Demystifying the National Association of Insurance Commissioners

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Contextualizing the Insurance Crisis

Insurance is a major plank in the financial system. Trillions of dollars from insurers' investments flow to various segments of financial markets—and insurers constitute some of the largest players in the corporate bond, municipal bond, and commercial mortgage markets. Insurers have the potential to amplify systemic risks across the economy, as occurred when AIG became the largest recipient of federal bailout money in U.S. history during the 2007-08 financial crisis.

Last summer, when State Farm and other major insurers announced they would no longer write new policies for homeowners in California due to growing wildfire risk, the *New York Times'* reporting on the story began with a starkly straightforward lede: "The climate crisis is becoming a financial crisis." Since taking office, President Joe Biden has taken steps to acknowledge this reality, and the regulators he has appointed to the Financial Stability Oversight Council (FSOC) have concluded that climate change is an "emerging and increasing threat to financial stability." Treasury Secretary Janet Yellen, the chair of the FSOC, has flagged concerning trends in insurance markets, and the FSOC's 2023 annual report warned that the "increasing frequency and severity of extreme weather could affect the solvency of insurers" and "could also affect the cost and availability of coverage for homeowners and businesses, which could have implications for financial stability."

Adding to the alarm is the limited authority that these federal financial regulators have to monitor insurance companies. Many people may be surprised to learn that thanks to the 1945 McCarran-Ferguson Act, the insurance industry in the United States is not subject to federal regulation, and that includes wide-ranging exemptions from federal antitrust enforcement. Instead, the industry is overseen by 56 state insurance commissioners (one per state plus Washington D.C. and five U.S. territories). These

state-level regulators, for their part, are members of and receive guidance from a private organization called the National Association of Insurance Commissioners (NAIC).

When Congress took up Wall Street reform through the Dodd-Frank Act of 2010, the insurance industry intensely lobbied to prevent any fundamental change to this state-based system for regulating insurance. However, Congress did recognize that the 2008 crash had been caused by a set of corporate actors that extended beyond commercial banks, which is why it empowered the FSOC to designate systemically important financial institutions (SIFIs) subject to strengthened federal oversight. One independent member with insurance expertise was assigned to sit on the FSOC and help determine which institutions qualified as SIFIs. Additionally, Congress recognized the importance of insurance to overall financial stability by creating the Federal Insurance Office (FIO), an agency within the Treasury Department that has broad authority to collect data and monitor issues within the insurance industry. Two additional insurance representatives serve as non-voting members of the FSOC: the FIO's director and a state insurance regulator chosen by the NAIC.

Rhode Island Superintendent of Insurance Beth Dwyer has been the NAIC representative to the FSOC since 2022. When her first two-year term ended last month, the NAIC voted to give her another stint. While Dwyer's presence on the FSOC will continue, the council is currently missing its lone insurance official with voting power. That's because the six-year term of Thomas Workman, the independent expert appointed by former President Donald Trump and confirmed by the Senate, expired in March. President Biden had the authority to fire Workman years ago—and we have argued that he should have. Now, Biden has the chance to nominate Workman's successor, and he should do so expeditiously.

As the resident experts advising the FSOC on insurance matters, Dwyer and the person chosen to replace Workman are important, if overlooked, figures. However, the FSOC's theoretical and tangential power to subject the nation's largest insurers to federal

oversight has been sublimated to the shadow power exerted by the NAIC, an unaccountable private institution.

Initially, three large, complex insurance companies (Prudential, MetLife, and AIG) were designated as SIFIs by the FSOC, and therefore subject to strengthened regulatory oversight from the Federal Reserve. Through a combination of legal challenges and deregulatory moves, the three insurance giants were able to shed SIFI designation. As a result, our financial system has been characterized by a more pronounced prevalence of "shadow banks." Large, complex financial institutions, including insurance companies, are considered shadow banks because of how they contribute to systemic financial risk without being regulated as SIFIs. The de-designation of insurance giants as SIFIs has impeded federal regulators' efforts to get a handle on new systemic risks that have emerged, most notably climate change.

There is also an urgent need to improve the models used by analysts throughout the financial services industry, including the actuaries who help set insurance rates. In short, historical precedent plays a major role in actuarial analysis, but the catastrophe models that inform that analysis require significant adjustment to be useful in an escalating climate crisis. The FIO touched on this problem in issuing its recommendation that the NAIC invest in catastrophe model upgrades, describing how "most models use assumptions that are primarily based on historical experience, even as the past is becoming less reflective of a future where the frequency, severity, and other characteristics of climate-related events are changing." Importantly, the FIO urged the NAIC to publicly share improved catastrophe models across a platform that could be useful to all state insurance regulatory offices, which tend to be under-resourced.

Yellen bears some responsibility for the lack of federal oversight over insurers and other shadow banks in our financial system. She was still Fed chair in 2017 when she voted with Trump's FSOC appointees to remove AIG's designation as a SIFI. As Treasury Secretary and chair of the FSOC, Yellen took more than two years to initiate a reversal of

Trump-era changes to the SIFI designation process. The “inappropriate hurdles” to the designation of non-bank firms that Yellen cited were lowered when the FSOC finalized new rules in November, though it seems unlikely that any new SIFI designations will be made before the end of Biden’s first term. The intransigence of the NAIC means that integrating insurance into the new SIFI framework is one of the best ways the FSOC and its member agency heads can re-establish a window into the insurance sector and mitigate climate-related risks.

Now that the FSOC has resurrected its SIFI designation process, it is important to appreciate the particular ways that the insurance sector is relevant to it. Financial stability experts Gregg Gelzinis and Graham Steele have detailed how “stress at a major insurance company due to an unexpected climate shock could be transmitted to banks and other nonbank financial companies that serve as creditors or counterparties to the failing insurance company” in a risk referred to as the “exposure channel.” Gelzinis and Steele have also described how “insurers may be forced to sell off illiquid assets at fire-sale prices to generate enough cash to pay unprecedented claims or to otherwise meet the cash demands of creditors and counterparties trying to reduce their exposure to the troubled firm,” in a risk known as the “asset liquidation channel.” Both of these transmission channels were highlighted in the FSOC’s new analytical framework.

The final two transmission channels that the FSOC’s new analytical framework outlines—“contagion” and “critical function or service”—evoke uncomfortable parallels to the 2008 housing crash that led to the FSOC’s creation. The FSOC defines the “critical function or service” channel as “disruption of a critical function or service that is relied upon by market participants and for which there are no ready substitutes that could provide the function or service at a similar price and quantity.” There is growing concern that a lack of affordable insurance could disrupt a critical piece of housing finance, especially if mortgages of diminishing value end up on the books of the government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac. Scholars have warned that sudden re-pricing of real estate assets and decline in property values could expose the

GSEs to massive losses. And this scenario is made more likely by poorly capitalized insurers that are receiving inflated financial stability ratings from credit rating agencies—a situation that might seem familiar.

Notwithstanding the warnings from Yellen and the FSOC, key aspects of the climate risk supervision framework that Biden officials are attempting to establish remain at the whims of a patchwork of state regulators. Through its insistence on achieving consensus across a body of 56 local regulators, the NAIC plays an obstructive role in a critical area of climate financial policy.

The NAIC exists primarily to stave off federal regulation while setting the lowest possible bar for state regulators. Notably, the professional organization gets a lot of its funding from industry, including fees that insurers pay in exchange for proprietary access to data, which begets regulatory capture. In addition, the NAIC's non-governmental structure means that it can avoid Freedom of Information Act requirements, leading to a lack of transparency. Furthermore, the NAIC is not subject to federal public notice and comment period requirements. As a result, consumer advocates have been hard-pressed to organize oppositional letters within the brief time windows provided, underscoring how the organization can skirt democratic accountability.

The NAIC Undermines More Ambitious Regulatory Action at the State Level

The NAIC is fiercely defensive of the state-based system of insurance regulation. It recognizes that establishing de facto national standards is an opportunity to create a low baseline that ultimately prioritizes the interests of insurers over those of consumers. After all, each state develops insurance laws according to the NAIC's model legislation.

As the risk of catastrophic events has grown in tandem with climate change over the past several decades, a clear pattern of insurer behavior has emerged. The so-called and self-proclaimed “experts” in risk assessment declare that they didn’t know what they were doing when they initially provided coverage, but now that a catastrophe has occurred, they know what they are doing when they withdraw that coverage. The result is that consumers and businesses who made long-term investments in property based on the belief that their properties were insurable are met by insurers saying, “I guess we got it wrong.”

The truth is the insurance industry has had decades to prepare for the effects of climate change. In fact, Munich Re issued a report about the implications of climate science for the insurance industry as far back as 1973. To prevent insurers from feigning ignorance and abandoning policyholders as climate change got worse, advocates like Ceres and Birny Birnbaum of the Center for Economic Justice—along with several forward-looking insurance regulators—began in the mid 2000s to urge regulators to require insurers to assess climate risk and provide their assessments and strategies through a public climate risk disclosure survey conducted through the NAIC.

The insurance industry consistently opposed any disclosure, and was successful in watering down the product that the NAIC ultimately developed. Former California Insurance Commissioner Dave Jones was alone in administering the NAIC’s voluntary Climate Risk Disclosure Survey in 2010 and 2011. Jones was soon joined by officials in New York, Washington, and elsewhere, but the survey took more than a decade to expand to the 27 jurisdictions that it includes today. It wasn’t until Biden’s election in 2020 that the NAIC and regulators finally tepidly embraced climate risk disclosures. Less than half of state regulators measure how insurers assess and manage climate-related risks, and the NAIC only adopted a standardized methodology for doing so in 2022.

A recent Ceres analysis of the NAIC's survey results reveals just how inadequate the disclosures have been. For instance, only 20% of insurers' disclosures even mention scenario analysis, and only a handful of companies reported considering scenarios where global temperatures rise more than 2°C. For context, the world is currently barreling toward roughly 3°C of warming, a truly cataclysmic outcome that insurers are evidently refusing to even contemplate. As the FIO report explains, insurance regulators in New York, Connecticut, and California had to act unilaterally to provide scenario analysis guidance.

To this day, climate risk disclosures through the NAIC's survey focus only on financial risks to insurers, and ignore disclosures related to the availability and affordability of insurance even in the face of ever-increasing frequency and severity of climate-related risks. Further, the NAIC and industry have consistently opposed the reporting of granular consumer market outcome data necessary to monitor insurer practices and responses to growing climate-related risks. The sorry state of insurance market monitoring by state insurance regulators was put on display in recent weeks when the NAIC issued a "special data call"—in 2024—to learn how insurers' responses to climate risk are affecting the availability and affordability of property insurance around the country.

Insurers fight disclosure of data and scenario analysis related to climate change because admitting how much information they have about climate projections and insurance market trends would reveal their playbook for a warming world: maximize profits, socialize losses. Indeed, a January *Wall Street Journal* article about climate-driven insurance market disruptions was headlined "Insurers Rake In Profits as Customers Pay Soaring Premiums." By resisting stronger regulatory measures and slow-walking uniform and robust climate data disclosures, NAIC members have enabled insurers to shift risk onto consumers through non-renewals, coverage exclusions and caps, and actual cash value coverage in place of replacement cost and higher deductibles.

The FIO's report examining climate-related risks and gaps in the supervision and regulation of insurers identified numerous examples beyond climate risk disclosure and scenario analysis where state insurance offices have been forced to act independently of the NAIC to make any progress whatsoever on mitigating the existential threat facing the insurance industry. The FIO report also details actions taken by the NAIC's Climate and Resiliency Task Force, but reveals them to be painstakingly slow and ineffective within the context of an escalating climate crisis.

For example, the FIO report identified one major challenge: the limitations of the risk-based capital (RBC) formula that the NAIC uses to set capital requirements. The current formula requires a special charge for hurricanes but excludes other climate-related perils such as wildfires, floods, and storms.

Capital requirements in all 50 states are based on the NAIC's model law, which is automatically updated at the discretion of NAIC's Capital Adequacy Task Force. Minutes from the task force's most recent meeting do not show any actions or updates to integrate climate risk beyond the 2022 steps highlighted in the FIO report. The first draft strategy document from the NAIC's climate resilience task force does not mention any further pending actions regarding the RBC formula. The Solvency Workstream of the NAIC's climate resilience task force has indicated its intention to gather data about insurers' exposure to wildfire risk, but has expressly clarified that this data will not be embedded into capital requirements. This process for integrating wildfire perils into capital requirements is playing out too slowly for the many communities facing soaring wildfire risk, including in Arizona, California, Colorado, Hawaii, Oregon, New Mexico, and Washington.

The NAIC doesn't just hinder stronger regulatory action at the state level. The organization also seeks to preempt federal intervention.

The NAIC Opposes Federal Intervention

The NAIC tends to be dismissive of reports and proposals from the Treasury Department. The NAIC's antagonistic attitude toward the FIO has been most visible when it comes to assembling insurance market data. In November 2022, one month after the FIO proposed a robust data collection process, the NAIC sent a letter expressing "deep concerns" over the FIO's proposal to Graham Steele, then Treasury's assistant secretary for financial institutions. The letter denounced Treasury's so-called "unilateral" approach, calling it "a missed opportunity to work collaboratively with [state] regulators on an issue we have both identified as a priority." Several months later, the NAIC announced a plan to issue its own call for data.

A December 2023 sign-on letter organized by Public Citizen detailed why a "piecemeal, state-level approach will not provide the timely nationwide review necessary to allow federal financial regulators to evaluate the potential for systemic risks." The letter called on the Office of Management and Budget (OMB) to approve the FIO's proposal even though advocates lamented Treasury's moves to narrow its scope.

OMB subsequently allowed the FIO to move forward with its separate initiative, thus rejecting the insurance lobby's argument that the NAIC's data call alone would be sufficient. However, in early March 2024, the FIO reached a deal with the NAIC to proceed with one combined data collection process. Treasury Undersecretary Nellie Liang claimed that the agreement will allow the FIO to "receive more data from a higher percentage of the market" than it would have under its own proposal."

Reporting on the deal fittingly labeled the NAIC a "trade organization," and soon, reasons to doubt Liang's claim that the deferral to the NAIC would result in more robust

data began to surface. The *New York Times* reported that state insurance regulators in Republican-led states would likely use their discretion to opt out of the data call entirely: "…each state regulator can decide whether to participate in the data call, and some of the states where homeowners face the greatest risks of damage from severe storms and where insurance markets are most turbulent—like Louisiana, Texas and Florida, where Republican politicians regularly balk at policies dealing with climate change—may either share limited data or opt out of the program entirely."

Any data collection on insurance trends and climate costs that excludes Florida, Texas, and Louisiana will be extremely constrained. Louisiana is projected to lose as much as 8% of its landmass by mid-century, and Florida and Texas follow close behind. Moreover, all three states rank among the top 10 in the Consumer Federation of America's (CFA) recent estimate of uninsured homeowners. CFA's report recommended a robust and publicly available data set to "track pre-existing and emerging inequalities in insurance markets." That outcome is less likely now that a deferral to the NAIC's data collection has been agreed to. For a sense of the forthcoming data collection's limited utility to informing public policy problems related to insurance, consider the results from the NAIC's climate risk disclosure survey, which are housed not on the NAIC's website, but on the California Department of Insurance's website. There is no sorting function for results by state. It's possible that even less information from the joint NAIC-FIO data collection will be made available to the public.

Another way that the NAIC projects its power is through congressional testimony. The NAIC is a deeply consensus-driven body. Even Democratic appointees with stronger regulatory instincts tout the importance of McCarran-Ferguson as doctrine, and tend to voice comfort with the NAIC's deliberative process when challenged as to why the FIO report recommendations for integrating climate into insurance supervision can't be implemented faster. During congressional hearings, insurance commissioners are often recruited by the NAIC to appear as witnesses. They will testify on different insurance topics "on behalf of the NAIC," implying that they speak for all insurance commissioners

rather than for themselves. As a consequence, they don't tend to give much insight into the insurance market or regulatory landscape in their state (even if it's different or stronger with respect to insurance discrimination or whatever else).

Captured Regulators

Whether elected or appointed, many members of the NAIC get their start working as insurance agents or lobbyists on behalf of the insurance industry. It is common for them to take this perspective to their work once they're in the job of regulating their former employers. One example is Tim Temple, the new insurance commissioner in Louisiana, arguably the nation's most vulnerable insurance market to the climate crisis. State politicians approved several insurance policy interventions during the 2023 legislative session, including some consumer-friendly reforms, such as a $30 million roof fortification program. However, the legislature also opted to strip the insurance commissioner of some of its power to regulate rates, potentially making a difficult job less appealing in the process. Last October, Temple—a 20-year veteran of the insurance industry—won an uncontested race for the office, despite campaigning on a platform of weakening consumer protection laws. Temple, who has compared coverage requirements to socialism and refused to support more funding for the state's roof fortification program, recently championed a new package of legislation making it harder to sue property insurers, despite the "complete failure" of a similar package passed in 2020 to deliver promised rate relief for auto insurance.

At the end of 2022, former insurance agent David Altmaier stepped down as the head of Florida's Office of Insurance Regulation (OIR). Altmaier's abrupt announcement—which was designed to skirt a new state law restricting public officials from lobbying—came as Florida's insurance market was in turmoil from Hurricane Ian. That climate disaster, one of the state's most recent, caused nearly $113 billion in damages and another record uptick in insurance company insolvencies. A *Tampa Bay Times* report on one

company that became insolvent identified serious lapses by Altmaier's OIR, including a failure to complete required financial condition exams every five years.

Days before resigning, Altmaier had been involved in negotiating a costly overhaul of Florida's insurance law, which was reportedly drafted with major input by State Farm and other large insurers. That law, which has proven politically vexing for the Florida GOP, has failed in its objectives of depopulating the state insurer of last resort or halting the exodus of insurers from Florida's market. Absurdly, Florida politicians, including its top insurance regulator, continue to blame the problems of Florida's insurance market on baseless conspiracy theories rather than on climate change.

Limited State Capacity and the Need for Reform

A coalition of advocacy groups recently warned Treasury Secretary Yellen: "There are serious reasons to doubt that state insurance offices have the capacity, expertise, and resources needed to rise to the challenge" of "protecting against climate-related financial stability threats within the insurance industry."

Prudential was the last insurance firm whose activities were subject to federal oversight. But since the FSOC voted in 2018 to remove Prudential's SIFI designation, no insurers have been subject to supervision by federal regulators. This means, as University of Michigan Professor Jeremy Kress explained in a paper criticizing the FSOC's Trump-era deregulation, that the primary regulator of Prudential—a complex, $832 billion multinational conglomerate—is the New Jersey Department of Banking and Insurance.

This is an alarming development considering the lack of bandwidth at most state insurance offices. According to University of Minnesota insurance scholar Dan

Schwarcz: “Approximately forty states have no more than three actuaries on staff to review rate filings. Instead, states increasingly rely on rate or form ‘analysts’ to review the rate filings of every insurer operating in their state. Yet most analysts simply do not have the technical background or experience to have the slightest chance of understanding, at any level of depth, the statistical rating and underwriting models that insurers are now deploying; such analysts are often hired right out of college, generally have no graduate degree, and are typically paid much smaller sums than could be fetched in private industry.”

Congress created the FSOC out of recognition that our financial system is complex, and that identifying and managing threats required better collaboration between different regulators. The FSOC was designed to catch financial stability threats that any individual regulator might have missed—and to act collectively to address them. Now that the FSOC has identified climate change as a systemic risk, and has flagged insurance as a key channel for spreading that risk, our unique system for regulating insurance in the United States cannot be an excuse for undermining the FSOC’s core mission of preventing another meltdown like 2008.

The far-ranging and interconnected implications of the fossil-fueled insurance crisis are already being named by the FSOC regulators. Secretary Yellen has cited a “protection gap” from the growing problem of uninsurance and underinsurance. Uninsurance, which the Consumer Federation of America estimates already represents at least $1.6 trillion worth of property, is poised to grow as insurance becomes less affordable. This will complicate an integral part of our housing finance system, and could make housing markets even less affordable. Federal Reserve Chair Jay Powell recently noted that this is contributing to inflationary pressures.

The FSOC and its member agencies must work with state-level policymakers to quickly implement the FIO’s recommendations for integrating climate risk into insurance supervision. Otherwise, an interlinked climate-insurance-housing crisis will spiral out of

control. As more and more U.S. real estate becomes uninsurable, it will become harder for housing consumers to obtain mortgages in certain parts of the country. Those unmortgageable areas, in turn, are poised to see a collapse in property values, local tax revenues, and funding for social services.

President Biden must act with urgency, filling the insurance expert vacancy on the FSOC as quickly as possible. Where the NAIC is serving as a barrier to needed action, Yellen and other members of the FSOC must work directly with state and local policymakers to obtain the data they need, institute essential regulatory reforms, and mitigate the pain that insurance market disruptions are causing. Failing to act could cause that pain to spill over into another Wall Street crash.