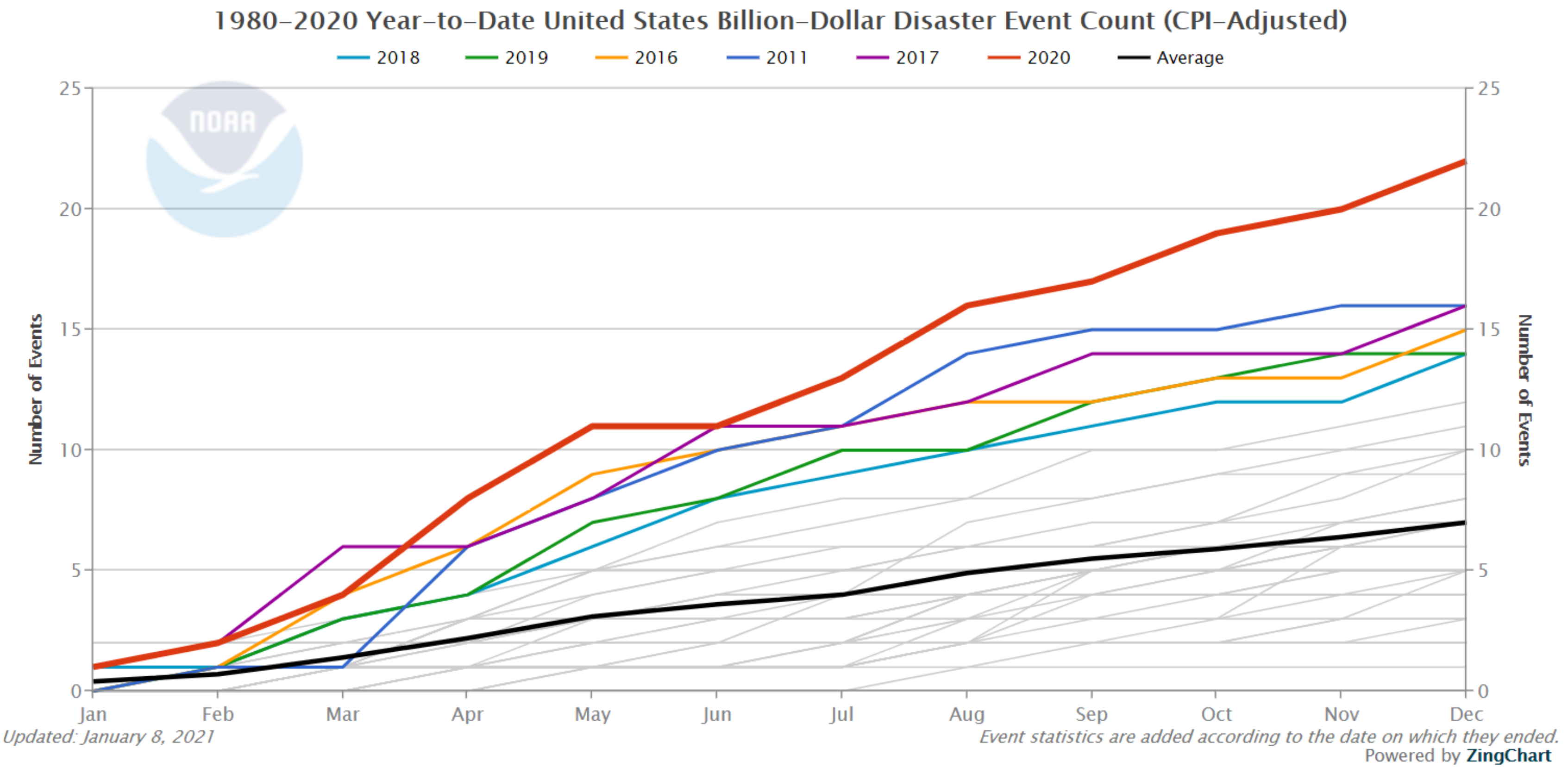
NEW YORK STATE OF OPPORTUNITY | Department of Financial Services

Proposed Guidance for New York Domestic Insurers on Managing the Financial Risks from Climate Change

April 8, 2021

Physical Risks from Climate Change are Accelerating



Source: [National Oceanic and Atmospheric Administration]()

Transition Risks are Accelerating

- **Policy and Regulation Change**
  - U.S. rejoined the Paris Agreement
  - Globally, governments are taking climate measures
- **Low-Carbon Technology Advancement**
  - Renewables to supply one-third of the world's electricity by 2025
  - Lifetime ownership of electric vehicles cheaper than gasoline cars
- **Changes in Public Sentiment and Demand Patterns**
  - 63% of U.S. adults worried about climate change
  - Worldwide proliferation in climate-related lawsuits
  - Net zero pledges by companies, banks, and asset owners/managers

Financial Risks from Climate Change

- **Financial markets are pricing climate risks but not enough**
  - Fossil fuel stocks' losses vs. renewables stocks' gains
  - Meaningful carbon premium in stocks around the world
  - U.S. homes in floodplains estimated to be overvalued by $34 billion
- **Credit rating agencies have taken notice and actions**
  - Moody's identified $8.7 trillion in rated debt with heightened climate risks.
  - S&P downgraded oil & gas companies.
- **Federal financial regulators increase focus on climate**
  - Federal Reserve Board
  - Securities and Exchange Commission
  - Federal Housing Finance Agency

Purpose of the Guidance

- Support our insurers in managing the financial risks from climate change (“climate risks”)
- Serve as a basis for supervisory dialogue

- DFS to develop timeframe by which insurers should have fully embedded their approaches to managing climate risks in the areas laid out in the guidance

Basis for the Proposed Guidance

- Discussions with NY insurers
- Review of insurers’ ERMs and ORSAs
- Review of insurers’ existing disclosure materials
- NY Insurance Law, NAIC manuals
- International regulators’ publications and guidance

Guiding Philosophy

- Climate change requires a **strategic** approach.
- A **proportionate** approach.
- Assess and manage both **physical** and **transition** risks on both **assets** and **liabilities**.
- Insurers' approach should **mature over time**:
  - Qualitative → quantitative
  - A few risk factors → more risk factors
  - Short term → medium to long term in scenarios and strategies
- **DFS's supervisory approach will evolve with insurers.**

3.1 Proportionate Approach

- Small insurers ≠ less climate risks
- Scenario analysis can be used by everyone

3.2 Materiality

- Insurers should make **informed judgments** about the significance of climate risks to their businesses.

- NAIC Examiners Handbook materiality benchmarks:
  - 5% of surplus or one-half of 1% of total assets
  - Subject to professional judgment and circumstances

- Certain risks may be material based on **external factors**

3.3 Risk Culture and Governance

3.3.1 Board Governance

- The board should **understand** and **assess** relevant climate risks
- Insurers should **designate** a member or committee of the board as well as a member of senior management to be **responsible for climate risks**, even if climate risks are not considered material now.

3.3.2 Risk Appetite

- Insurers should have a written risk policy with risk tolerance levels and limits for financial risks.
- Factors to consider:
  - Long term financial interest
  - Results of scenario analysis
  - Uncertainty and sensitivity of climate risks
- Start the process and evolve over time

3.3.3 Organizational Structure

- Include relevant control functions
- Clear roles and functions, processes and procedures
- Conduct objective, independent, and regular reviews
- Develop climate risk expertise at the board and employee levels
- Consider remuneration to align incentives

3.4 Business Models and Strategies

- Insurers are already exposed to climate risks and opportunities
- Be aware of changes in business environment and address them strategically
- Business strategy should be implemented at the entity, business unit, and product line level.
- Use scenario analysis and stress tests to help set business models and strategy
- Document the analysis

3.5 Risk Management

3.5.1 Risk management framework

- Address climate risks through **existing ERM functions**
- Identify, assess, monitor, manage, and report on their exposure to these risks
- Document in their written ERM and board risk reports the climate risks considered
- Manage and monitor risks over a long-term horizon
- Review the analysis on a regular basis

3.5.1 Risk management framework

- Risk identification and prioritization
- Risk appetite, tolerances, and limits
- Risk management and control
- Risk reporting and communication

3.5.2 Climate's Impact on Existing Risk Factors

- **Credit risk** – Effect of physical and transition risks on counterparties' profitability and viability
- **Legal risk** – Climate-related regulatory requirements, risk of litigation for failing to adapt to climate change or to avoid or minimize adverse impacts on the environment
- **Liquidity risk** – A lack of reliable information on climate-sensitive exposures could cause procyclical market dynamics

3.5.2 Climate's Impact on Existing Risk Factors

Market risk

- Consider how physical and transition risks affect current and future investments
- Monitor on an ongoing basis
- Consider timeframe of climate risks relative to maturity of fixed income assets, and sudden credit rating changes

3.5.2 Climate's Impact on Existing Risk Factors

- **Operational risk** – Consider how climate-related events adversely impact assets and business continuity

- **Pricing and underwriting risk** – Consider:
  - Increased natural catastrophes → increased claims
  - Transition risks' impacts on underwriting

- **Reputational risk** – Consider negative publicity from:
  - Underwriting or investing in high-carbon sectors
  - Reduction in insurance affordability or availability

3.5.2 Climate's Impact on Existing Risk Factors

Strategic risk – Consider:

- How climate risks affect competitive position and financial condition
- Constraints on business caused by risk-based pricing rising beyond demand elasticity and customer willingness to pay
- Correlation between liabilities and assets

3.5.3 ORSA

- Describe how climate risks are identified, categorized, managed, and monitored, including assessment tools and methods used
- If climate risks are **not material**, **document the justification**.
- If climate risks are **material**, **document assessment process**.
- **Proportionate** approach
- Asses **short-** and **long-term** risks
- **Implement** climate-related policies and procedures **at the entity level**, using group's expertise and resources where appropriate

3.6 Scenario Analysis

Why use scenario analysis for managing climate risks?

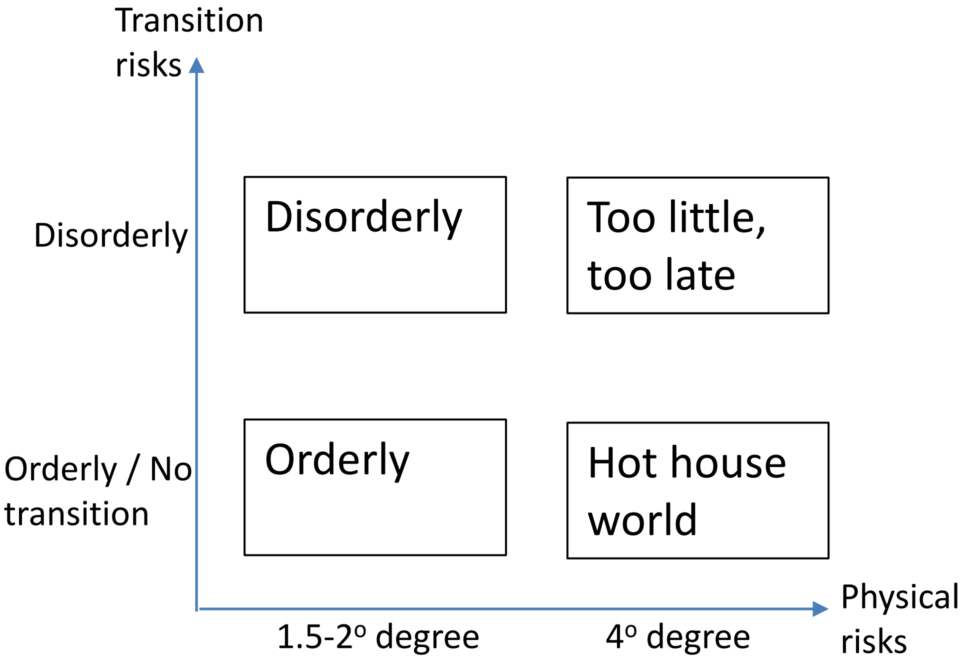
- Past ≠ Future
- Inherent uncertainty of climate risks
- Need longer term thinking and planning

How is Scenario Analysis for Climate Different?

- Scenarios considered: physical and transition risks
- Time horizons considered

Aspects that are the same

- Both liabilities and assets (for P&C insurers)
- Not relying solely on historical data



3.6 Scenario Analysis

- Use scenarios to understand the impact of climate risks on solvency, liquidity, and ability to pay claims. Consider:
  - Whether reactive actions are realistic or not
  - Merits of precautionary actions
  - Climate risks not fully reflected in asset pricing
  - Abrupt shifts in market
- There are publicly available resources on scenario analysis.
- Can be qualitative to start.

3.7 Public Disclosure

- Publicly disclose approach to managing climate risks
- Go beyond operational metrics and cover physical and transition risks’ impacts on underwriting, investments, and strategies
- Encourage disclosure by the wider economy
- Disclosure approach to mature over time
- Engage with Taskforce for Climate-related Financial Disclosure (TCFD) and other initiatives

Public Consultation Process

- Webpage: https://www.dfs.ny.gov/industry_guidance/climate_change#public-consultation
- Submission: insurance_climate_guidance@dfs.ny.gov
- Deadline: 11:59 p.m. EDT on Wednesday, June 23, 2021
- Who can comment? – Anyone and everyone
- All comments, including commenters' info, will be posted
- Comment template available on webpage

Template for Comments

Detailed Guidance for New York Domestic Insurers on Managing the Financial Risks from Climate Change

Deadline: Wednesday, June 23, 2021 at 11:59pm

Institution/Company	**Title**
Name	
Email address	**Phone number**

Please enter your comments on this chart. When entering feedback, please make sure that:

- each comment deals with a single issue only;
- you indicate the relevant section by using the drop down menu in the Section column;
- you indicate the relevant paragraph(s) by specifying the paragraph number(s) in the Paragraph Number(s) column; and
- you indicate whether your comment is a proposed amendment, clarification or deletion.

Please feel free to insert more rows if you have more comments.

If you have general comments not tied to a specific section, please enter them in the General Comments Section at the bottom of the page.

All comments, including the names and affiliations of the commenters, will be posted on DFS's website.

Please submit your comments to insurance_climate_guidance@dfs.ny.gov.

ID	Section	Paragraph Number(s)	Type of Comment	Detailed Comment
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Sheet 1

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Amendment
Clarification
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