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PUBLISHED ARTICLES

Climate Change – Taking the Temperature of the Insurance Industry and State Regulators

Barry Wells

Reality or "Fake News"? Science based or science fiction? The debate continues, and while these are certainly important considerations, you'll find no answers to these particular questions in this offering. Rather, Interested Reader, the intent of this article is to share a high level overview regarding climate change, with a focus on the insurance industry's perspective and the manner in which the regulatory community is responding to this critically important issue. Admittedly, while I'm not an expert in this area, I am very interested in the topic, and as such, I'm hoping to share information that you'll find both helpful and interesting.

Let's start with an overview to better understand what climate change or global warming, as it's often referred actually "is," its impact and how the heck has it been created. Climate change is just that, a change in the earth's climate, resulting in a rise in the average temperature of our atmosphere. Changes in climates have been experienced throughout the United States, as well as in other parts of the world. We are all familiar, for example with the warming of the polar ice cap but also, some are suggesting the recent flooding in Paris is also directly related to climate change. Okay, so that's climate change but what is the cause, which - aha moment - is the center of the ongoing debate. The scientific community believes the cause is "us," humanity, the human collective…you and me, and largely through the emission of those pesky "greenhouse gasses." A greenhouse gas is defined as one that contributes to the greenhouse effect by absorbing infrared radiation, e.g., carbon dioxide and chlorofluorocarbons. Others believe, that human-generated greenhouse gas emissions are too small to significantly impact our climate and the Earth is capable of absorbing the increases. Rather, some believe climate change in the 20th century is the direct result of natural processes, such as fluctuations in the sun's heat and ocean currents. Wherever you come out on this debate, I believe we can all agree the Earth's climate is certainly under change.

It's been documented that temperatures have increased approximately 1.8°F since the early 20th Century, and in 2013, the Intergovernmental Panel on Climate Change (IPCC) Fifth Assessment Report concluded that "It is extremely likely that Intergovernmental Panel on Climate IPCC) Fifth Assessment Report concluded that "It is extremely likely (that human influence has been the dominant cause of the observed warming since the mid-20th century.»

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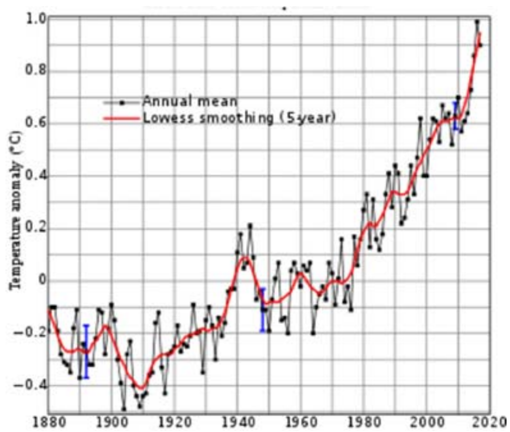
For illustration, the following chart maps the average temperature increase from 1880 to 2016 in 20 year spans.

Global Land-Ocean Temperature Index



Global mean surface temperature change from 1880 to 2016, relative to the 1951–1980 mean. The black line is the global annual mean and the red line is the five-year lowess smooth. The blue uncertainty bars show a 95% confidence limit. Source: NASA GISS.

Regardless of the cause, there is certainly reason for concern and one, which the National Association of Insurance Commissioner's (NAIC) has recognized. In 2008 the NAIC issued a White Paper entitled The Potential Impact of Climate Change on Insurance Regulation. In that document the NAIC commented that "As regulators of one of the largest American industries, the insurance industry, it is essential that we assess and, to the extent possible, mitigate the impact global warming will have on insurance." Further, the NAIC noted "For the purposes of this paper, the Task Force assumes that global warming is occurring. We believe that there is ample evidence in support of this assumption in a variety of other reports and studies, so we have decided not to focus on the scientific aspects of global warming. We believe the time has come for regulators to work with the insurance industry to thoroughly examine the impact of climate change issues on the insurance industry and make necessary regulatory changes and raise important issues in order to protect consumers and ensure a vibrant insurance market as we move into the future." I would strongly encourage readers to refresh yourselves on the NAIC's White Paper, which included a discussion of the following topics:

- Building Codes
- Land Use Planning
- Impact on Policyholders
- Post-Event Living Expense Increases
- Discounts and Credits as Incentives to use Green Building
- Materials after Loss
- Use of Tiered Rating Plans To Encourage the Use of Low-Emissions Vehicles
- Research and Education
- Property and Casualty Insurer Market Issues
- Life Insurer Issues
- Health Insurer Issues
- Disclosure of Climate Risk

With that, let's turn our attention to the insurance industry and the regulatory community's response to climate change. In an Aug. 1, 2017 article for Fortune, entitled "As Oceans, Rise, Insurers Flee" an excerpt noted a recent industry study found "that last year there were 750 major "loss events" like earthquakes, storms, and heat waves, well above the 10-year annual average of 590. Analytics firm CoreLogic found that 6.9 million homes along the Atlantic and Gulf coasts are at risk of damage from hurricane storm surge that could cost more than $1.5 trillion." Is the insurance industry prepared to address ongoing weather natural disasters, at the level discussed above? Ernst Rauch, the head of the Corporate Climate Centre at Munich Re. commented in a December 2017 article for the Insurance Journal, "Sometime in the future there will be the situation where people cannot afford any longer to buy catastrophe insurance — this is what we want to avoid," Lloyd's of London has commented that climate risk is "the" (emphasis added) number one issue confronting the insurance industry. There is an irony here that an industry, which in many respects has relied on the past to forecast risk, must now become more vigilant in considering the future, especially when it comes to assessing the implications of climate change on assessing future risk.

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This has not been an easy dynamic for many U.S. insurers who have been slower in the process because the issue is such a political hot potato; however, insurers are taking action, largely focused on attempting to manage or limit exposures, and especially those in high-risk areas. For example, Allstate, for instance, has said that climate change has resulted in the company's decision to cancel or non-renew policies in many Gulf Coast states. As reported by the Climate Action Organization, Allstate has reduced the number of homeowners' policies in Florida from 1.2 million to 400,000 with an ultimate target or on more than

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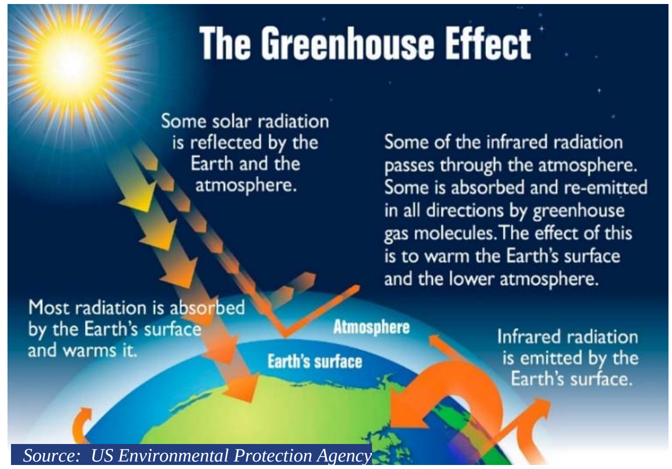
100,000. Also, Allstate has limited activity in an estimate dozen of other states.

I don't want to paint too bleak of a picture, as many in the global insurance industry are embracing potential opportunities resulting from climate change. In an article by Dr. Evan Mills, Staff Scientist, US Department of Energy - Lawrence Berkeley National Laboratory, entitled Responding to Climate Change – The Insurance Industry Perspective, Dr. Mills cites various business opportunities presented by climate change and notes, "hundreds of billions of dollars will be spent on clean energy technologies and other responses, which represents an enormous new capital base with associated business operations requiring insurance. Several large insurers have already established special practices dedicated to the diversity of customers participating in this new market. Examples include AIG's Global Alternative Energy Practice, Allianz's Climate Solutions, Aon's Agri-Fuels Group and Chubb's Green Energy Team."

Finally, the following chart, is an interesting overview illustrating some of the industry's activities related to climate change, and which appeared with Dr. Mills' article. Please take note with regards to the focus of insurers activities. Certainly, developing new insurance products directed at carbon reduction, related to automobile policies for example, would be expected, but also consider the outreach the industry is doing regarding creating awareness and leading by example. Carbon risk disclosure, which was first discussed in the NAIC's 2008 White Paper, is an

Illustration of the Greenhouse Effect

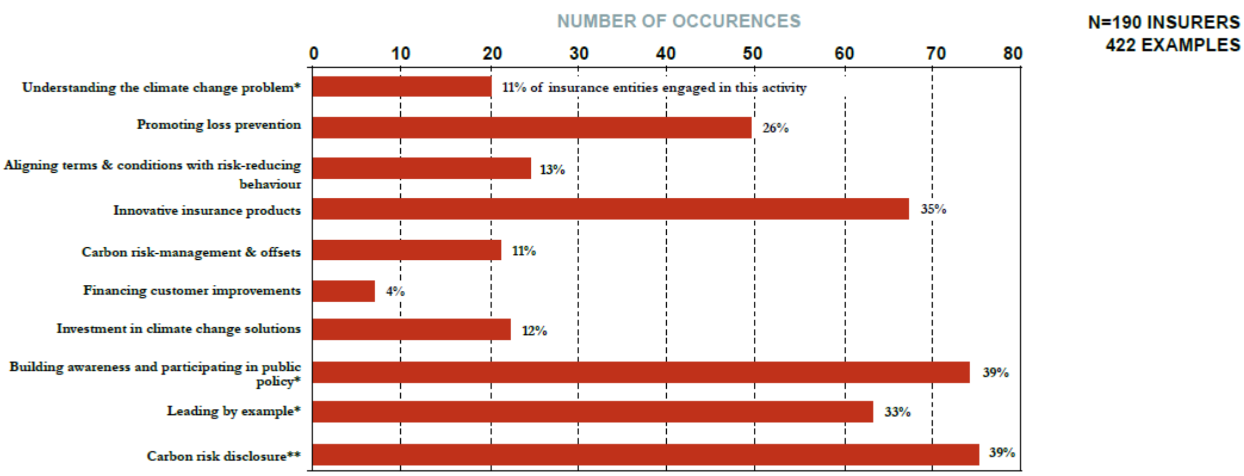


Source: US Environmental Protection Agency

important initiative, which has benefited both consumers and regulators in assessing the extent that carbon risk is impacting a particular insurers business. Consumers are better able to consider in context to carbon risk, whether or not to purchase insurance products from an insurer, while regulators are better able to monitor the financial condition of a company, based on that company's carbon disclosures.

The NAIC and state regulators have been equally engaged in assessing the impact of climate change and monitoring insurer activities, which includes the NAIC's Climate Change and Global Warming (C) Working Group – Property and Casualty Insurance (C) Committee, (the Working Group) who has taken up a broad range of topics. For example, for 2018,

Range of Insurer Activities Related to Climate Change



** For these three categories, a maximum of one is tallied, as there is too much subjectivity in assigning Weights to each individual activity.*
*** Multiple-year responses to a given disclosure initiative (eg., Carbon Disclosure Project) are counted once. Please reference Dr. Mills article for a detailed explanation of the individual activities.*

Climate Change – Taking the Temperature of the Insurance Industry and State Regulators – continued from **page 3** ; focusing their attention on the following:

- Review the enterprise risk management efforts by carriers and how they may be affected by climate change and global warming.
- Investigate and receive information regarding the use of modeling by carriers and their reinsurers concerning climate change and global warming.
- Review the impact of climate change and global warming on insurers through presentations by interested parties.
- Investigate sustainability issues and solutions related to the insurance industry.
- Review innovative insurer solutions to climate change, including new insurance products through presentations by interested parties.

In my opinion, the Working Group's bill of particulars for 2018, clearly acknowledges the importance of the ongoing assessment of climate change.

There has also been speculation as early as 2010 that new climate change related regulations, may be considered. This speculation grew out of the NAIC's adoption of their 2008 White Paper, which was followed by a 2010 Insurer Climate Risk Disclosure Survey (the Survey) in 2010. The survey was comprised of eight questions designed to assess insurer strategy and preparedness in the areas of investment, mitigation, financial solvency (risk management), emissions/carbon footprint and engaging consumers. The survey has been administered online and reported to a database created by the California Insurance Department since the 2012 reporting year. In 2013 regulators in California, Connecticut, Minnesota, New York and Washington required insurers writing in excess of $100 million in direct written premiums to disclose their climate-related risks using this survey. In 2015 it was estimated that approximately 87 percent of the market is reporting on climate change.

In conclusion, Interested Readers, will new climate change related regulations be developed? While there doesn't appear to be any public information suggesting new regulations I believe the most reasonable answer is let's wait to see. While insurers are focusing on the activities discussed above, state regulators and the NAIC continue to monitor the insurer's activities through the Survey and gauge, in collaboration with the states and input from the industry, future regulatory actions.

Climate change isn't going away and while I've attempted to offer highlights in this article, there is much to consider.

Regardless of your perspective on the climate change debate, I encourage you to "keep current" with this topic, which much like our weather, will only continue to change.

Barry L. Wells

Barry Wells is a Senior Director with Risk & Regulatory Consulting, LLC (RRC), and has over 30 years of insurance industry and consulting experience. Barry is primarily involved with RRC's market regulation practice for lines of business including, health, property/casualty and title insurance. He has extensive technical and executive level experience related to the insurance industry, including evaluating insurance operations and controls, with a focus in claim management, regulatory compliance and TPA management.

Barry's expertise also involves serving as the Senior Director and Examiner-In-Charge regarding multistate market conduct examinations as initiated by the NAIC Advisory Organization Examination Oversight Working Group. He has served IRES in a variety of capacities, including serving as a CDS Vice Chair for 2017 and 2018.

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