



**North Dakota
Insurance
Department**

Safeguarding Promises. Fostering Fairness.
Jon Godfread, Commissioner

Insurance Coverage for the Lignite Coal Industry

Interim Energy
Development and
Transmission Committee



SB 2287 – Cost, Availability and Risks Associated with Insurance Coverage of Lignite Coal Industry

- SECTION 1. STUDY OF LIGNITE COAL INDUSTRY INSURANCE - REPORT TO THE LEGISLATIVE MANAGEMENT. During the 2021-22 interim, the insurance commissioner, in consultation with the North Dakota insurance reserve fund, shall study the availability, cost, and risks associated with insurance coverage in the lignite coal industry. The study must include consideration of whether the current insurance market adequately or appropriately calculates the risk factors specifically connected to the coal industry and whether there is a need for a state-based insurance product that insures against current risk factors at an appropriate cost. The insurance commissioner shall report its findings to the legislative management and implement any necessary recommendations by June 1, 2022.



Background

- Started in late 2020 – LEC funded a study on the forces impacting insurance rates in the Lignite Coal Industry
- Findings presented to the 67th Legislative Assembly
- Resulted in the passage of SB 2287
- Study was conducted by Guidehouse in consultation with Insurance Department and the NDIRF:
 - 7 Lignite companies
 - 6 Insurance Commissioners
 - Industry experts (actuarial, underwriting and claims)



Current Drivers of Rising Insurance Costs

Current Hard Market Scenario

- What is a soft or hard market?
- Catastrophic Losses
- Low Investment Yields
- Reinsurance
- Industry consolidation

Environmental Social Governance Movement

- Industry Organizations
- Insurance Carrier Movements
- COP 26 United Nations Climate Change Conference



What is a Soft or Hard Market?

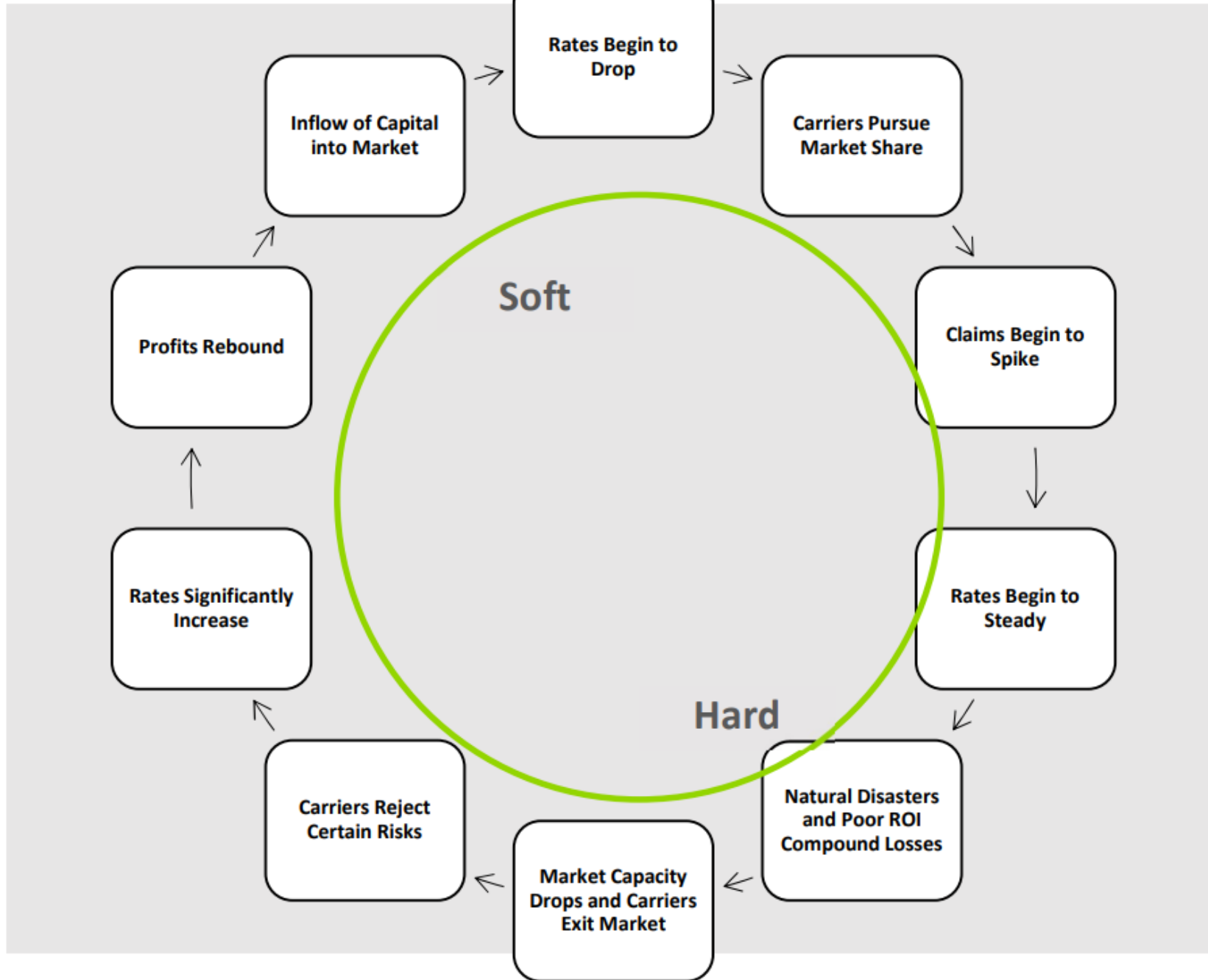
- Soft Market
 - Profitability in on the rise
 - Increased capital flowing into the market
 - New entrants join – competition increases
 - Leading to lower rates and potentially relaxed underwriting standards
- Soft Markets are cyclical
 - Margin pressures
 - Growing books of business leads to enhanced risks
 - Leads to increased claims
 - Low interest rates
 - Catastrophic losses
- Leads to a hard market



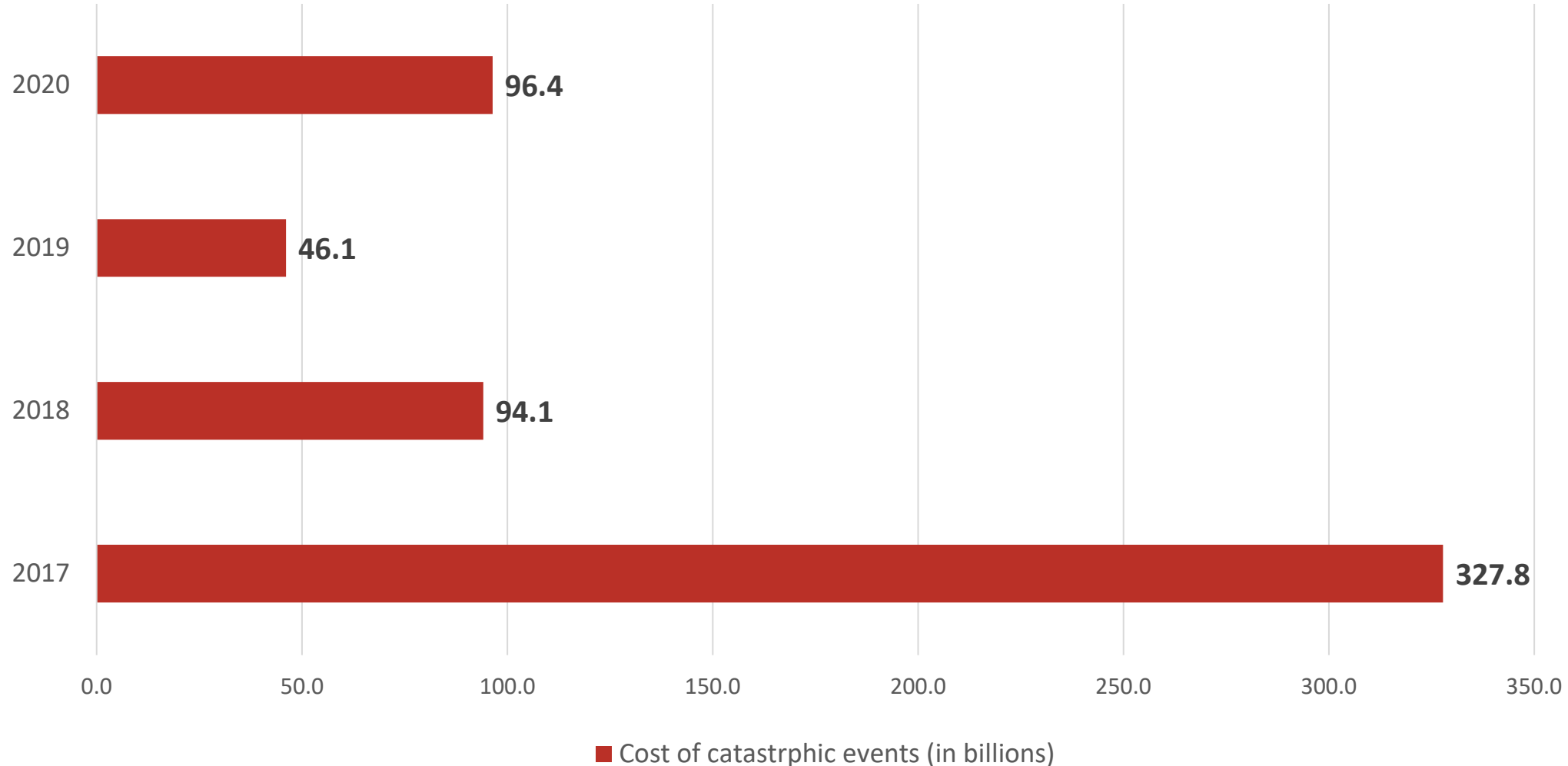
What is a Soft or Hard Market?

- Hard Market
 - Pressure to increase rates OR
 - Exit market all together
 - Tightening of underwriting standards
 - Competition decreases/risk consolidation increases
 - Leading to higher rates and potentially fewer options
- Hard Markets are cyclical
 - Financial condition slowly improves
 - Tighter underwriting leads to fewer claims
 - Profits bounce back
 - Capital returns to the market
- Leads to a soft market

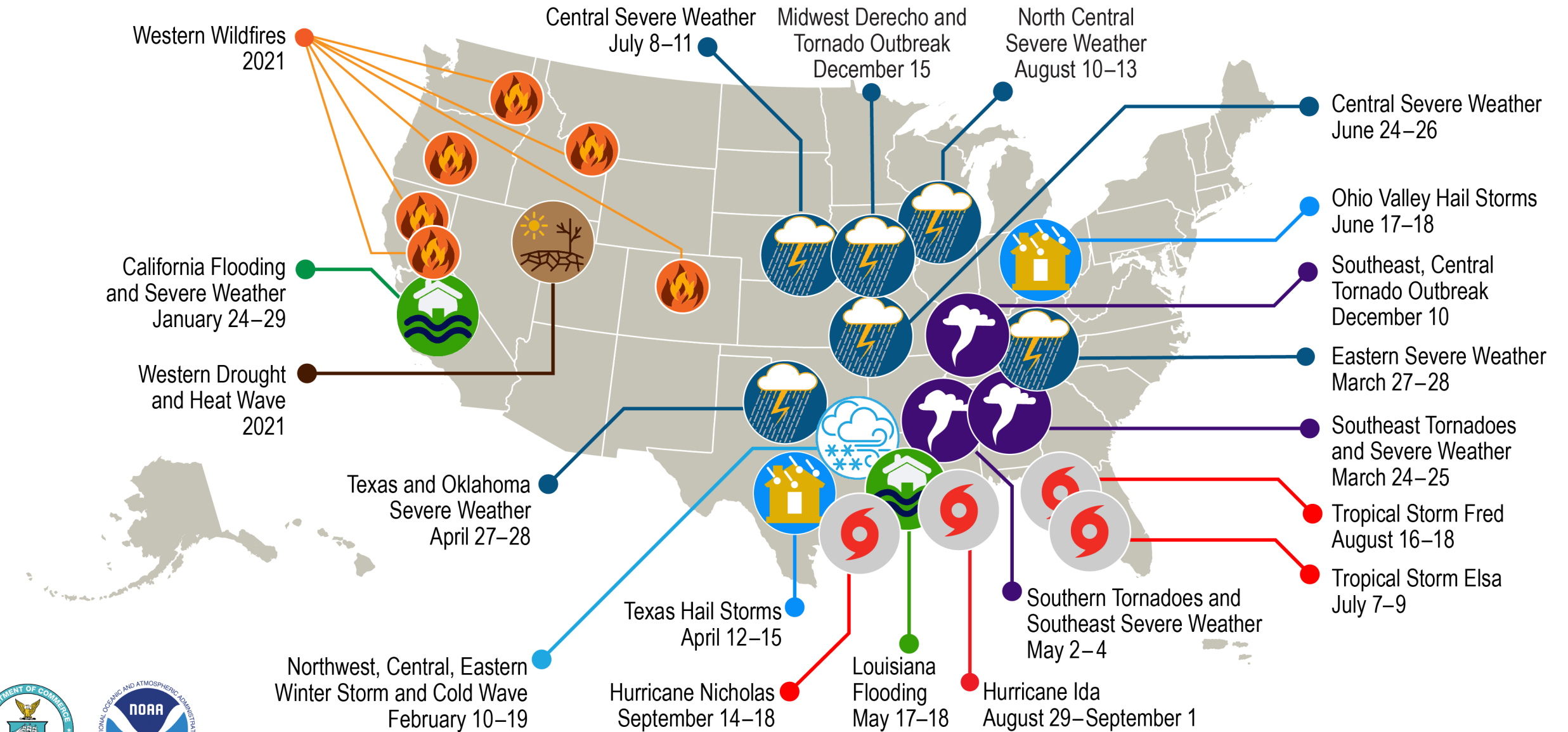
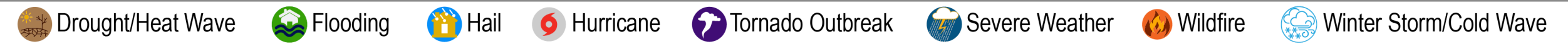




Catastrophic Losses in the U.S.

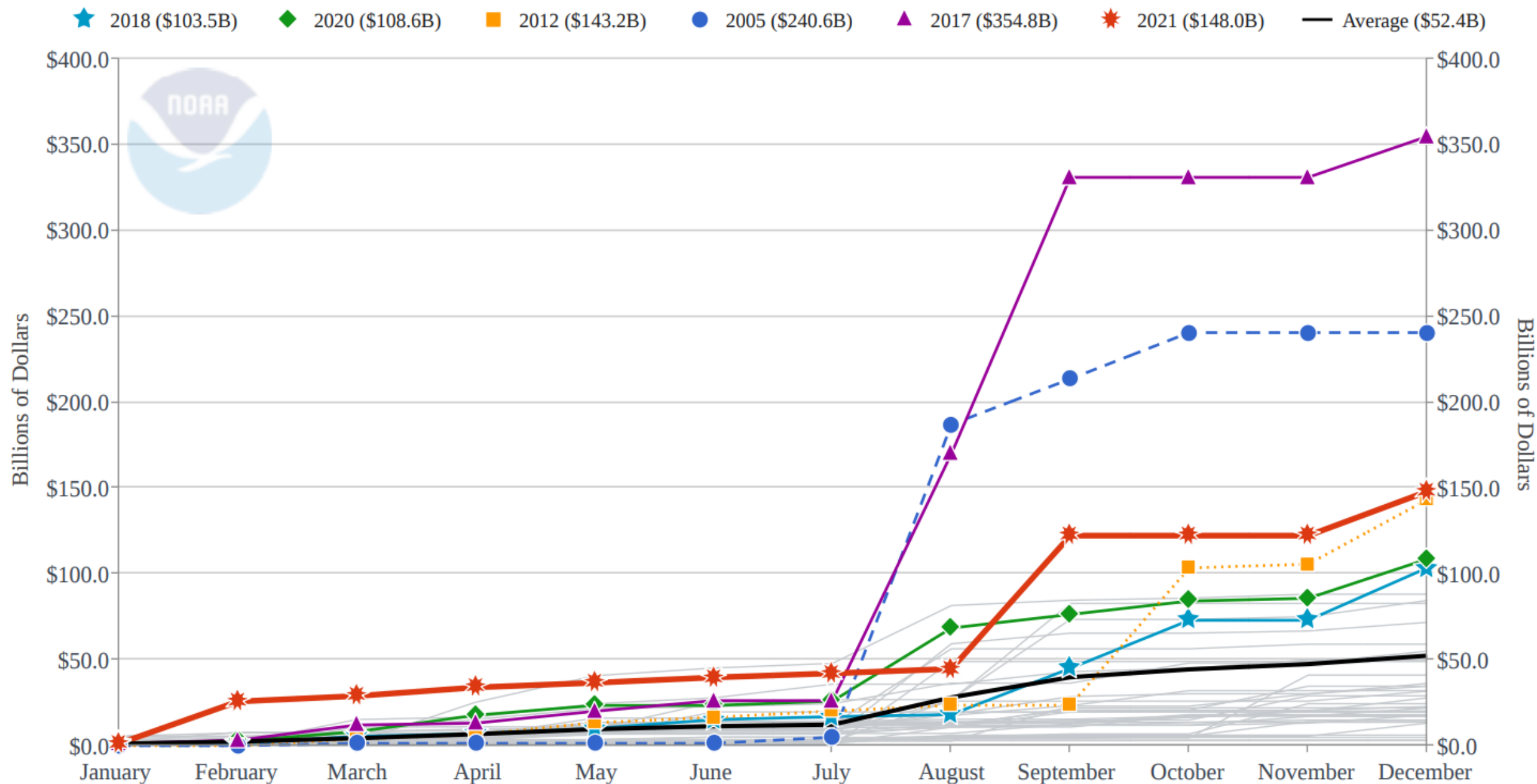


U.S. 2021 Billion-Dollar Weather and Climate Disasters



This map denotes the approximate location for each of the **20 separate billion-dollar weather and climate disasters** that impacted the United States in 2021

1980-2021 United States Billion-Dollar Disaster Event Cost (CPI-Adjusted)



Updated: April 8, 2022

Event statistics are added according to the date on which they ended.

Low Investment Yields, Reinsurance & Consolidation

- Low Investment Yields
 - Interest rates were held at record lows by the Federal Reserve
 - Rates have just started rising
 - P&C Insurers traditionally hold stable long-term investments
- Reinsurance
 - Given the increases in catastrophic losses 2022 global reinsurance rates double digit increases
- Industry Consolidation
 - Lignite Industry access to only two insurers (FM Global and Aegis)



Environmental, Social and Governance Movement (ESG)

- Over the past 15 years has transitioned from activist movements (Unfriend Coal) to multi-national self-regulating organizations (SROs)
- Movement within the insurance industry to establish decarbonization commitments and exit plans for doing business with fossil fuels.



Fossil Fuel Industry Movements

- UN-convened Net-Zero Insurance Alliance (NZIA)
 - 20 of the world's largest insurers
 - Goal of accelerating to net-zero emissions by:
 - Setting underwriting criteria and guidelines for GHGs
 - Engaging with clients on their decarbonization strategies
 - Integrating net-zero and decarbonization related risk criteria into risk management frameworks



Insurance Carrier Movements

- Individual Carriers
 - Tokio Marine (top 20 multinational carrier) – No new underwriting for coal-fired generation projects. Possible exception for Carbon Capture Storage.
 - AXIS (reinsurer) – Stricter climate policies – No new insurance for coal plants or infrastructure, both new and existing
 - No new insurance for companies which generate 20% or more of their revenues from coal.
 - Prudential – Zero emissions by 2050, restricting new direct investments in companies that derive 25% or more of revenue from coal.
 - AXA – Halting investments in and underwriting of new upstream greenfield oil exploration
 - 2023 will begin to factor policy into new coverage for upstream greenfield oil exploration



Insurance Carrier Movements

- Individual Carriers
 - FM Global and Aegis
 - Committed the coal industry and taking different approaches to underwriting and risk management
 - No intention of exiting coal but have concerns about being the last two left.
 - Employ a mutual structure that helps insulate them from external pressures
 - Not immune from market pressures, under hard market have enacted tighter underwriting standards.



COP 26 UN Climate Change Conference

- Energy Transition Council Priorities
 - Coal and fossil fuel transition (provide support and exit options to retire coal plants and cease building new capacity)
 - Just transition (creating new jobs for coal dependent regions)
- Global Coal to Clean Power Transition Statement
 - Scale up technology and policy to transition away from coal by 2030
 - Cease issuance of new permits for coal power plants and end direct government support for coal fired generation
- Statement on International Public Support for the Clean Energy Transition
 - End new direct public support for fossil fuel energy sector by end of 2022
 - Public and private sector financial flows is critical for driving the transition away from fossil fuels



Now What?

- ESG movement is continuing to gain momentum – Only two major insurance companies still provide coverage for most of the Lignite Coal Industry.
- Potential Solutions
 - State Reserve Fund
 - Captive Market



State Reserve Fund

- Leverage NDIRF and Bank of North Dakota to create a state-based insurance fund
 - Lacks diversity of risks
 - Anti-Selection due to potentially higher rates with state option
 - Extremely capital intensive
 - Requires novel governance structure that is not duplicated elsewhere
- Ultimately, this is not a viable solution



Self-Insurance/Captive Insurance

- Captive Insurance Company – wholly owned and managed by a group, association, corporate parent company.
 - Pure/Single Parent Captive
 - Risk Retention Group
 - Group Captive
 - Rental Captive
 - Protected/Incorporated/Segregated Cell Captive
- Captives act as a risk financing and retention mechanism to provide policyholders protection from external insurance market forces. Hard markets and limited coverages for certain risks have made captives a viable alternative solution for many years.



Captive Considerations - Regulatory

- 30 States have captive laws on the books
 - North Dakota is NOT one of them
- Requirements
 - Initial capital threshold
 - Registration
 - Premium taxes, etc.
- Concerns – we would want it to be very narrowly tailored



Captive Considerations - Financial

- Greater control over cash flow management
 - Underwriting profits are held in reserve to benefit the members
 - Member pays premiums relative to their own loss experience, not subject to the volatility of the insurance market
- Concerns
 - Significant capital outlay to meet minimum capitalization requirements
 - Startup costs – Administration, claims handling, rate setting



Captive Considerations - Risk Management

- Greater control over claim management process
 - Greater control can lead to better monitoring
 - Unused loss funds can be returned to the members
 - Centralized approach orientated towards independence and risk control.
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- Concerns – Requires more staff, that may or may not benefit in the long run



Recommendation

- Further study of Captive Insurance Option
 - Captive insurance exists precisely to close the gap some LEC members are facing
 - Captive insurance has been successful in some states
- Study the feasibility of forming a captive market for the Fossil Fuel Industry in North Dakota
 - Would need support from both Coal and Oil and Gas and perhaps production agriculture
 - Analysis to include regulatory considerations, risk, financial/tax requirements and legal structure.
 - Captives are not without risk, and we need to further understand what the framework could look like and what the financial structure would need to be

