As Global Temperatures Set New Records, Policyholder Advocates Continue to Deny the Science

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We learned this week that July 4's average global temperature of 62.92 degrees Fahrenheit was the world's hottest day since at least 1979, when the U.S. National Centers for Environmental Prediction began keeping records, and potentially the hottest in about 125,000 years.

And yet, in a world in which even ExxonMobil concedes the reality of climate change and touts that it is "playing a leading role in the transition to a lower-emission future," it appears that insurance "consumer advocates" constitute the group most steadfast in their refusal to come to grips with what adapting to a warmer planet inevitably entails.

For the insurance industry itself, there is no doubt that the effects of climate change are already here and that, as the world's wealthiest and most-insured nation, the economic impact (but not the human toll) has been felt most acutely in the United States. According to the United Nations' World Meteorological Organization, U.S. catastrophes have accounted for $1.7 trillion of the $4.3 trillion of economic damage from extreme weather, climate and water-related events around the globe between 1970 and 2021.

Broker Aon PLC finds that the United States accounted for 75% of last year's $132 billion of global insured losses from natural disasters, led by the $50 to $55 billion of insured losses stemming from Hurricane Ian. Swiss Re, which found similar estimates, also notes that 2022's totals were 45% higher than the 10-year average of $91 billion in insured losses, and continued a three-decade-long trend of insured losses growing by 5% to 7% annually.

These trends clearly have been reflected in market pricing, with Guy Carpenter recently reporting that mid-year 2023 reinsurance renewals for U.S. property-catastrophe accounts were the highest in 17 years. They've also been reflected in declining availability of property insurance in certain catastrophe-prone markets, as seen in the ongoing collapse of the Florida homeowners market and high-profile decisions by State Farm and Allstate to cease writing new coverage in wildfire-stricken California.

And also unsurprisingly, insurance regulators around the world are seeking, as the International Association of Insurance Supervisors put it earlier this year in announcing the launch of an 18-month consultation on the topic, "a globally consistent supervisory response to climate change within the insurance sector."

For its part, in response to President Joe Biden's Executive Order on Climate-Related Financial Risk, the U.S. Treasury Department's Federal Insurance Office recently published a report offering 20 policy recommendations to improve insurance regulators' supervision of climate-related risks. These include possibly creating charges in risk-based capital (RBC) formulas for floods, convective storms and other climate-related risks; enhancing the NAIC Catastrophe Modeling Center's capabilities to help regulators better assess insurers' climate-related risks; and moving toward a single "materiality" standard for climate-related risks to be used in insurers' Own Risk and Solvency Assessment (ORSA) summary reports.

FIO also proposes various information-gathering measures that, depending on their levels of cost or intrusiveness, probably will engender some industry pushback. But by and large, the suggestions to improve how prudential overseers incorporate climate risks are reasonable and almost certainly necessary, in some form or another.

But in response to the FIO report, the group United Policyholders issued a statement with its own set of recommendations, nearly all of which amount to seeking ways to suppress, delay or ignore the price signals that guide consumers in how and where to build as we adapt to a changing climate. As United Policyholders declares:

> We oppose allowing insurers to pass along reinsurance costs to policyholders. Reinsurance rates are not regulated and frequently fluctuate. We also oppose allowing insurers to have unlimited use of predictive CAT models to set rates. Unlike rating tools that are based on

> historical facts and actual weather and claim events, CAT models are developed by for-profit companies to sell to for-profit insurers. They apply forward-looking algorithms to project future losses. Their advocates are persuasive, but they have a track record of decreasing availability and affordability.

It would seem obvious that catastrophe models that project, as climate science itself does, that future losses will be worse than past losses will have to be reflected in coverage that is more expensive and less available for those properties most at risk of loss. It seem equally obvious that, given such trends, rates based solely on "historical facts and actual weather and claim events" will be insufficient. Sticking one's head in the sand to pretend these weren't facts about the world is tantamount to denying climate change itself.

This stance extends to several of United Policyholders' other proposals. The group proposes that California "develop a public high dollar catastrophic coverage layer facility" to provide reinsurance to the California Earthquake Authority and the California FAIR Plan, and that Congress "begin drafting a national disaster insurance model to provide a basic amount of essential dwelling, building code upgrade and temporary living expense coverage."

Obviously, the animating principle here appears to be broad distrust of business itself, as seen in the shade thrown at cat models for being "developed by for-profit companies to sell to for-profit insurers." But more fundamentally, the only reason to propose public insurance and reinsurance facilities is to allow them to charge less than private-sector firms would. And it's certainly true that governments can offer insurance products that are not "for profit," because they can rely on taxpayers to make up the difference between the cost of coverage and the claims that will eventually roll in. We need look no further than the National Flood Insurance Program, which remains tens of billions of dollars in debt to American taxpayers.

But is that a good idea? Providing coverage at less than actuarially justified rates amounts to subsidizing choices to live in harm's way, rather than allowing those price signals to encourage people to harden their homes or, ultimately, to move to places with less exposure to the kinds of disasters that climate change will inevitably make more costly. Instead, we have seen the reverse trend, with Americans moving to places with greater exposure to catastrophe risks. As researchers from the University of

Vermont put it:

> We find that, controlling for socioeconomic and environmental factors, people have been moving toward areas most at risk of wildfire, and toward metropolitan areas with relatively hot summers. As climate change advances, we can expect to see hotter summer temperatures and heightened risk of wildfire, meaning that if these migration trends continue, more and more people will be in danger from heat and fire. We hope our findings will contribute to more awareness of these growing dangers, while providing empirical evidence to guide planners and policymakers as they design strategies for climate resilience and hazard preparedness.

Of course, price signals from insurance and reinsurance could play an appropriate role in countering or reversing these settlement patterns, but for regulatory schemes like California's Prop 103 that seek to suppress them. Indeed, California embodies United Policyholders' preferences in denying insurers the ability to reflect reinsurance costs and limiting their ability to use prospective catastrophe models. This is why, even after the state's extreme wildfires in 2018 and 2019, and despite trailing only Hawaii in median home prices, Californians in 2020 paid an annual average of $1,285 in homeowners insurance premiums across all policy types—less than the national average of $1,319.

Not only do such regulations interfere with price mechanisms that could otherwise facilitate climate adaptation in the states that implement them, but researchers Sangmin Oh, Ishita Sen, and Ana-Maria Tenekedjieva find that they engender counter-productive cross-subsidies across the country:

> Using two distinct identification strategies and novel data on regulatory filings and ZIP code level rates, we find that insurers in more regulated states adjust rates less frequently and by a lower magnitude after experiencing losses. Importantly, they overcome these rate-setting frictions by adjusting rates in less regulated states, consistent with insurers cross-subsidizing across states. In the long run, these behaviors lead to a decoupling of rates from risks, implying distortions in risk sharing across states.

Adaptation to climate change will be a difficult, wrenching process with no shortage of political pain points. There no doubt will be a role for governments to play in assisting citizens with mitigation, relocation and potentially even subsidies to finance crushing insurance costs. But it serves neither those policyholders nor society at-large to ignore the information that insurance markets are providing, much less the climate science that powers today's catastrophe models.

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