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NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

3601 Vincennes Road, Indianapolis, Indiana 46268
Phone: 317.875.5250 | Fax: 317.879.8408

122 C Street N.W., Suite 540, Washington, D.C. 20001
Phone: 202.628.1558 | Fax: 202.628.1601

www.namic.org

June 25, 2012 *Sent Via E-Mail to Becky Meyer*

Mr. Pat McNaughton
Chair, Impact of Climate Change Exam Subgroup
National Association of Insurance Commissioners (NAIC)
2301 McGee Street, Suite 800
Kansas City, MO 64108

RE: Proposed Updates to the *Financial Condition Examiners Handbook*

Dear Mr. McNaughton:

The National Association of Mutual Insurance Companies (NAMIC) appreciates the opportunity to comment on the "Proposed Updates to the *Financial Condition Examiners Handbook*" referenced above. NAMIC is the largest and most diverse national property/casualty insurance trade and political advocacy association in the United States. Its 1,400 member companies write all lines of property/casualty insurance business and include small, single-state, regional, and national carriers accounting for 50 percent of the automobile/homeowners market and 31 percent of the business insurance market.

Regarding the proposed updates, we offer the following observations:

I. The additional content proposed by the Subgroup repeatedly uses the term "climate change" without explaining what the term is supposed to mean in the context of insurer financial regulation. This is a problem because the proposed additions seem to imply that risks ostensibly associated with "climate change" are qualitatively different from risks associated with weather and other natural phenomena—risks that are already accounted for in the financial examination process.

When the absence of a definition of "climate change" was mentioned during the Subgroup's May 10 conference call, one participant suggested that a useful definition could be found in the NAIC's 2008 white paper, *Potential Insurance-Related Impacts of Climate Change on Insurance Regulators*. Unfortunately, the closest the white paper comes to offering a definition of "climate change" is a brief statement that appears in the Introduction:

> The [Climate Change and Global Warming (EX)] Task Force is starting with the assumption that global warming is occurring. The Task Force believes that there is ample evidence in a variety of other reports and, therefore has not attempted to replicate studies of the scientific aspects of global warming.

From this, one could infer that the NAIC equates "climate change" with "global warming," but that is hardly enough to enable insurers to understand what unique risks financial examiners believe are associated with climate change/global warming.

II. Each of the proposed additions to the Handbook is based on one or both of the following assumptions: First, the proposed additions presuppose that climate change necessarily poses a distinct risk to the financial condition of every insurance company. Second, as alluded to above, the proposed additions assume that climate change-related risks are separate from other risks (including weather-related risks), and that they can (and should) be managed independently of other risks. We examine each of these assumptions.

- ***Regarding the notion that climate change poses a distinct risk to the financial condition of every insurance company***

  Much of the proposed additional content appears to be rooted in this assumption, as evidenced by questions such as: "How does the company consider climate change risks when determining its investment strategy and/or monitoring the risks in its investment portfolio?" Formulated this way, the question implies that an insurer could not reasonably conclude that special consideration of the potential impact of climate change on its financial condition is unwarranted. To eliminate this bias, the question should instead ask, "Does the company believe that climate change poses risks that should be considered in managing its investment portfolio? If so, describe those risks and the company's strategy for managing them."

  In the same vein, another proposed question asks: "What risks have been identified related to climate change and how are these risks incorporated into the company strategy?" The question implies that the onus is on the company to identify particular climate change-related risks and that it has a duty to "incorporate" them into "the company strategy." But suppose a company's managers decide that climate change poses no risks to the company whatsoever. The wording of the question suggests that this would be regarded as an unacceptable heresy.

  We could cite several more examples of proposed additions that are similarly biased in favor of the idea that climate change creates distinct risks that apply specifically to the financial condition of every insurance company. As far as we know, there is no objective basis for assuming that the idea is correct. Unless the Subgroup has evidence to the contrary, it should examine each proposed addition with an eye toward ensuring that the suggested wording is neutral and free of bias.

- ***Regarding the notion that that climate change-related risks are discrete and separate from other risks, and that they should be managed independently of other risks***

  Because climate change is a process that occurs in very small increments over very long periods of time, any special risks that it might entail cannot be isolated and predicted in a way that it is meaningful for insurers. As the respected catastrophe modeler Karen Clark pointed out at a recent NAIC national meeting, climate change is not susceptible to insurance catastrophe modeling.

> No one knows precisely when or where the effects of climate change will be most pronounced, but some pessimistic forecasts posit that the Earth's average temperature will increase by as much as 3.5 degrees Celsius over the next 100 years. That translates to .35 degrees Celsius per decade and .035 degrees Celsius per year. While catastrophe modeling and analysis of weather-related loss trends allow insurers to continually refine their underwriting and pricing to account for changes in weather patterns, it hardly makes sense to expect insurers to base their underwriting and pricing decisions on the possibility that the average global temperature might increase by a tiny fraction of one degree per year. We wonder, then, what is to be gained by instructing examiners to "perform a walkthrough of the underwriting process and observe how the impact of climate change is considered when establishing risk exposure limits [and] establishing prices," especially given that property insurance policy periods typically cover no more than 12 months.

III. With regard to insurer investment portfolios, a proposed addition to the handbook instructs examiners to "review the company's investment strategy for inclusion of climate change risks and the method for monitoring the investment policy to determine what considerations of climate change are included." Everyone agrees that insurers should diversify their investment portfolios to protect against future market fluctuations. But the suggestion that a special diversification strategy is needed specifically to "protect against the effects [of] climate change" raises a host of questions. What would such an investment strategy look like? Would the strategy be premised on the notion that, because of "climate change," certain investments are to be avoided and others embraced? According to what criteria would an examiner evaluate a company's "method for monitoring the investment policy to determine what considerations of climate change are included"?

One possible consequence of this approach is that some insurers will feel pressured to invest in "green" industries as a way of demonstrating fidelity to what could reasonably be perceived as an NAIC agenda. Insurers might note that the NAIC went so far as to endorse such investments in its 2008 white paper on climate change:

> Although climate change will challenge the existing methods for regulating the investment practices of insurers', [sic] the move to mitigate its effects will also provide new investment opportunities. These investment opportunities will arise as new economic sectors emerge to provide goods and services that are environmentally friendly. The move from the current system of energy use to new alternatives will involve substantial changes to the generation and distribution of new forms of energy. Development of technology to make production of energy from solar, wind, geothermal, and nuclear sources more efficient will require capital, as well as creation of the infrastructure, to generate and distribute energy from those sources. *Increased investment in these areas may be an attractive opportunity for some insurers.* [Emphasis added.]

An attractive opportunity? As of June 18, the Renewable Energy Industrial Index (RENIXX), which tracks the performance of stocks of renewable energy companies, had lost 31.6 percent of its value since the beginning of this year. It had lost 91.2 percent of its value since the beginning

of 2008.[1] At least a dozen such companies have filed for bankruptcy within the past year alone, and many more are "teetering on the brink," according to a report published in May of this year.[2] The lesson here is that financial examiners should be very careful about how they deploy their authority, as their efforts could actually have the effect of undermining the financial stability of the companies whose solvency they are supposed to protect.

IV. Conclusion

No industry in the U.S., and possibly the world, is subject to a mandatory climate risk disclosure regime of the sort that is currently being contemplated by this Subgroup. If we have learned anything since the NAIC embarked on its initial foray into the climate change debate five years ago, it is that the relationship between climate change and insurance is complicated, uncertain, and contentious. The *Insurer Climate Risk Disclosure Survey* produced by the Climate Change and Global Warming (EX) Task Force in 2009 failed to garner the support of most insurance commissioners in large part, we believe, because the survey's authors insisted on including questions that were implicitly prescriptive and based on questionable assumptions. We look forward to working constructively with the Subgroup to ensure that the mistakes of the past are not repeated.

Sincerely,

Robert Detlefsen, Ph.D.
Vice President, Public Policy

[1] http://www.renewable-energy-industry.com/stocks/renixx_history.php?changeLang=en_GB#

[2] http://hockeyschtick.blogspot.com/2012/05/worldwide-crash-of-green-energy.html