The Fed - Pricing of Climate Risk Insurance Regulation and Cross-Subsidies

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Homeowners’ insurance, a $15 trillion market by coverage, provides households financial protection from climate losses. Insurance premiums (rates) are subject to significant regulations at a state level in the United States. Using novel data on filings made by insurers to regulators, we propose a metric to quantify the extent of regulation in individual states. We provide evidence of decoupling of insurance rates from their underlying risks and identify regulation as a driving force behind this pattern. Rates are least reflective of risk in states we classify as "high friction", i.e. states where regulations appear most restrictive. We identify two sources behind the decoupling. First, in high friction states, rates have not adequately adjusted in response to the growth in losses. Second, insurers have cross-subsidized high friction states by raising rates in low friction states. Our results imply that households in low friction states are disproportionately bearing the risks of households in high friction states. More broadly, our findings question whether insurance rates can play a useful role in steering climate adaptation and whether households will have continued access to insurance.

**Url:**<https://www.federalreserve.gov/econres/feds/pricing-of-climate-risk-insurance-regulation-and-cross-subsidies.htm>