with lower average income, higher proportion of people of color, and/or formerly red-lined communities."[17]

Relatedly, The Federal Reserve Bank of New York has published research indicating that flood mapping itself has created unintended burdens on lower-income Americans. The report examines a problem in which "flood maps may have inadvertently clustered those households financially less able to bear the consequences of a disaster into areas that may still pose a significant flood risk."[18]

Putting the two elements together, it becomes clear that socioeconomic conditions that generate lower credit-scores for communities of color and tether those communities to neighborhoods more vulnerable to climate-related disasters—meaning the current insurance crisis is having an outsize impact on the most financially vulnerable Americans.

For those homeowners receiving renewal notices with 20, 30, and 40 percent premium increases, especially those with fixed- or low-incomes, the affordability problem becomes indistinguishable from the availability problem we discuss below. For families who struggled to pay a $200 per month premium, a sudden jump to $280 per month can be devastating. As the price hikes get more and more extreme, the likelihood increases that people either slash their coverage by taking on more of the risk themselves through lower quality coverages, decide to go without coverage (if they do not have a mortgage), or find that they can no longer afford to own their home. As we discuss below, these options have their own consequences and reflect a public policy weakness around property insurance markets.

The insurance availability crisis exposes a need for more industry oversight

The second aspect of the homeowners insurance crisis facing consumers, one that seems to have earned even more of the headlines than the price increases, is the refusal of insurers to write new business in certain states and the complete withdrawal from some markets. The speed with which insurers have pulled out of regions and states under the banner of climate risk is understandably confusing and distressing to insurance policyholders. For two decades, insurers and their trade associations resisted requirements for insurers to perform and report a climate risk disclosure. But quite abruptly, after ignoring the growing climate risk for years, insurers are telling us that they now understand the scale of the risk and have no option but to withdraw without warning from neighborhoods they have covered for decades. Whether the decisions to walk away from markets comes in the form of media-focused announcements or quiet reconfigurations of internal underwriting rules, the problem of suddenly curbed sales plays out the same for homeowners, renters, and other property owners who cannot get the coverage that is required by their lender and needed for their own security.

Florida and California markets have gotten the most attention for insurers' decisions, but residents of several other states, including Colorado, Georgia, and Louisiana, among others have also seen

[17] Kousky, C. and French, K., 2022. Inclusive Insurance for Climate-Related Disasters: A Roadmap for the United States. Boston: Ceres.
[18] Blickle, K. S., Engelman, K., Linnemann, T., & Santos, J. A. (2023). *Moving Out of a Flood Zone? That May Be Risky!* (No. 20230420b). Federal Reserve Bank of New York.

companies implement or attempt similar withdrawals or limitations on sales. In fact, a 2021 NAIC survey of homeowners found that,

> More than one-third of respondents in Pacific (36%; Alaska, California, Hawaii, Oregon and Washington), West South Central (34%; Arkansas, Louisiana, Oklahoma and Texas) and Middle Atlantic (33%; New Jersey, New York and Pennsylvania) states reported challenges in getting or renewing homeowners insurance because of natural disasters.[19]

As California is so often highlighted, an important correction to the insurance industry's claims are in order. Insurers and their regulation-averse partners often claim that companies are reducing sales in California due to regulations that prevent companies from getting the rate increases they need. The facts, however, tell a much different story than the industry wants the public to believe. According to publicly available data,[20] between 2021 and August 2023:

- California home insurance companies requested 109 rate increases;
- 71 insurance companies were approved to increase rates to precisely the level they requested;
- 20 were approved to increase rates, but at a lower level than originally requested;
- 18 companies withdrew their rate hike requests; and
- On average, insurers requested rate hikes of 13.2% and received increases of 12.5%, excluding the withdrawn filings, meaning that insurers received 95% of the increases they sought.

Those increases were a boon to California insurers. Even though insurers are making the insurance market terribly difficult for many Californians, the state's homeowners have provided insurers with a market that has been significantly more profitable than the nation as a whole over the last three years for which data are available, according to National Association of Insurance Commissioners data.[21] The pullback from California appears to be an act of political bullying in an effort to gain traction for the industry's deregulatory agenda – see the reinsurance pass-through discussion below, for example. While the target of this bullying may be regulators and policymakers, the victims are California homeowners who, like so many Americans living in increasingly exposed communities, are encountering an insurance market that is failing them.

In Florida, the other target of much attention, the declining availability of coverage has been more extreme. Floridians are facing complete withdrawals of brand name insurers such as Farmers (affecting a reported 100,000 policyholders[22]) and AAA, and an estimated 15 insurers have stopped writing new policies over the past 18 months, according to the Insurance Information Institute, as

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[19] Groshong, L., Gerson, T., Czajkowski, J., & Zhang, J., July 2021. Extreme Weather and Property Insurance: Consumer Views. NAIC. Retrieved from https://content.naic.org/sites/default/files/CIPR%20Consumer%20property%20ins%20report%208-21_0.pdf.

[20] Rate Filing Approvals. California Department of Insurance. Retrieved from https://www.insurance.ca.gov/0250-insurers/0800-rate-filings/0100-rate-filing-lists/rate-filing-approvals/index.cfm.

[21] Report on Profitability by Line by State in 2023. January 2023. NAIC. Retrived from https://content.naic.org/sites/default/files/publication-pbl-pb-profitability-line-state.pdf.

[22] Valinsky, Jordan, July 12, 2023. Farmers Insurance Pulls Out of Florida, Affecting 100,000 Policyholders. CNN. Retrieved from https://www.cnn.com/2023/07/12/business/farmers-insurance-florida/index.html.

reported by *The Washington Post*.[23] Additionally, the same reporting highlights, seven Florida insurers have become insolvent in that period. In Louisiana, another oft-noted market in freefall, 11 have become insolvent while 50 insurers have ceased offering policies in some parishes, according to the *Post*'s reporting.

When their voluntary market options shrink, consumers are often left with unsustainable alternatives. For some, shopping around may provide a standard market path to coverage, but shopping has not produced robust choices in the hardest hit regional markets. Too often, over the past year, we hear from homeowners and homebuyers seeing their private market options shrink to zero. Then, consumers face lower-quality, higher priced choices, or no choice at all.

<u>The residual market: insurers of last resort</u>

The most common option for those shut out of the voluntary insurance market[24] is the residual market, or insurer of last resort. These generally come in two forms: 1) the more common FAIR plans that are managed and backed by the insurers selling voluntary policies in a state and 2) the state-managed Citizens Insurance companies in Florida and Louisiana. About two-thirds of the states use one of these mechanisms for last-resort options, with Colorado creating a FAIR plan for its stressed homeowners market just this year. Even though these last-resort options tend to be very expensive, the policies generally provide more restricted coverage than many people need from their homeowners insurance. The policies typically do not cover theft, liability, or water damage, and they often cap the amount of coverage available for both rebuilding and for personal property. This means that, in addition to the weight of the high-cost FAIR plan or Citizens policies that homeowners must buy, consumers also need to shoulder the cost of a Difference in Conditions, or wraparound, policy to fill the gaps.

Nationally, about 2.2 million homes are covered by these insurers of last resort, with more than half of those homes covered by Florida's Citizens. There are an additional half million windstorm policies sold through the residual markets for people who cannot get hurricane coverage in the private market. All told, Americans spent over $6 billion purchasing home and windstorm insurance through the state residual markets in 2022.[25] The number of homes covered by the residual market mechanisms has surged by 67% since 2019, and it appears poised to grow more. In Louisiana, Citizens issued 154,507 policies in 2022 compared to 47,093 in 2021.[26] In Florida, despite legislative policies promised to reduce the number of Floridians forced to rely on the state's Citizens Property Insurance Corporation, the state-backed insurer's 2023 operating budget predicts that by the end of this year it

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[23] McDaniel, Justine, July 12, 2023. Citing Climate Change Risks, Farmers is Latest Insurer to Exit Florida. Washington Post. Retrieved from https://www.washingtonpost.com/climate-environment/2023/07/12/farmers-insurance-leaves-florida/.
[24] The "voluntary" market is the traditional private sector market for insurance where most people buy their coverage.
[25] A Firm Foundation: How Insurance Supports the Economy. Insurance Information Institute. Retrieved from https://www.iii.org/publications/a-firm-foundation-how-insurance-supports-the-economy/a-50-state-commitment/residual-markets.
[26] "Annual Statement for the Year 2022 of the Louisiana Citizens Property Insurance Corporation." Available at https://www.lacitizens.com/docs/default-source/financial-reports-and-statements/2022-management-discussion-and-analysis.pdf?sfvrsn=1676ee03_2#:~:text=Major%20events%20occurring%20in%202022%20for%20LCPIC%20were%3A&text=The%20number%20of%20policies%20issued,over%20the%20past%20two%20years.

will be serving an additional half million residents, with 1.7 million policyholders who turn to it because the private market has failed to provide an option.

Troubling as it is that so many Americans are forced into these last-resort programs, efforts to "depopulate" the residual market programs around the country create additional and unnecessary burdens on homeowners. In Florida, homeowners are not eligible if there is a policy available to them that is up to 20% more expensive than that state's Citizens company would charge. In Louisiana, state law requires that the Citizens premium be set either 10% more expensive than the costliest premium in the local market or 10% higher than its own actuarial indication, whichever is costlier. (That state is now offering payment of more than $50 million from taxpayers to insurers as part of their depopulation effort, but there are serious concerns that the money is flowing to financially unstable insurers that may not be able to survive a disaster even with their government subsidy.[27]) The idea behind both states' Citizens pricing rules is to prevent the last-resort insurer from competing with the private, voluntary market. In California, the same insurers forcing more customers into the FAIR plan by restricting their owns sales tried to block, through litigation, the Insurance Commissioner's orders to improve the quality of coverage in the FAIR Plan.

It is bad enough for consumers that private insurers will not offer the critically important homeowners insurance people need, but it makes no sense for the same carriers to litigate and lobby to make the last resort policies poorer quality than is needed and more expensive than is actuarially required. Put differently, if private insurers do not want to provide coverage in some communities, the policy response should focus on ensuring availability of quality and affordable options and not be spent worrying about the insurer-of-last resort being too competitive with the uninterested insurers.

Surplus lines insurance

Another market to which some homeowners turn when the voluntary homeowners insurance market fails to provide coverage is the non-admitted, or surplus lines, market. These policies do not face the same regulatory oversight that the much more common "admitted" home insurance companies receive and, importantly, they are not participants in state guarantee funds that serve as a claims-paying backstop if an insurer becomes insolvent. CFA is very concerned that, with the tightening of the home insurance market, more homeowners are being placed with surplus lines carriers without understanding the risk that there will be no financial protection if their insurer becomes insolvent and they have outstanding, unpaid claims for their home.

Force-placed insurance

Finally, some consumers who can no longer afford the premium hikes confronting them and cannot identify an affordable option find themselves canceling coverage. If they own their home outright, they now also own all the risk of loss, whether from a catastrophic storm or a burst pipe. For those with a mortgage, their lender will cover the home with a force-placed, sometimes called lender-placed, insurance policy, with the expensive premium added to their monthly mortgage payment.

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[27] Finch II, M., March 20, 2023. Why Louisiana keeps turning to low-rated insurers to reduce Citizens' policy load. *NOLA.com*. Retrieved from https://www.nola.com/news/why-louisiana-keeps-turning-to-low-rated-insurers-to-reduce-citizens-policy-load/article_dc7524fc-c523-11ed-a2ea-7b75224b7a76.amp.html

Often, these force-placed policies only pay claims to the lender – even though the premium is charged to the homeowner – so the consumer who couldn't afford their own insurance is now stuck paying for a high-priced policy that provides them no benefit whatsoever.

Nonprofit organizations also face a property insurance availability crisis

Related to the withdrawals confronting Americans seeking to insure their homes, we briefly want to highlight the crisis facing many nonprofit organizations. These community serving groups rely on the commercial property insurance market for their coverage, but, for several years, there has been a diminishing number of carriers willing to sell insurance to nonprofits. Many nonprofits turn to a special insurance alternative known as Risk Retention Groups (RRGs) for their liability coverage, a mechanism created by federal legislation in response to the liability insurance crisis of the 1970s and 1980s. However, RRGs are currently prohibited from underwriting property insurance coverage. As nonprofits find themselves unable to obtain property insurance within the traditional commercial insurance market, we would urge an expansion of the risk retention law, as contemplated in the Nonprofit Property Protection Act, to allow the sale of property insurance to these organizations. CFA raised alarms about this problem and testified in support of this proposal in 2020, and, as the problem only gets worse in light of climate risk, we recognize and appreciate Chairman Brown's attention to this aspect of the issue.

The hollowing out of homeowners insurance policies brings the crisis to those who still have voluntary market options

Before we move to discussing productive strategies for tackling the problem of climate risk for insurance markets, we need to recognize the unfairness and disutility of the current approach to this problem that many insurance companies are implementing around the country. This third element of the homeowners insurance crisis has received less attention than affordability and availability, but has broad impacts. Specifically, the insurance industry is reducing *its exposure* to climate-related risk by providing less coverage in their policies, rather than focusing on working with consumers and communities to reduce the actual risk and danger of disasters. A.M. Best's News & Research Service's recent reporting on Hanover Insurance's strategy provides a good example:

> Hanover Insurance Group Inc. is increasing and adding deductibles for perils and moving to actual cash values on homeowners' roofs, while raising rates by strong double digits, President and Chief Executive Officer John "Jack" Roche said recently. Product changes will have a significant impact on reducing Hanover's future catastrophe vulnerability, he predicted.[28]

Even when insurers continue to sell coverage, they are slashing the value of the protection, hollowing it out, and increasing the deductibles homeowners face such that consumers are forced to retain more and more of the catastrophic risk associated with owning a home. It means that even for homeowners who can meet their lenders' requirements for coverage, their insurance policies are not meeting what the family relies on to protect their most valuable asset.

[28] Kiriluk-Hill, R. August 21, 2023. Observers: Manufacturing Changes Can Improve Cat Losses for Insurers Stressed by Greater Storm Frequency. Bestwire.

As our colleagues at United Policyholders explain,

> A glaring example is the trend of policy language that limits payouts for roof damage to the depreciated (Actual Cash) value of the roof at the time of the loss – and doesn't pay to fix the roof. The practical impact of this trend is that people of moderate to modest means can't properly fix their roofs when they're damaged in a tornado, hurricane, hailstorm or storm.[29]

One area in which we have seen a particular weakening of coverage is for those policies covering manufactured and mobile homes. Most are now Actual Cash Value policies and those that still provide replacement coverage have rules that tend to limit the recovery to less than what is needed. To receive the full benefit, policies may require policyholders to "replace" in the current location, limiting their recovery if the park in which they resided does not reopen. Often, the HVAC systems are subject to contents coverage limits rather than the larger dwelling coverage limits, and foundations may not be covered by the insurer at all. In short, those living in mobile home communities are finding themselves bearing much more of the risk despite the fact that, as *Consumer Reports* recently reported, the policies can be twice as expensive as traditional homeowners insurance policies.[30]

The insurance industry is also relying more on scoring algorithms, predictive models, and drone imaging of properties to reduce their exposure. These models and scores, which can cut people off from access to coverage, are not receiving the necessary regulatory scrutiny. Nor are there protections when insurers make underwriting and pricing decisions based on drone flyovers that may lead to misunderstood characteristics and incorrect assumptions about risk. It is difficult for homeowners to get redress when these techniques overestimate their risk level or they are not given the information or opportunities to address hazards that lower their score, and the result is higher premiums, more non-renewals, and refusals to sell coverage.

Another tack taken by the insurance industry to diminish its exposure to disaster claims has been to focus on limiting consumer rights to hold insurers accountable when they deny, delay, or underpay claims. Indeed, in Florida, just as reports were surfacing that many Hurricane Ian survivors were being defrauded by their home insurers, as the Washington Post later reported in grim detail,[31] the Legislature and Governor adopted legislation to diminish the legal rights of mistreated policyholders. It was as though the ability of defrauded customers to demand justice from rogue insurers was having more of an impact than the billions of dollars of actual damage done when the Category 5 Hurricane Ian slammed into Florida, leaving 150 people dead, and tearing a swath of destruction across the state. Again, consumers are stuck with less protection, but the risk remains.

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[29] Bach Talk. May 13, 2020. It's Time to Restore Insurance Safety Nets. United Policyholders. Retrieved from https://uphelp.org/bach-talk-its-time-to-restore-insurance-safety-nets/.

[30] Gill, L., August 18, 2023. How to Save on Insurance for a Manufactured Home. *Consumer Reports*. Retrieved from https://www.consumerreports.org/money/homeowners-insurance/how-to-save-on-insurance-for-a-manufactured-home-a7960045232/

[31] Sacks, B., March 11, 2023. Insurers Slashed Hurricane Ian Payouts Far Below Damage Estimates, Documents and Insiders Reveal. *Washington Post*. Retrieved from https://www.washingtonpost.com/climate-environment/2023/03/11/florida-insurance-claims-hurricane-ian.

This second tack to addressing the growing risk of disasters suggests a head-in-the-sand attitude about the realities of climate change. As our colleague, Birny Birnbaum of the Center for Economic Justice noted,

> If you're not going to accept climate change as a reality, then you're left with making up false villains, like litigation, as the driver of higher rates… [Florida's recent tort overhaul is] not going to do anything to reduce insurance premiums because it's not doing anything to reduce claim costs.[32]

The other approach by the industry – slashing coverage to reduce its own exposure – acknowledges climate change but only serves to reduce the amount that companies pay out without helping protect homeowners, renters, and other property owners who end up bearing that uncovered risk. Both tactics are misaligned with the real need Americans have for securing their homes and protecting their communities.

Safe housing is essential to individual, family, and community well-being. The increasing lack of affordable or quality home insurance and diminishing marketplace options are adding another layer of complications to the manifold housing problems Americans face. Driven by climate change and, as we discuss below, problems with the industry's structure and incentives, this home insurance crisis has cascading effects across the American economy. In order to address it, it is important to identify the causes and develop solutions that do more than just shift risk back to homeowners and taxpayers.

Drivers of the Crisis: Climate Change Increases Risk and Unregulated Reinsurance Costs Skyrocket

First, and foremost, we must invest in reducing climate-related risk

The problems facing homeowners, renters, and other property owners result from a confluence of several different problems. We must, however, begin with the indisputable fact that the cost of insuring property is rising because climate change is driving an increase in the risk of loss. Swiss Re, the world's second largest reinsurer, provided data and commentary to this effect in an August 2023 news release:[33]

> In the US, a series of severe thunderstorms prompted insured losses of USD 34 billion in the first half of 2023, the highest ever insured losses in a six-month period….
>
> The effects of climate change are evident in increasingly extreme weather events. Jérôme Jean Haegeli, Swiss Re's Group Chief Economist, said: "The effects of climate change can already be seen in certain perils like heatwaves, droughts, floods and extreme precipitation. Besides the impact of climate change, land use planning in more exposed coastal and riverine areas, and urban sprawl into the wilderness, generate a hard-to- revert combination of high value

[32] Vesoulis, A., August 23, 2023. Insurers Gave Ron DeSantis Millions. He Made It Harder to Sue Them. *Mother Jones*. Retrieved from https://www.motherjones.com/politics/2023/08/florida-home-insurance-crisis-desantis/.

[33] Severe Thunderstorms Account for Up to 70% of All Insured Natural Catastrophe Losses In First Half of 2023, Swiss Re Institute Estimates. August 9th, 2023. Swiss Re. Retrieved from 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.

exposure in higher risk environments. Protective measures need to be taken for insurance products to remain economical for such properties at high risk. It is high time to invest in more climate adaption."

As noted earlier, the discussions concerning this issue have too often focused on the insurance challenges in California and Florida. Real as the challenges are in both those states, this crisis must be recognized as a national threat; the growing risk is far more expansive than those two markets. In its news release, Swiss Re noted that Texas was the state most affected by the costly 2023 thunderstorms, and the Texas Department of Insurance reported that it anticipates the final insurance costs from the state's severe winter snowstorm event in February 2021 would reach $11.2 billion.[34] That is just one state example; the insurance implications of climate change are widespread. Other recent evidence of the breadth of the problem include:

- the Maui fire, a tragedy of unimaginable scale;
- a violent and historic flood that shocked Vermont earlier this summer;
- a Virginia Beach tornado that damaged more than 100 homes this past spring[35] just weeks after a spate of nine EF3 tornadoes cut a path of damage from Arkansas to Delaware as climate change shifts or expands Tornado Alley eastward;[36]
- derechos that raced through Iowa, South Dakota, Nebraska, Illinois, and Minnesota have been linked to climate change[37] causing expensive damage that has left despairing home and farm owners fighting to get their claims paid;[38] and
- the Colorado legislature's creation of a FAIR plan in that state as growing wildfire risk (and the after-effects of a catastrophic wildfire in 2021) has made coverage unavailable to many residents.

The increasingly widespread risk of disaster exacerbated by climate change must inform the thinking and policy orientation of any approach to addressing the insurance market. Insurers have long used stochastic methods – recognizing the randomness of catastrophic events – to help build into their underwriting and pricing the risk of occasional disasters. But as climate change increases the frequency and intensity of those disasters, even as the randomness remains, it is clear that the risk question is shifting from finding the right pricing for these events to whether or not private markets can even insure for climate-related disasters if nothing is done to limit the growth of risk.

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[34] Insured Losses Resulting from the February 2021 Texas Winter Weather Event; Catastrophe Statistical Plan Data as of March 31, 2022. Retrieved from https://www.tdi.texas.gov/reports/documents/feb2021-tx-winter-weather-summary-mar2022.pdf.

[35] https://www.13newsnow.com/article/news/local/mycity/virginia-beach/months-after-virginia-beach-tornado-demolition-crews-tear-down-most-severely-damaged-homes/291-d9f4fc98-8994-4c6b-8a7f-7ff52f9314d4

[36] Jacopo, J. April 4, 2023 Is Tornado Alley shifting due to climate change? Scientists explain how warming climate affects tornado activity. *ABC News*. Retrieved from https://abcnews.go.com/US/tornado-alley-shifting-due-climate-change-scientists-explain/story?id=98347077. See also, Nouri, N., & Devineni, N. (2022). Examining the changes in the spatial manifestation and the rate of arrival of large tornado outbreaks. *Environmental Research Communications*, *4*(2), 021001.

[37] Smith, G., July 7, 2022. July 5 derecho intensity linked to climate change. Retrieved from https://iowaenvironmentalfocus.org/2022/07/07/july-5-derecho-intensity-linked-to-climate-change/

[38] Fry, E., August 9, 2021. 'Almost everyone is getting screwed': After climate disasters, homeowners find their battle with insurers is just beginning. *Fortune*. Retrieved from https://fortune.com/2021/08/09/climate-change-natural-disasters-storms-wildfires-floods-home-insurance-claims-iowa-derecho/

Limiting the growth in risk, then, should be a top priority.

Strategies for addressing the impact of increasing catastrophic risk that benefit all stakeholders in the market require a cooperative effort among insurers, consumers, and government. This will take several forms, which we present here as bullet points that we hope inspire further discussion and action:

- Government should provide increased funding for community level mitigation grants (such as the Building Resilient Infrastructure and Communities, or BRIC, grants offered by FEMA) and direct investment in pre-disaster prevention efforts (such as California's dramatically expanded wildfire prevention budget)
- States should expand the individual grant programs (such as Alabama's FORTIFIED program and South Carolina's Safe Home Program) that are helping homeowners upgrade their roof and make other home hardening improvements.
- To make them financially viable for consumers, mitigation grants should be made exempt from federal and state tax, as has been proposed this year by Senator Feinstein (S. 1953) and Representative LaMalfa (H.R. 4070).
- Insurers should be incentivizing safer homes by agreeing to underwrite and provide premium discounts for communities and individual consumers who take steps to protect their homes. In California, new rules require discounts when homeowners invest in wildfire defenses and risk reduction, and Nevada regulators have promised an expedited review for insurers when they submit filings to simply add discounts to for homeowners who take mitigation measures.
- Insurers should be required to conduct rigorous climate risk analysis and be given a timeline to stop insuring and investing in the oil and gas firms fueling climate change. It is unfair to consumers when companies seek profits from investments that hasten climate change while they demand rate hikes to pass along the costs of climate change to their policyholders. On the other hand, insurer investments that reduce climate change's impact or strengthen vulnerable communities' resilience in the wake of climate disasters should be encouraged.
- Standard insurance policies should be crafted to allow policyholders to rebuild to fortified building standards or replace their home by moving to a safer location without losing access to the full benefits of coverage; and
- Communities and property owners must also be investing in the effort to harden and protect properties from the increasing risks, which, as described above, should be supported through public programs and rewarded with insurance discounts.

Addressing the problems gathering where growing catastrophic risk and the insurance market meet also require another, broader level of public policy discussion. Namely, land use, property development, and housing policy decisions need to reflect the realities of climate change and be joined with this discussion. Otherwise, as insurance expert and reformer Harvey Rosenfield notes, we will continue to "allow[] insurance companies to make land use policy through rates."[39]

[39] Rosenfield, H., September 5, 2023. Opinion: How home insurers are trying to bully California politicians into a disastrous bailout. *Los Angeles Times*. Retrieved from https://www.latimes.com/opinion/story/2023-09-05/home-property-insurance-bailout-legislature-gavin-newsom-wildfires-california

One element of this broader discussion, for example, will be the fact that high risk communities are often the only ones that are affordable to low- and moderate-income Americans who have either been priced out of less risky geographic locations or have, as a result of historic discrimination, been forced to live in the most vulnerable parts of cities and regions. Another point of consideration will be the distinction that could be made between property owners and renters who have been living in regions now deemed more vulnerable to climate change and those who are "coming to the risk" by buying or building homes in those regions despite current knowledge of the increased risk to the regions. All of this is to say that the discussion cannot stop with insurance alone; reducing our collective exposure to the increased risks wrought by climate change involve several aspects of public policy that deserve focus alongside, and in conjunction with, efforts to improve the state of the nation's property insurance markets.

We conclude this part of our testimony with a hopeful note from testimony by the California Building Industry Association's Dan Dunmoyer (himself the former head of the Personal Insurance Federation of California), who recently told California lawmakers:

> We are the only building industry association in America that has supported the most strict fire hardening standards of any building industry in the US. Since 2010 - here's a positive note on today's hearing - since 2010, since we've been using the newest codes, not a single one of our master planned communities with regular mitigation have burnt.[40]

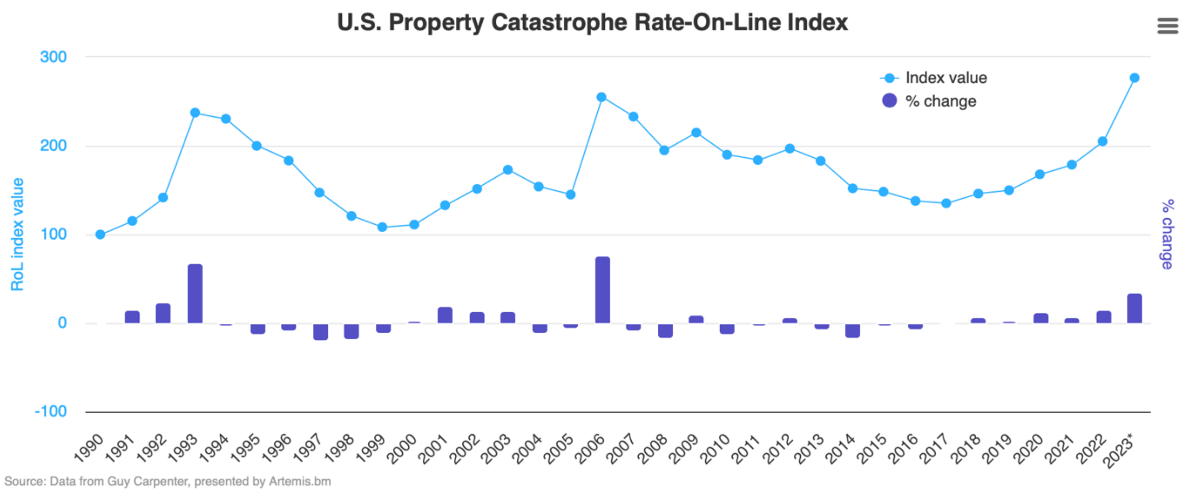
The unregulated, global reinsurance market is a central player in the crisis

Just as homeowners purchase insurance to offload their personal risk of loss, the insurers that take it on for a premium pass some of their policyholders' risk on to reinsurance companies. This reinsurance serves as a hedge against the catastrophic losses that can accrue to insurers when disaster strikes and they cover homes in the affected communities. Unlike the "direct" insurance companies that sell property insurance to homeowners and others, which is regulated in various degrees by state law, reinsurance provided to those direct insurers is sold in an unregulated global market. Reinsurance undoubtedly enhances the ability of insurance companies to provide coverage, but reliance on the private reinsurance market can lead to a systemic affordability and availability crisis, as we are currently seeing.

According to the most recent data from Marsh McLennan subsidiary Guy Carpenter's Rate-On-Line Index, the cost of property catastrophe reinsurance is about double the rate seen in 2017. The index indicates that reinsurance rates jumped 35% from January 2023 to July 2023 alone, such that insurers are confronting not only the sharpest reinsurance rate increases since 2006 – the year after Hurricanes Katrina, Rita, and Wilma devastated Florida and the Gulf Coast – they are now paying the highest rates for reinsurance since Guy Carpenter began its index in 1990, as shown in the Guy Carpenter U.S. Property Catastrophe Rate-On-Line Index graph below.[41]

[40] At 3:07:30 during hearing of Joint Hearing Insurance and Emergency Management Committee, Wednesday, June 14, 2023. Retrieved from https://www.assembly.ca.gov/media/joint-hearing-insurance-and-emergency-management-committee-20230614.

[41] As reported and presented by Artemis, retrieved from https://www.artemis.bm/us-property-cat-rate-on-line-index/.



Not only has the cost of reinsurance skyrocketed for insurance companies, the capacity of the reinsurance market to back policies with severe disaster exposure has tightened up. Notably, reinsurance companies have been more proactive than direct insurers with respect to investigating, analyzing, and incorporating climate risk into their decision making. As the companies are unregulated and global in nature, being forward thinking about the realities of climate change and its risk has helped those firms protect their capital – especially with high interest rates offering better and lower risk returns on that capital – but that awareness has not generally created downstream benefits to American neighborhoods and property owners. Instead, reinsurers' deep understanding of climate risk has helped to push many state insurance markets into an affordability and availability crisis.

While the escalating effects of climate change are a root cause of this dynamic, an example of the burden created by the failure of the reinsurance market to meet the needs of the American insurance market is found in an insurance line not usually considered to have an exposure to climate risk: earthquake insurance. In public presentations by the California Earthquake Authority (CEA), the CEA's Chief Executive Officer Glenn Pomeroy has shown that the Authority's reinsurance expenditures have increased by about 42.7% over the past five years even though its claims paying capacity has only increased by about 10.9% and its policy count is virtually unchanged. As of April 2023, more than 55 cents of every homeowners' earthquake premium dollar was spent on the various reinsurance contracts the CEA uses. Moreover, in testimony before the CEA's public governing body in January, Mr. Pomeroy highlighted "a decline in the amount of risk transfer [reinsurance] available to the CEA" and explained that it may not be able to meet its claims paying capacity target as a result, and the board has authorized a drastic cut to some of the coverages available to Californians. Earthquakes are not directly impacted by climate change, but the cost and availability of insurance needed to cover earthquake damage has been dramatically impacted by climate risk due to the CEA's reliance on the private reinsurance market.

In public policy discussions about the impact of high reinsurance rates around the country, we have seen the insurance industry attempt to twist the problem into an argument for weakening California's reinsurance-related and other consumer protections for homeowners and renters. Under California law, home insurers are generally allowed to hedge their insurance risk by purchasing as much private reinsurance as they determine to be appropriate, which is no different than other state markets.

However, in California, the insurers cannot pass the excess cost of that reinsurance on to their policyholders. They can use the premium they normally collect from customers to pay the premium charged by reinsurers (and because reinsurance reduces their exposure, the insurance companies do not need all the premium they originally collected), but when the unregulated reinsurance costs explode beyond the justified rates for insurance, insurance companies are not allowed to keep on raising rates on Californians to chase the high cost of global reinsurance.

Other states with climate-related catastrophic exposure, such as Florida, Louisiana, and Colorado, allow insurers to pass through these unregulated reinsurance costs, and that has only led to impossibly high consumer premiums *in addition to* major coverage reductions, underwriting tightening, and market withdrawals. The protections provided under California's voter-approved Proposition 103 that are targeted by insurers do not exist in other states and unprotected policyholders are worse for it. Florida's weak rate regulation and reinsurance pass-through, for example, has pushed homeowners' insurance premiums two to three times higher than they are in California, and Citizens covers 17% of the Florida market, compared to 3% for the California FAIR Plan, so there is no reason to claim that Florida's pass through of exorbitant reinsurance premiums to policyholders has made for a healthier market or better consumer outcomes. California homeowners, having been protected from the ravages of the reinsurance market, are, to be sure, facing some similar challenges plaguing other state markets. But giving insurers the ability to pass along exorbitant reinsurance costs has not led to market stability, which illustrates why the industry's goal of forcing individual homeowners to bear the burden of the volatile reinsurance market is no solution at all.

The fundamental problem regarding reinsurance lies with the fact that the global reinsurance companies, in an era of growing climate risk, do not provide a sufficient and reliable backstop for the American homeowners insurance market. Shifting the burden of that market from direct insurance companies (which, at the very least, have the scale and sophistication to negotiate with reinsurers if they know they need to try and control costs) to individual American homeowners who are desperate for coverage and cannot negotiate with insurance companies, let alone the reinsurers, is irresponsible. The focus should be on providing a more reliable backstop for the nation's insurance market.

Supplementing the private reinsurance market with a public reinsurance facility could help stabilize regional insurance markets and expand insurance coverage across the country

A meaningful public-private partnership is needed to address the serious market failures in property insurance markets. Such a partnership – as we see in many other developed countries – would provide some government support in exchange for insurers offering a meaningful product. The way forward is for the federal government to provide a mega-catastrophe reinsurance backstop in exchange for insurers offering, and states requiring insurers to offer, a meaningful insurance product – one that covers all the major perils without gaping holes. By capping insurers liability, the federal reinsurance program would provide the needed certainty of risk exposure to insurers.

After the September 11, 2011 terrorism attacks on the United States, it became clear, as reinsurance companies withdrew or reduced their terrorism backstop for the property insurance market, that the nature and threat of terrorism was too difficult to insure through the private commercial insurance and reinsurance markets alone. Congress enacted the Terrorism Risk Insurance Act (TRIA), in which the United States provided significant levels of reinsurance coverage to insurance companies in exchange for the companies keeping terrorism coverage in their policies. This was a necessary, taxpayer-backed response to a looming insurance availability crisis for American businesses and other property owners.

Climate change is causing a similar insurability crisis, primarily felt by American homeowners, as property reinsurance premiums skyrocket and becomes less available. A TRIA-like solution should be developed as a key component for taking on this challenge. We would advocate for some changes to the structure of TRIA – specifically we believe property insurers should be required to pay some reasonable premium for the backing to protect taxpayers from carrying all of the burden – but the analogy is appropriate and the benefits could have an even wider impact on Americans.

We will not use this testimony to detail the shape such a program might take, but we offer a few overarching points to highlight what a well-constructed federal backstop for the American home insurance market could provide.

- A relatively low-cost reinsurance backing for qualifying insurance companies will allow insurers to have confidence in, and sustainable limits to, their exposure to catastrophic risk.
- Similar to TRIA's requirement to offer coverage, a condition for accessing the public reinsurance facility would be to sell meaningful, quality coverage to residents even in higher risk, but historically insured, communities.
- By serving the entire country, the public reinsurance pool would have a diversified book of exposures that makes it more sustainable and less expensive.
- A public reinsurer could require insurers to offer All-Risk policies – including windstorm, flood, and earthquake – which would dramatically increase the number of Americans with flood and earthquake protection and reduce reliance on the various residual markets and government insurers of those risks.[42]
- By increasing the availability and quality of insurance coverage across the country – especially where disasters are uninsured or underinsured – fewer taxpayer resources will be needed for FEMA-funded post-disaster recovery.

A public reinsurance backstop does not need to entirely replace the reinsurance market to provide essential relief to the United States homeowners insurance market. But it is clear that private reinsurance contracts cannot alone support the risk transfer needs required to support fully functioning home insurance markets. When American businesses were suddenly facing the loss of the property insurance protection they needed because of a newly understood threat of terrorism, the federal government stepped in to stabilize the market and, in 2019, the Senate voted 71-23 to continue this important public backstop for the commercial property insurance market. Homeowners and renters across the country should be offered the same assurances and backing as the nation confronts the emergence of an even larger threat.

[42] In a December 15, 2022 presentation to the National Association of Insurance Commissioners "C" Committee, the Center for Economic Justice's Birny Birnbaum proposed a similar idea focused on flood insurance: "Transform the NFIP from a direct provider of flood insurance to a TRIA-like reinsurer for mega-flooding events with state-specific attachment points."

Conclusion

Escalating premiums and reduced availability in American homeowners insurance markets are causing significant disruption and hardship in the lives of millions of homeowners and tenants who rely on insurance coverage as an essential (and often mandatory) tool of financial security. The central problem that we cannot ignore is that the risk of property loss is escalating as climate change endangers a wider swath of the country with each passing year. As a second, but unavoidable, concern, the reinsurance protection that provides an important backstop to the insurers selling property coverage has become too expensive to reasonably meet the needs of the home insurance market generally and climate-vulnerable regions in particular.

By focusing their strategy on eliminating their own exposure to climate change rather than on addressing the actual risks themselves, insurers have left American consumers in the bind that calls us to this hearing today. Effectively addressing these intersecting problems demands a holistic approach to climate risk and property insurability. That perspective requires public policy makers and regulators to focus on a range of strategies that will reduce the risks posed by climate change, strengthen communities, and use innovative public-private partnerships to create a sustainable insurance market that will yield affordable and quality property insurance coverage to Americans as we confront climate change together.