Testimony of
The National Association of Insurance Commissioners

Before the
Senate Committee on Commerce, Science
And Transportation

Regarding:
Climate Science: Empowering our Response to Climate Change

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Testimony of Commissioner Sean Dilweg
Wisconsin Insurance Division

On Behalf of the National Association of Insurance Commissioners

Chairman Rockefeller, Ranking Member Hutchison, and Members of the Committee on Commerce, Science and Transportation, thank you for the opportunity to testify today. My name is Sean Dilweg. I am the insurance commissioner for the state of Wisconsin and I am here on behalf of the National Association of Insurance Commissioners. In my testimony, I will focus on the NAIC's position and thinking on the potential insurance related impacts of climate change, I will also offer suggestions for insurance regulator action to protect consumers and address insurer solvency, recognizing climate change related risk continues to grow.

Let me first begin first by stating that the most important duty of an insurance commissioner is to protect insurance consumers. It is the primary job of any insurance regulator to ensure that insurance companies remain solvent so that they can pay claims as they become due, and to ensure that insurance customers' and claimants' rights and interests are protected.

Investments

It is imperative regulators examine how climate change will impact the investments insurers hold and establish applicable regulatory standards for the investment practices of insurers. Direct and indirect investments in real estate represent a portion of all assets held by insurers. Many of these properties are located within coastal areas with

increasing risk from climate change influenced weather perils like hurricanes and flooding. As investors in these properties, insurers may be exposed to greater investment risk. Insurance regulators need to recognize that the risk of weather-related losses on real estate is complex. It can arise not only from declining asset values, but also the costs of fortification, physical damage to structures, and associated business interruption.

Historically, and from a viewpoint of social construct, insurance has helped shape towns and cities as an essential financial security tool for individual and community economic development, with a corollary that availability and affordability are also essential. It is clear that loss mitigation and loss prevention are the most viable solutions to both current marketplace problems and the growing threat of climate change and global warming. It is the only way to moderate and reduce the incidence and severity of catastrophe events.

Accordingly, it is vitally important that insurers begin to assess and take into account the effects of climate change on all lines of insurance, from intensified hurricanes off of the coast of Africa to the dryness of a Midwest summer. Changes in climate have a direct effect on our insurable interests and the companies and policyholders that each state regulates.

Mitigation

Insurance regulators must assess and, to the extent possible, mitigate the impact that climate change will have on insurance and encourage insurers to provide incentives for policyholders to engage in practices that will ultimately strive to limit losses. As such,

insurers have historically played a leading role in loss mitigation efforts. For example, as a result of fire disasters, insurers led the effort to improve building codes and develop new building and loss mitigation techniques to reduce the effects of fire. Insurers in coastal regions are often leading proponents of better land use policies and mitigation efforts, such as roof strapping and storm shutters. Likewise, insurers can help mitigate the impact of climate change by promoting adoption and vigorous enforcement of uniform building codes. They can also promote building code upgrades and retrofits of existing structures by offering premium discounts for proven loss mitigation building techniques, and by advocating for lender or government sponsored low interest loans for these mitigation activities.

Some insurers have developed new products that provide coverage for green buildings. Fireman's Fund Insurance Company has introduced Certified Green Building Replacement and Green Upgrade coverage, a new coverage specifically for green commercial buildings that addresses the unique risks that come along with sustainable building practices.

CAT Modeling

The NAIC heard from several catastrophe modeling firms who explained how climate change factors into risk modeling techniques. Catastrophe models provide insurers with the ability to assess risk and price their products with some degree of accuracy. However, these models tend to have a short-term focus of generally five years or less, while climate change modeling takes a much longer view -- 10 years or more -- and

attempts to evaluate the risk impact of gradual changes in climate instead of measuring the risk associated with swift and severe events as well as the frequency of those events. The NAIC also heard from scientists working at the National Center for Atmospheric Research (NCAR) who indicated that climate change modeling is relatively new and still evolving. In light of this, the NAIC recognizes that as the science behind climate modeling evolves, it will provide better tools for companies and regulators and could increasingly factor into insurance decision-making.

NAIC Climate Change Task Force And White Paper

In 2007, the GAO reported that climate change was an emerging high risk area with long-term growth in exposure to private and federal insurers but that the two sectors were responding, assessing and incorporating the potential long-term financial impacts differently. As an initial step in addressing the issue, the NAIC formed the Climate Change and Global Warming (EX) Task Force. The Task Force was charged with, among other duties, the responsibility of drafting a white paper documenting the potential insurance related impacts of climate change on insurance consumers, insurers and insurance regulators. The Task Force recommended its white paper, *The Potential Impact of Climate Change on Insurance Regulation,* and the NAIC adopted it on June 2, 2008.

In sum, the Task Force white paper (attached) discusses investment issues facing insurers and notes that some investment opportunities will arise. It encourages insurers to evaluate the geographic spread of the risks they are insuring and encourages insurers to

develop contingency plans. The White paper also emphasizes the importance of greater disclosure. It encourages insurers to become involved in strengthening building codes and advocating for sound land-use planning and become more involved in loss prevention and mitigation. It also recognizes the impact of demand surge, post-event living expense increases, and issues with business interruption coverages and suggests that new solvency regulatory tools are needed.

The NAIC Task Force also provides a forum to bring together all interested parties for a transparent discussion and development of required information standards, innovative product ideas, and evolving technologies. The Task Force has been involved in number of key efforts:

- Presentations by the US Green Building Council (USGBC) on Green Building Standards and the environmental impact of building green. Topics included the impact of commercial and residential building on our environment; the environmental, lifestyle, and business advantages of building green; and information on USGBC's educational offerings.

- Discussions on innovative "Green" insurance products offered by Fireman's Fund. Representatives from Fireman's Fund, a subsidiary of Allianz, spoke about their variety of "green" insurance products, such as providing insurance coverage for certified green buildings and upgrades of traditional buildings following a loss, and a "green" homeowners policy (available to Illinois as of June 1, 2008 and many other states starting in July 2008). Homeowners products have taken a lead from the commercial products, and both have been well received in all regions nationwide.

- Presentation on CALSTRS Green Investment Strategy by its CEO, Jack Ehnes. Subjects included the incorporation of the United Nations' Principles for Responsible Investments (PRI) that integrates active ownership and environmental, social, and governance issues into ownership policies and practices; the readiness, preparedness, responsiveness of the US insurance industry for Climate Change; the current vagueness and lack of voluntary disclosure of climate risk; and requiring questions that would allow for better

understanding of potential impacts on affordability of insurance and insurers' financial health.

- A presentation on the California perspective on Climate Change by Lisbeth Landsman-Smith of the California Department of Insurance, and Max Moritz of Environmental Science, Policy, and Management, from U.C. Berkeley. Topics included development of a more comprehensive plan for handling the implications of fire hazards; refinement of Fire Hazard Severity Zone (FMHZ) mapping and a more risk-based approach; and an increase of equitability and reduction of uncertainties, in addition to assessing fees and research funding.

- The Climate Risk Disclosure Working Group met in Boulder, Colorado at the National Center for Atmospheric Research (NCAR) on September 11, 2008. During the meeting, the Working Group:
  - Heard from three scientists regarding current climate change research and modeling.
  - Heard a presentation from Risk Management Solutions (RMS) examining current hurricane model capabilities and reliability;
  - Discussed the August 15, 2008 draft *Climate Risk Disclosure Proposal*, including verbal comments from interested parties.

- Presentations from EQECAT and AIR regarding how climate is considered in hurricane catastrophe models. During the presentations the regulators:
  - Discovered that there are issues related to merging atmospheric data with historical hurricane data, particularly with projections in the 1-10 year range. To compensate, modelers are beginning to use multiple models with varying assumption methods (both historical and a blend of historical and predictive). However, the modelers agree that there will be relatively more intense hurricanes with more rainfall, with intensity increasing dramatically by approximately 2020.
  - Learned that modelers are less certain regarding projections about the number of hurricanes that will make landfall in the U.S. due to the conflicting hurricane scenarios between the Atlantic and Pacific Coasts.

- Presentation from Henry Fox (Fox Consulting) providing an update on the development of climate trend data. He discussed his research on historical weather trends in separate weather zones throughout the U.S. over a 50 year period in an effort to forecast future weather trends. His patented forecasting methods are unique in that they place a heavier weighting on more recent years. His findings suggest that some zones show increases in average temperature or rainfall while other zones show decreases. He did not believe his findings support the overall global warming theories. He suggested that his work could be used by the insurance industry and American businesses to better understand long term weather-related risks in the weather zones examined.

- A presentation from 3C, a company that provides carbon neutral services, regarding how the European Union and U.S. carbon trading markets function. 3C also provided information to the Task Force about a joint venture product involving 3C and Allianz called Ecomotion.

- Discussions on pay as you drive insurance.

Additionally, looking forward at 2009, we anticipate that the Task Force will look at hosing a possible climate change summit, and consider development of a guidance document aiding insurers in how they should respond to the *Insurer Climate Risk Disclosure Survey,* referenced below.

Disclosure

It is challenging for regulators to determine how well-prepared the industry is for the challenges of climate change. U.S. Insurers lag in SEC disclosure that relate to climate change. Only 15% of U.S. insurers surveyed discussed climate change in 10K filings, compared to 100% of electric utilities and 78% of oil companies. There was also a poor response to the Carbon Disclosure Project where only 30% of U.S. insurers responded, compared to 70% in Europe and 62% in rest of world.

The NAIC has taken a forward looking approach to developing assessment tools that identify the potential impact climate change has on insurers and how insurers are assessing those risks. The *Insurer Climate Disclosure Survey* is the first of its kind in any industry and could serve as a model for financial institutions to gain insight into the impact of climate change on their industries.

The *Insurer Climate Risk Disclosure Survey* is a mandatory public survey document that will be phased in over the next few years. It represents a good first approach to climate

change so that regulators, consumers and companies can begin to understand how climate change is affecting the risks that are underwritten everyday. The *Disclosure Survey* is the is meant to be a starting point and the Task Force recognizes that as the science behind climate modeling evolves, so must the approach of regulators.

The *Disclosure Survey* standardizes climate risk disclosure information to make it easy for companies to provide that information. Given the infancy of this issue, the *Disclosure Survey* has been kept to eight general reporting questions for insurers that meet certain premium thresholds. However, it still provides some measure of transparency so that investors and regulators can better identify risks.

The questions seek general information from insurers about things they have done to reduce greenhouse gas (GHG) emissions in their operations, whether they have a climate change statement of policy, whether they consider climate change as they choose investments and what they have done to encourage policyholders to reduce losses caused by climate influenced events. Further questions delve deeper into insurer use of climate computer simulation modeling, analysis of climate change's impact on an insurer's investment portfolio and how the insurers are engaging their constituencies on the topic of climate change.

Insurance regulators believe this is the first step of many in assessing insurance industry efforts to measure the impact of climate change on insurer operations and policyholders.

Regulators also have a role to play in ensuring that environmental benefits claimed by insurers are authentic and reasonably quantified to lend validity to these efforts.

The NAIC supports efforts to increase the exactness of climate science as a basis for more accurate product pricing and in more climate science research funding to speed the delivery of relevant climate change information to market.

We look forward to working with the Committee and Congress on this issue as the science continues to evolve. Thank you for holding this hearing, for inviting me here today, and for your continued interest and leadership. I am happy to answer any questions.