

Testimony of Mike Kreidler
Washington State Insurance Commissioner

Before the
United States House of Representatives
Select Committee on Energy Independence and Global Warming

Regarding:
Economic Impacts of Global Warming—Insurance

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Washington State Insurance Commissioner**

Chairman Markey, Ranking Member Sensenbrenner, and members of the Committee, I thank you for the opportunity to testify here today on the economic impact of global warming on the insurance industry.

My name is Mike Kreidler, and I am the elected Insurance Commissioner for the State of Washington. I am active in many of the committees of the National Association of Insurance Commissioners (the "NAIC"). Related to the topic matter of today's hearing, I serve as Co-Chair of the NAIC's Climate Change and Global Warming Task Force.

Today I would like to provide my perspective on how insurers and the economy will be affected by climate change.

- First, the most important job of an insurance commissioner is to protect insurance consumers. This is accomplished by maintaining strong, cooperative regulatory oversight of insurer solvency and monitoring insurer marketing activities so that a healthy competitive marketplace exists to serve consumers.
- Second, global warming will be a real challenge for Americans and the insurance industry.
- Third, global warming will affect different states and different segments of the insurance marketplace in different ways.
- Finally, I will not be presenting any easy solutions to this issue, but will explore some areas that need to be considered and addressed if we are to manage the risks associated with global warming and climate change.

1. Insurance Regulation and Consumer Protection

The most important job of an insurance commissioner is to protect insurance consumers. This is accomplished by maintaining strong, cooperative regulatory oversight of insurer solvency and monitoring insurer marketing activities so that a healthy competitive marketplace exists to serve consumers.

In its simplest form, insurance regulation is about two things. The primary job of an insurance regulator is to ensure that insurance companies remain solvent so that they

can pay claims as they become due, and to ensure that insurers treat their customers and claimants right. An insolvent insurer does not have the resources to pay its claims and, therefore, is of no use to either its policyholders or those with claims against them. An insurer that fails to comply with state consumer protection laws and regulations also can be a problem if it fails to deliver the expected insurance benefits to consumers at times when they are needed the most.

The goal of financial regulation is to protect consumers against excessive insurer insolvency risk. Insurance regulators protect the public interest by requiring insurers to meet certain financial standards, and taking remedial action when needed. This becomes important in the context of climate change when you try to balance the need for consumers to access affordable insurance products with the insurers' ability to deliver the products to the public in a way that minimizes the risk of insolvency.

Regulatory requirements are of little value if there is no mechanism in place to monitor insurers' compliance with the requirements. The purpose of solvency monitoring is to ensure that insurance companies are meeting regulatory standards and to alert regulators if action is needed to protect policyholders' interests. State regulators have established a vast solvency monitoring system that encompasses a range of regulatory activities, including financial reporting, early-warning systems, financial analysis and on-site insurer examinations. Annual and quarterly financial statements filed by insurers serve as the principle source of information to assess insurers' financial positions. Insurers are generally examined every three years. States coordinate the financial examinations through the NAIC association or zone exams process to avoid duplicative or redundant examinations of the same insurer.

Market regulation deals with insurer pricing, product development and market practices. If insurers are able to use their market power to raise prices above competitive levels, then regulators can improve market performance by setting a price ceiling at the competitive price level. This rarely happens because the competitive structure of most markets prevents insurers from acquiring significant market power. Things are different when insurers are faced with catastrophe risk. There are times when insurers believe that certain catastrophe coverages cannot be underwritten profitably. When this conclusion is reached, they react by withdrawing from markets, cancelling policies and introducing coverage limitations. There is evidence that this is occurring in many coastal jurisdictions today.

Market regulation includes the regulation of insurance prices and review of the contractual policy language before it is sold to consumers. This basic consumer protection helps both the insurer and the policyholder by having an expert state employee review the insurance contract before the transaction with the policyholder. Property and casualty insurance contracts are based on state laws and regulations and it helps things go smoother if a person who knows the state civil justice system and requirements enacted by the state legislature reviews the contract for statutory compliance.

2. Global Warming will be a Real challenge for Consumers and the Insurance Industry

Global warming and the resultant climate change will challenge insurers and consumers on many levels. Climate change appears to be impacting weather patterns which, in turn, affect insured property losses. Rising ocean temperatures appear to be affecting hurricane activity. Drought is impacting the health of many of our nation's forests, thus increasing wildfire risk. In 2006, the U.S. recorded the second warmest summer in history. Record windstorms have hit the Pacific Northwest recently. These are but a few of the potential impacts of climate change that could have a profound effect on Americans and insured property losses.

While 2006 was quiet in terms of hurricane activity, we need look no further than 2004 and 2005 to find significant impacts caused by hurricanes in the Gulf and Atlantic Coasts. According to the Insurance Information Institute, eight of the ten most costly catastrophes in the United States have been hurricanes. Of those eight hurricanes, six occurred during the 2004-2005 hurricane seasons. The insured losses from the devastating Hurricane Katrina (2005) alone were larger than Hurricanes Charley, Ivan, Hugo, Rita, and Frances combined.

In the wake of the increased hurricane activity, some insurance companies have stopped writing or restricted the writing of insurance in the Gulf and Atlantic Coasts because of the high risk posed to properties from increased hurricane activity. This is causing availability and affordability problems in some areas as consumers have fewer options. Some insurance companies are looking to use new risk models based on increasing projections of future hurricanes instead of past historical hurricane information. These models predict more hurricane activity, which will likely drive the cost of property insurance in those states even higher. If property insurance is not available, or becomes "practically" unavailable because the cost is so high that consumers cannot

afford it, it will affect the economic development in areas at risk from hurricanes and potentially the national economy as a whole.

While scientists cannot say for sure that all of this increased hurricane activity is attributable to global warming, or climate change in general, it is obvious that something has changed. Scientists generally agree that there is a relationship between warmer ocean temperatures and the intensity of hurricanes. Thus, higher ocean temperatures would be an indication that, while the number of named storms might not increase, the intensity of those storms would be greater. An added complication is that hurricanes could form at higher latitudes, thus exposing a greater number of states to significant hurricane damages.

In Washington State, we are vulnerable to a number of weather-related perils that are impacted by climate change. Flooding, drought, and windstorms are of serious concern.

Last November, western Washington experienced some of the worst flooding in state history. Hundreds of homes were flooded, and roads and bridges were washed away throughout the area. Picturesque Mount Rainier, not too far from my home, received a record 18 inches of rain in 36 hours, and the National Park has sustained damage that will take years to repair.

After the flooding came the wind. Last December, the Pacific Northwest, including western Washington, experienced the most severe windstorm in state history. Over 1.8 million homes lost power, and 18 people were killed. The storm caused hundreds of millions of dollars in damage to homes and property.

Drought is a serious concern in eastern Washington. The lack of precipitation and changing precipitation patterns threaten agriculture, fish habitat and forest health. This impacts the foundation of our state's economy and puts thousands of people at risk from wildfires.

While this may not seem relevant at first, Washington also has significant earthquake risk. Should a shallow fault earthquake in the Seattle area occur, or the massive subduction earthquake predicted for the Cascadia fault 70 miles off our coast, our state would sustain enormous losses. If climate change continues to affect weather losses, factoring in earthquake risk, the combined risks could result in a similar situation, as in the Gulf and Atlantic Coast regions where property insurance can be unaffordable or unavailable.

While property and casualty insurers will have the most identifiable increase in exposure because of climate change, life insurers will face increased challenges as well. Insurers and regulators will have to consider whether increased numbers of catastrophic events may be so overwhelming as to result in a notable increase in mortality. A severe storm or flooding event may cause significant casualties. “Brown outs” and “grid failure,” combined with more frequent heat waves, have been identified as a possible outcome of climate change. Increased mortality is a foreseeable result. Evidence for this comes from the experience in Europe in 2003 where record high temperatures led to a health crisis where over 35,000 people perished. The heat wave, coupled with a severe drought caused a crop shortfall in Southern Europe. Given such scenarios, insurers and regulators have to consider the pricing, and perhaps the structure of life insurance policies in light of new environmental conditions.

Human health will be impacted by climate change in ways that are not yet fully understood. Health care delivery mechanisms, including health insurance, will be challenged in ways that we are just beginning to explore. Global warming poses the potential for more frequent and severe epidemics or perhaps pandemics. On a less catastrophic level, basic health care will be challenged by increased respiratory and asthmatic problems resulting from climate change. Heat-related illness might also rise. And on a very basic level, consideration should be given to the increased cost of medical care for persons displaced from their regions by catastrophic events triggered by climate change. These people will need health care outside their traditional provider networks, from providers who do not have their health records. Insurers and regulators must work together to develop responses to these challenges.

3. The Effects of Global Warming will not be Uniform

The most obvious impact of global warming will be on property and casualty insurers. They provide coverage for some of the events that have the most obvious and dramatic outcomes. In particular, hurricanes, more intense thunderstorms, tornadoes, lightning, large hailstorms and wildfires can cause substantial property losses.

The insurance industry collects data on catastrophes. This data is reported to the Insurance Services Office’s Property Claims Services or PCS. PCS uses a \$25 million threshold to define a catastrophic event that triggers this special data reporting. According to PCS, six of the top ten U.S. catastrophes of all time have occurred since 2004. All of these happened to be hurricanes (Katrina and Wilma in 2005; Charley, Ivan,

Rita and Frances in 2004). Over the last decade, there has been an average of 26 catastrophes per year. Insured losses in 2006 dollars averaged \$18.5 billion per year over the period, but ranged from \$3.3 billion in 1997 to \$63.9 billion in 2005. If 2004 and 2005 are excluded, the average drops to \$11.4 billion.

For the first quarter of 2007, the largest catastrophe was the tornadoes that hit Alabama and Georgia in early March, resulting \$460 million in insured losses. Total catastrophe losses for the quarter stood at \$1.2 billion, covering seven events. Clearly, it is not just hurricanes that cause catastrophic losses.

The event of most concern is the hurricane. Not all jurisdictions experience hurricanes. They are generally a phenomena of the Atlantic and Gulf Coast states. Even within these states, with the possible exception of Florida, the effects of hurricanes are more dramatic within a short distance of the coastline than in the interior parts of the states. Thus, the results and impact of climate change will vary dramatically from state-to-state and within a state. This is particularly true for those states with coastal exposures.

4. There are no Easy Solutions

There are no easy solutions in dealing with the impact that climate change will have on consumers, the insurance industry, and the economy. I believe you have taken an important first step in forming this committee. Once society recognizes there is a problem, we can work together toward finding solutions.

While there are a number of things that can be done at the local, state and federal level, I would like to suggest three areas where we can start: building codes and land use decisions, a national greenhouse gas reduction policy, and reform of the National Flood Insurance Program (NFIP).

We cannot stop natural disasters like hurricanes, wildfires, and windstorms, but there are measures that states and local governments can take to mitigate damage. The first thing we should consider is where we build and how we build there. By mitigation, I mean taking concrete steps to reduce or eliminate risk to property from weather-related hazards and their effects. In practical terms, this involves strengthening building codes for new structures by making them more resistant to hazards such as wind, flood, and

fire. It also means enforcing building codes currently in place, and overcoming the pressure to weaken building codes when natural hazard activity is “quieter” than normal.

We also need to take a careful look at where we develop and redevelop our communities. We need to first ask ourselves, “Is the risk so great from some perils that we should not build here?” Then we must ask the question, “If we decide to build here, what measures should be taken in construction to protect lives and property from the risks they will face?”

I also believe we need to deal with the source of the global warming and resultant climate change problem. Increasing greenhouse gas emissions (GHGs) are significantly contributing to global warming and climate change. As a member of the Washington State Climate Advisory Team (CAT), I learned that 30 of the top 75 world emitters of GHGs are U.S. states. This is a national problem and the federal government needs to take meaningful action to address climate change by creating a national strategy to reduce GHGs. Washington State Governor Chris Gregoire and her colleagues from Arizona, California, Oregon, and New Mexico joined in signing the Western Regional Climate Action Initiative to help reduce GHG emissions. This regional initiative shows great leadership in dealing with global warming and climate change. We can do more, and the federal government should become part of the solution.

And finally, the federal government should consider serious reform of the National Flood Insurance Program (NFIP). From studies I’ve seen, flooding is significantly impacted by climate change. Whether storm surge from hurricanes in the Gulf Coast or the potential river basin flooding in Washington and other states, we’ve seen how devastating floods can be. Instead of simply increasing the borrowing authority for the NFIP, the government should accelerate flood map modernization, continue to examine flood rates and underwriting eligibility, enforce flood plain coverage requirements, and study whether or not expanding the NFIP requirement to all mortgages in designated flood plains could help the program and those it serves. The NFIP is an important part of mitigating the potential financial consequences of climate change for millions of property owners, and we need to ensure it remains viable for the future.

Given the variety and complexity of ideas under consideration, I strongly endorse the concept of a National Commission on Catastrophe Preparation to weigh the merits of each idea and develop the best mix of solutions. Clearly, there are a number of forward-thinking ideas that need further consideration, but they should be framed to answer the question, “Will this make insurance for individuals and businesses more available, and

more affordable?" We will work with the Committee to find the right answers to that question. The lessons of recent catastrophes may be the warning we need to start making those decisions, so I thank you for holding this hearing, for inviting me here today, and for your continued interest and leadership on this crucial issue. I'd be happy to answer any questions you may have.