Testimony of

Robert P. Hartwig, PhD, CPCU

Director, Risk & Uncertainty Management Center and

Clinical Associate Professor of Finance

Darla Moore School of Business

University of South Carolina

To the

United States Senate

Committee on the Budget

For the Hearing Entitled

“Next to Fall: The Climate-Driven Insurance Crisis is Here – And Getting Worse”

December 18, 2024

Washington, DC

UNIVERSITY OF
SOUTH CAROLINA
Darla Moore School of Business

Thank you, Senator Whitehouse, Ranking Member Grassley and members of the Committee.

Good morning. My name is Robert Hartwig and I am a Professor of Risk Management, Insurance and Finance at the University of South Carolina's Darla Moore School of Business. I also serve as Director of the School's Risk and Uncertainty Management Center.[1] Prior to joining USC, I spent 23 years in the in the property/casualty insurance and reinsurance industries, the last decade of that as President and Economist of the Insurance Information Institute, an international property/casualty insurance trade association based in New York City. During that time, I have had the opportunity to work on a wide variety of issues related to the industry's exposure to catastrophic loss and its financial performance during periods of economic uncertainty.

Let me get straight to the point. The insurance industry is not in the midst of a climate-driven crisis nor is it about to "fall." Strength and stability are the hallmarks of the industry. Indeed, a recent report from AM Best, the largest insurance rating agency in the U.S., found that the cumulative impairment rate of AM Best-rated insurers over any 15-year period from 2001-2023 was 0.3%, down significantly from the 3.9% for the 1977-2001 period (see Exhibit 1).[2] In other words, there is no evidence that the industry is on the precipice of collapse, despite material increases in insured losses arising from natural disasters over the past quarter century. Solvency-focused regulation and sound risk management by insurers are key drivers of these improvements. Furthermore, in the eyes of federal and state regulators, the insurance industry does not pose a systemic risk to the financial system or the broader economy. There are no insurers designated as Systemically Important Financial Institutions (SIFIs) and since 2017 the US Treasury's Financial

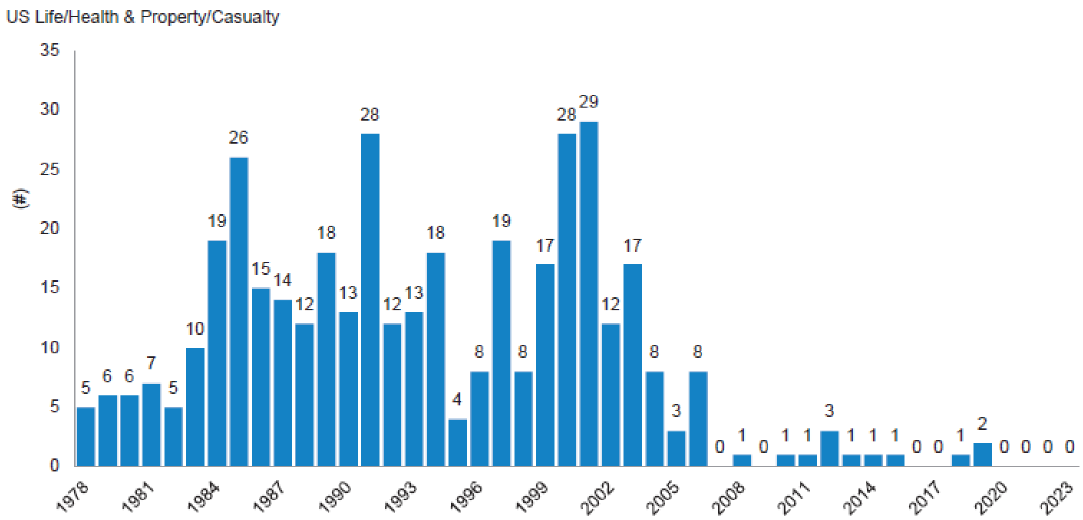
[1] Contact information: Tel: (803) 777-6782; Email: robert.hartwig@moore.sc.edu.

[2] AM Best. "Impairments of AM Best-Rated Insurers Have Declined Since 2001." (October 16, 2024). Accessed at: https://news.ambest.com/newscontent.aspx?refnum=261435&altsrc=23. Impairment rates are for AM Best-rated companies with a Financial Strength Rating (FSR) of A- or above. Since 2021, natural catastrophes caused or contributed to the impairments of 20 small insurers, 14 or them in Florida and Louisiana. None were rated by AM Best at the time of impairment and 11 of the 20 had never been rated by AM Best. Fraud and litigation were cited as contributing factors in five of the impairments.

Stability Oversight Council (FSOC) has effectively ceased relying on non-bank SIFI designations for regulatory purposes.

Exhibit 1

Number of Insurer Impairments by Year



Lastly, data collected by this Committee on non-renewal rates for homeowners insurance reveal that a small increase in the non-renewal rate for the US overall is largely driven by increases in Florida and California (see Exhibit 2). The same pattern of increase is *not* observed in other large, disaster-prone states such as Texas and New York, suggesting idiosyncratic issues play a major role in determining insurance availability and affordability in both Florida and California. Notably, the median non-renewal rate among the fifty states has varied little over the period from 2018 through 2023. In the vast majority of states, therefore, 99%-plus of homeowners are able to renew their policies each year.

Exhibit 2

Homeowners Insurance Non-Renewal Rates, 2018-2023

	FL	CA	TX	NY	US	Median State
2023	2.99%	1.72%	0.83%	0.57%	1.06%	0.86%
2022	3.00%	1.33%	0.68%	0.50%	0.83%	0.68%
2021	1.29%	1.12%	0.64%	0.39%	0.68%	0.61%
2020	0.97%	0.85%	0.46%	0.26%	0.53%	0.48%
2019	1.02%	1.03%	0.64%	0.35%	0.68%	0.66%
2018	0.79%	0.94%	0.81%	0.39%	0.80%	0.79%

Source: US Senate Budget Committee.

Crises vs. Dislocations

Climate risk is today—and has always been—and important determinant in the cost of insurance and for that reason climate change is an issue that insurers and reinsurers monitor closely. There has been a tendency, however, to over-attribute the impact of climate change when describing the state of insurance markets. History and research have demonstrated that the impact of climate change on insured losses is incremental and relatively small. The dynamics of insurance markets are far more complex than can be explained by climate change in isolation, with insured losses and ultimately the price and availability of coverage determined by a range of factors, including, according to Swiss Re, the following:[3]

- population growth and urbanization
- accumulation of asset values in exposed areas;
- inflation
- litigation

[3] Swiss Re Institute. "Natural Catastrophes and Inflation in 2022: A Perfect Storm." *sigma* No. 1/2023. Accessed at: https://www.swissre.com/institute/research/sigma-research/sigma-2023-01.html.

For the purposes of my testimony, I will address each of these issues in the context of their impacts on insurance markets and the potential for each to produce localized market dislocations.

Population Growth, Urbanization and the Accumulation of Asset Values in Exposed Areas

Since 1970, the US population has increased by 65%. Population in catastrophe-prone states has been far larger. The population of hurricane-prone Florida, for example, is up 217% since 1970—with Texas up 160%. The situation is similar in Western states vulnerable to major wildfire risk. The populations of California, Washington and Colorado are up 98%, 126% and 162%, respectively.[4] The influence of demographics relative to climate (in the context of hurricane risk) is displayed in Exhibit 3.[5]

Localized population growth trends can further amplify losses. Hurricane Ian in 2022 made landfall in the Cape Coral-Ft. Myers metro area along Florida's west coast—where population is up 620% since 1970 (Exhibit 4). Even though 2022 was a year in which the number of major hurricanes was below both expectations and the historical annual average, Ian nevertheless stands as the second-costliest hurricane in US history with some $55 billion in insured losses. The example of Hurricane Ian illustrates the dominance of demographics over climate change as a driver of insured loss.

[4] US Census Bureau. "Historical Population Change Data (1910-2020)." Accessed at: https://www.census.gov/data/tables/time-series/dec/popchange-data-text.html.

[5] Swiss Re Institute. "Ian Revisited: Disentangling the Drivers of US Hurricane Losses." Nov. 2023. Accessed at: https://www.swissre.com/institute/research/sigma-research/sigma-2023-01.html.

Exhibit 3

Changes in Built-Up Land in the Hurriance Ian Area

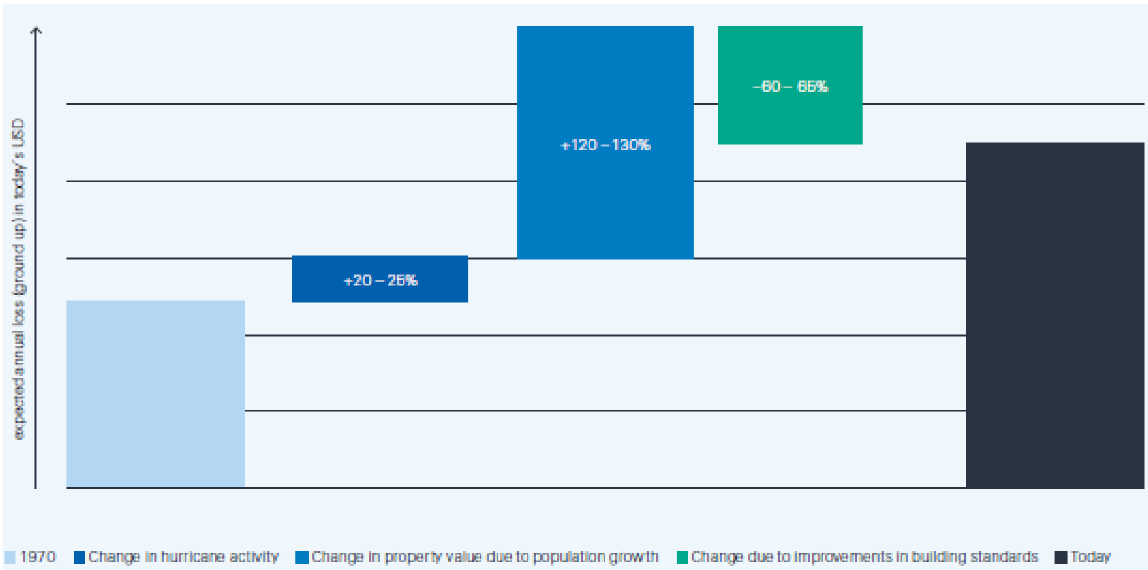
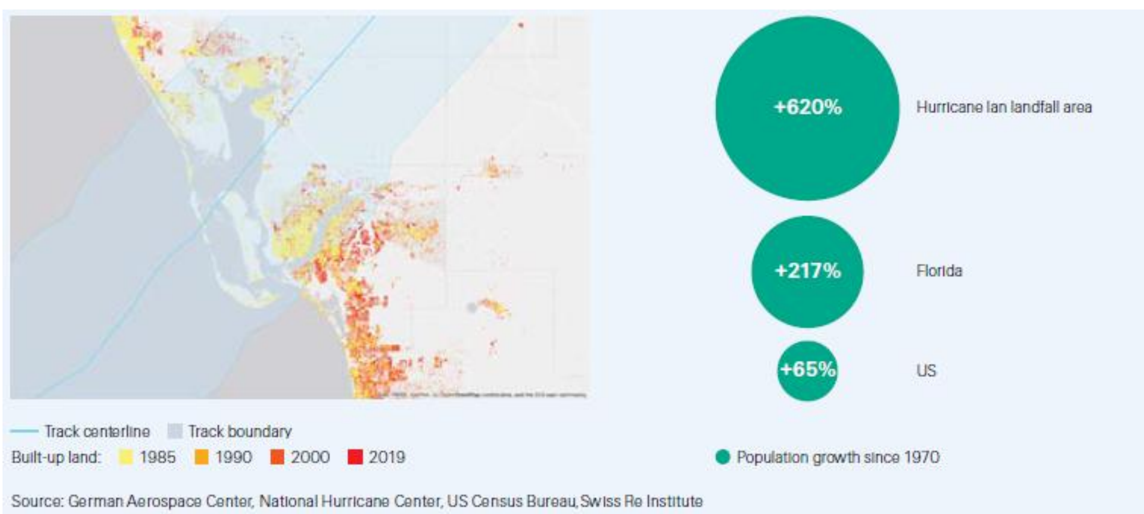


Exhibit 4

Changes in Built-Up Land in the Hurriance Ian Area (left) and Population Growth (right)



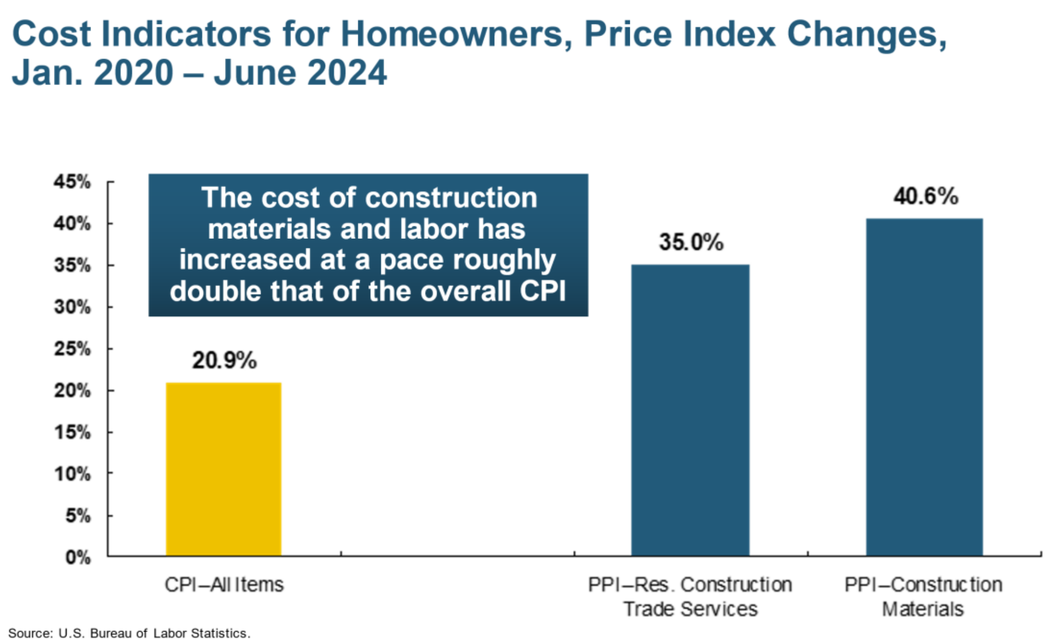
Source: See footnote 3.

Inflation

Supply chain disruptions and trillions in fiscal stimulus during the Covid-19 pandemic pushed inflation in the United States to its highest level in 40 years.

Rising from 1.2% in 2020 to 4.7% in 2021 before peaking at 8% in 2022[6], inflation impacted the price of goods and services throughout the economy, including those that directly influence the cost of repairing and rebuilding structures damaged not only by major natural disasters, but property claims of all sizes, from all property perils, throughout the country. Inflation of this magnitude was not anticipated by insurers and led to a sharp and sustained increase in claim costs, compounding the increases associated with near-record catastrophe losses. Insurer loss ratios rose materially, necessitating upward rate adjustments which continue to this day. Inflation as experienced by property insurers in recent years is materially higher than the general level of inflation as measured by the CPI. From January 2020 through June 2024, the cost of construction materials increased by 40.6%, nearly double the 20.9% increase in the overall CPI over the same period. Likewise, the cost of residential construction trade services was up 35% (see Exhibit 5). Again, the impact of economic inflation on property insurance claim costs dominates any impact from climate change.

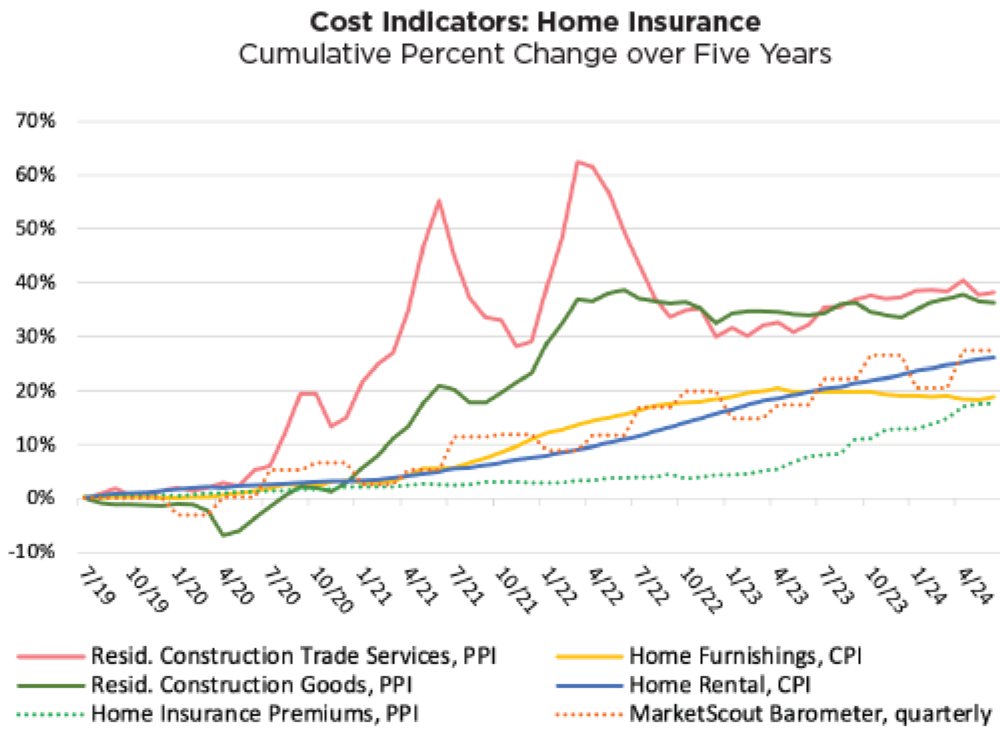
Exhibit 5



[6] As measured by the Consumer Price Index (CPI), US Bureau of Labor Statistics.

It is important to note that the increase in home insurance premiums has lagged far behind increases in the price of construction goods and services as well as home furnishings and rents. In other words, home insurance premiums as a share of the total cost of homeownership has actually fallen. As displayed in Exhibit 6, home insurance premiums rose by approximately 18% between mid-2019 and mid-2024 while rents and the median home price rose by approximately 30%.

Exhibit 6



Source: APCIA from US Bureau of Labor Statistics and MarketScout Corp.

Litigation and Fraud

Litigiousness and fraud have also contributed to the upward trend in claim costs—driving premiums upward and reducing coverage options for some policyholders. In recent years, Florida has become the undisputed epicenter for insurance litigation. According to the Florida Office of Insurance Regulation, the state accounted for 76% of all homeowners insurance-related litigation nationwide in

2021 despite accounting for only 7% of homeowners claims that year.[7] In 2022 (latest available), Florida's share of homeowners insurance litigation had dropped to 71%, even though the state that year accounted for 15% of all open claims nationally. From 2018 through 2023, Homeowners Defense and Cost Containment Expenses increased by nearly 75%.[8] Excessive litigation contributed not only to higher premiums but a more-than-doubling in the policy count at Citizens Property Insurance Corp., the state's insurer of last resort. The recent leveling-off in the number of personal policies in force at Citizens is early evidence that reform legislation passed in 2021 and 2022 is beginning to improve insurance availability in the state.

Summary

Insured losses from natural disasters across the United States continue to rise and will continue rise for the foreseeable future. Climate change drives incremental system costs. But the dynamics of insurance markets are complex. Indeed, many factors have contributed to the record and near-record losses experienced in recent years. Foremost among these factors has been the rapid increase in population and property exposures in areas that have always been vulnerable to variability and volatility in the climate. These demographic pressures have been amplified by the highest rate of inflation since the 1980s, which has pushed up the cost of building materials and labor. Litigation, too, has added billions to the cost of providing insurance.

Pressure on insurance markets associated with all these factors has pushed up premiums and resulted in availability issues in a number of states. Meaningful reforms, coupled with investments in mitigation, are proven solutions that can help ensure the stability of insurance markets across the country.

[7] Florida Office of Insurance Regulation. "Property Insurance Stability Report." January 1, 2023. Accessed at: https://floir.com/docs-sf/default-source/property-and-casualty/stability-unit-reports/january-2023-isu-report.pdf.
[8] Florida Office of Insurance Regulation. "Property Insurance Stability Report." July 1, 2024. Accessed at: https://floir.com/docs-sf/default-source/property-and-casualty/stability-unit-reports/july-2024-isu-report.pdf.

Thank you for you for the opportunity to testify before the Committee today. I would be happy to respond to any questions you may have.