The Sky is Falling: Climate-Related Impacts on the Property Insurance Market

By Seth D. Lamden (SL), *BlankRome*

The increasing frequency, severity, and unpredictability of extreme weather events continues to present challenges to insurers, reinsurers, policyholders, and regulators. While climate change may lead to increased premium revenue due to higher demand for property insurance, the number and size of claims promises to outstrip the increased revenue. Policyholders in some high-risk areas are already struggling to find property insurance. Allstate and State Farm recently announced that they would stop selling insurance to California homeowners, and since last year at least four major insurers have stopped selling homeowners insurance in Florida. Other property insurers are excluding or limiting coverage for damage caused by hurricanes and wind in at-risk areas, as well as increasing premiums and deductibles.

We asked two of the College's renowned property insurance specialists, **Gina Clausen Lozier** *(Clausen Choquette PLLC)* and **Rick Hammond** *(Insurance Claims and Litigation Consultants, LLC)*, to provide some insights on the impacts of climate change on the property insurance industry. Gina is based in Florida and focuses her practice on representing commercial policyholders. Rick is based in Illinois and provides insurance industry, underwriting, and regulatory expert consulting and testimony services.

SL: What are some property insurance trends you are seeing as a result of the increased frequency of catastrophic weather events?

Rick: As a result of the increased risk exposure resulting from weather catastrophes, several big insurers have scaled back their home insurance business costal states to avoid paying billions of dollars for anticipated wildfire damage, or have decreased or eliminated the sales of new policies in these locations. Although many state agencies are striving to keep premiums affordable for consumers, the economic cost of climate change keeps spiraling upwards and many insurers say they can't increase rates high enough to cover the damage occurring in the highest exposure locations.

A 2005 report authored by three insurance industry experts, cited a fifteen-fold increase in insured losses from catastrophic weather events (those with over $1 billion of damages) in the past three decades - losses that have far out-stripped premium increases, inflation, and population growth over the same time period. The report was written by Dr. Evan Mills, a scientist with the U.S. Department of Energy's Lawrence Berkeley National Laboratory; Richard Roth Jr., former chief property and casualty actuary and assistant commissioner at the California Department of Insurance who now works with a leading U.S. actuarial consulting firm; and Eugene Lecomte, president emeritus at the Institute for Business and Home Safety in Boston and 50-year veteran in the insurance industry. Mindy S. Lubber, president of Ceres, that commissioned the study noted:

> Insurance as we know it is threatened by a perfect storm of rising weather losses, rising global temperatures and more Americans than ever living in harm's way. Insurers and regulators have failed to adequately plan for these

escalating weather events that scientists predict will intensify in the years ahead due to warming global temperatures.

Gina: A lot of my clients have properties located in Florida, which is unfortunately subject to extreme weather events, most notably from hurricanes and flooding. Given its propensity to experience catastrophic losses, the insurance market has suffered resulting in the following trends:

- There has been significant debate, and blame, regarding the cause of Florida's "insurance crisis" which has resulted in a substantial overhaul of Florida's Insurance Code in recent years including the removal of statutory attorneys' fees in an insurance dispute.

- The number of insolvencies has increased putting pressure on Florida's Insurance Guaranty Association to handle and resolve a significant volume of claims.

- Reinsurers are unwilling to assume risks in Florida's market.

- Insurance companies are substantially increasing premiums and offering insurance on less favorable terms, such as high deductibles and low sublimits on coverages. Additionally, some underwriters require replacement of building elements such as roofs prior to agreeing to insure a risk.

SL: If this trend continues, where will Florida policyholders be able to obtain homeowners property insurance?

Gina: In 2002, the Florida Legislature created the not-for-profit Citizens Property Insurance Corporation to provide both windstorm coverage and general property insurance for homeowners who could not obtain insurance elsewhere.

SL: Is insurance provided by Citizens comparable to private homeowners insurance?

Gina: Citizens is a statutorily created governmental entity that is often described as the "insurer of last resort." Given it is not a traditional insurance company, it is not subject to the same requirements as the private market. As an example, Citizens is not subject to Florida's statutes governing "bad faith" conduct and is not liable for extracontractual damages.

An additional difference between Citizens and the private market is that flood insurance is now required as of April 1, 2023, for new Citizens personal residential policies that include wind coverage for covered property within the special flood hazard area. The requirement to secure and maintain flood coverage for personal lines residential policies resulted from the December 2022 legislative session.

One common misconception is that Citizens must insure a property if coverage is otherwise unavailable. Unfortunately, I have had many clients who were not able to procure coverage, even with Citizens, given ongoing litigation or unrepaired damages as the property did not meet Citizens underwriting requirements.

SL: What changes have you seen regarding property insurance for commercial policyholders?

Gina: The most significant trend is the availability of insurance at rates that are adequate but not excessive. In Florida, there are few domestic carriers that continue to write commercial risks. Accordingly, most commercial property owners are forced to utilize the surplus lines market. While this provides availability, it comes at an increased cost, less statutory regulation under Florida's Insurance Code as well as no protection under Florida's Insuranc Guaranty Association in the event of insolvency.

SL: What are insurance regulators' main concerns regarding weather-related impacts on the property insurance markets?

Rick: It is first important to note that the primary mission of the various states' Departments of Insurance is consumer protection and insurer solvency. With respect to consumer protection, most Departments strive to protect consumers by providing relevant assistance and information regarding their insurance issues, by efficiently regulating the insurance industry's market behavior, ensuring financial solvency, and by fostering a competitive insurance marketplace. The Departments' mission is intended to protect all consumers, not just claimants and insureds, but those consumers who pay their premiums month-in and month-out and who may never make a claim, but whose dollars nevertheless fund the claims and expenses paid by their insurers.

That said, from an economic standpoint, financial solvency and insurer stability are two of the most important goals that Departments focus on. Simply, because an insurer's financial *instability* jeopardizes the rights and security of its policyholders and consumers at-large who depend on an insurer's ability to defend and indemnify policyholders and third parties in the event of a loss or catastrophe. Unfortunately, insurance regulators' efforts to ensure financial stability by insurers is being challenged by rising global temperatures that are causing significant increases in hurricanes, floods, hailstorms, wildfires, droughts and heat waves, and an associated increase in insurance claims. Although the insurance industry is highly regulated, insurance companies can and do fail for a variety of reasons. For example, they might underprice their products and/or have a greater-than-expected number and/or severity of insurance claims arising out of climate change.

SL: What are insurance regulators doing now to assess how to respond to climate change?

Rick: In response to these issues and risk exposures, the National Association of Insurance Commissioners (NAIC) recently formed a Climate and Resiliency Task Force whose mission is to serve as the coordinating NAIC body for discussion and engagement on climate-related risk and resiliency issues, including dialogue among state insurance regulators, industry, and other stakeholders. This Task Force will:

- Consider how state insurance departments that opt into the insurer's climate risk disclosure reporting requirement review the information received.

- Evaluate financial regulatory approaches to climate risk and resiliency in coordination with other relevant committees, task forces, and working groups, such as the International Insurance Relations Committee, the Property and Casualty Insurance Committee, the Financial Condition Committee, and the Financial Stability Task Force, including:

  - Evaluation of the use of modeling by carriers and their reinsurers concerning climate risk.
  - Evaluation of how rating agencies incorporate climate risk into their analysis and governance.
  - Evaluation of the potential solvency impact of insurers' exposures, including both underwriting and investments, to climate-related risks.
  - Evaluation and development of climate risk-related disclosure, stress testing, and scenario modeling.

- Consider innovative insurer solutions to climate risk and resiliency, including:

  - Evaluation of how to apply technology and innovation to the mitigation of storms, wildfires, other climate risks, and earthquakes.
  - Evaluation of insurance product innovation directed at reducing, managing, and mitigating climate risk, as well as closing protection gaps.

- Identify adaptation, resilience, and mitigation issues and solutions related to the insurance industry.

- Consider pre-disaster mitigation and resiliency and the role of state insurance regulators in resiliency.

- Engage with the Center for Insurance Policy and Research Catastrophe Modeling Center of Excellence regarding climate-related risk and mitigation research and analysis.

All that said, it's becoming clear that the U.S. is experiencing more frequent and more powerful weather events that pose huge challenges for the insurance industry. The question becomes the extent to which the country is heading towards an uninsurable future.

SL: What coverage options are available for policyholders that either can't get windstorm coverage or have high deductibles?

Gina: Parametric insurance coverage is becoming increasingly popular in Florida, especially in the islands following the Irma and Maria storm season. Given the intensity of storms and the unavailability of traditional products, I expect its popularity will continue to grow outside its traditional use in the reinsurance space.

ACCC: What is parametric insurance and how does it work?

Gina: According to IRMI, "parametric insurance is an agreement under which an entity assuming risk (the "insurer") agrees to pay the indemnitee (the "insured") an agreed amount upon the occurrence of a specified event, such as an earthquake or hurricane of specified intensity." A key difference between parametric and traditional indemnity insurance is the policy pays out on occurrence as opposed to the loss itself. As an example, a parametric policy may pay $100,000 in the event of a pre-defined parameter such as a Category 1 Hurricane.