2021 Update on New York Domestic Insurers’ Management of the Financial Risks from Climate Change

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Executive Deputy Superintendent, Climate Division
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Physical Risks from Climate Change

Sources: edn Hub, San Antonio Express News
Intergovernmental Panel on Climate Change: Sixth Assessment (2021-22)

“The scale of recent changes across the climate system as a whole...are unprecedented over many centuries to many thousands of years”*

Extreme weather events (storms, heat waves and droughts) more frequent and severe than predicted

Increasingly adverse health impacts

Loss and damage across many economic sectors and ecosystems

* Intergovernmental Panel on Climate Change, AR6 Climate Change 2021: The Physical Science Basis
Transition Risks from Climate Change

Europe's energy future: the plan to cut Russian fossil fuels and speed up the green transition

In partnership with The European Commission

Bloomberg US Edition

Politics
EU Nations Back 15% Gas-Cut Target as Russia Reduces Flows

- Ministers sign off on voluntary rules to cut demand by 15%
- Rules may become mandatory under emergency supply situation

Sources: Bloomberg, euronews.next
Transition Risks from Climate Change

Bloomberg

Green | New Energy

Renewable Power Costs Rise, Just Not as Much as Fossil Fuels

Costs to build and run new solar and wind facilities are still cheaper than gas or coal plants, BNEF survey finds.

Green | Climate Politics

Senate Deal’s ‘Huge’ Carbon Cuts Would Keep US Climate Goals Alive

The Inflation Reduction Act would cut up to 1 billion tons of carbon dioxide and get the US closer, but not all the way, to its Paris Agreement target, experts say.
National & International Climate-Related Financial Supervision

- **NAIC Climate & Resiliency (EX) Task Force:**
  - Aligned Climate Risk Disclosure Survey with Taskforce on Climate-related Financial Disclosure (TCFD)
  - Recommended updates to Exam Handbook and ORSA Manual

- **International Association of Insurance Supervisors:**
  - Established Climate Risk Steering Group
  - Application Paper on the Supervision of Climate-related Risks in the Insurance Sector

- **SEC:** Proposed “Enhancement and Standardization of Climate-Related Disclosures for Investors”

- **Banking Regulators:** Principles on Management of Climate-Related Financial Risks
Final DFS Insurance Climate Guidance & Implementation Timetable
# DFS Expectations

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### Overarching themes

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### Supervisory guidance

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3.6. Risk Culture and Governance

3.6.1. Board Governance

• The board should understand relevant climate risks.

• **Designate** a member or committee(s) of the board to be responsible for overseeing climate risks, even if climate risks are not considered material now.

• Designated board member can be at the group or entity level.

• Designate **senior management** as responsible for management of climate risks.

• Board oversight of implementation of public commitments
3.6.3. Organizational Structure

• Manage climate risks through *existing* ERM functions
• Clear roles and functions, processes and procedures
• Conduct *objective, independent, and regular* internal reviews
• Develop *climate risk expertise* at the board and employee levels
• Consider remuneration to align incentives
Reporting to DFS on Implementation

• Insurer response due 11/30/22.

• Channels of reporting
  1. NAIC Climate Risk Disclosure Survey, include relevant information on Governance.
  2. Request for Information

• Senior management review of responses is expected.
DFS Analysis of NAIC Climate Risk Disclosure Survey Responses
Methodology

• Same methodology as last year’s report

• 5 out of 8 questions analyzed → 3 themes

• Covered 85 insurer groups’ and 10 unaffiliated insurers’ 2021 Survey responses/TCFD reports

• Insurers were rated as “Yet to Start (= 1),” “Early Stage,” “Making Progress,” or “Good Progress (= 4).”

• Reviewed progress compared to 2020 responses
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<th>Question</th>
<th>Yet to Start</th>
<th>Early Stage</th>
<th>Making Progress</th>
<th>Good Progress</th>
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<td>Q3: Process for identifying climate risks and impacts on your business</td>
<td>No process in place to identify or assess climate risks. Identification done ad hoc, or responsibility assigned to a third-party.</td>
<td>Process of risk identification and assessment is in place but unclear whether the process addresses climate risks, and details on the process are insufficient. Risk identification and management cover only physical risks or only liabilities for P&amp;C insurers.</td>
<td>Process of climate risk identification and assessment is in place and imbedded in ERM. Some information provided on the process, data, and models used, and which business areas or product lines are considered. Risk identification and management cover only physical risks or only liabilities for P&amp;C insurers. Broad recognition of physical and/or transition risks without linking them to its business.</td>
<td>Process of climate risk identification and assessment is in place and embedded in ERM and the risk appetite framework. Details on organizational structure, processes, data, and models are provided. Describes how assessment of climate risks informs business strategies and risk mitigation strategies. Impacts of climate risks on branded risk factors beyond operational and reputational risks analyzed. Risk identification and management cover both physical and transition risks, and both assets and liabilities.</td>
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Summary of Findings

• Overall, there was progress compared to prior report, but wide range of sophistication.
  • On average the industry is in the “Making Progress”
  • “Good Progress”= Implemented many Guidance expectations

• Areas for Improvement:
  • Assignment clear roles and responsibilities
  • Formalizing integration into risk management framework
  • Evolving to quantitative assessment of risks
  • Medium to long term scenario analysis
DFS Application of Disclosure Materials

1. Understand insurers’ status in managing climate risks
2. Identify good practices to share with the industry
3. Support risk-based supervision
4. Verify compliance
5. Inform establishment of future timelines

Insurers’ ratings are used for DFS’s supervisory purposes and not publicly disclosed.
Overall Status of Insurers’ Management of Climate Risks

Group Premium-Weighted Ratings for Insurers Across the Three Themes
Composite Ratings Across Insurance Lines

Percentage of Groups/Unaffiliated Companies by Number

Percentage of Groups/Unaffiliated Companies by Group Premium
Composite Ratings of P&C Groups/Companies by Size

Yet To Start  Early Stage  Making Progress  Good Progress

≥ $10 billion  $2 billion - $10 billion  $500 million to $2 billion  < $500 million
Rating Changes for P&C Groups/Companies

% of Insurers Whose Ratings Increased by One or Two for the Five Survey Questions

% of Insurers Rated Low in 2020 that Had a Rating Increase in 2021 on the Investment Question
Composite Ratings of Life Groups/Companies by Size

- ≥ $20 billion
- $9 - $20 billion
- $3 - $9 billion
- < $3 billion

- Yet To Start
- Early Stage
- Making Progress
- Good Progress
Rating Increases for Life Groups/Companies

% of Insurers Whose Ratings Increased by One or Two for the Five Survey Questions

% of Insurers Rated Low in 2020 that Had a Rating Increase in 2021 on the Governance Question
Composite Ratings of Health Groups/Companies by Size

- Yet To Start
- Early Stage
- Making Progress
- Good Progress
Rating Increases for Health Groups/Companies

% of Insurers Whose Ratings Increased by One or Two for the Five Survey Questions

% of Insurers Rated Low in 2020 that Had a Rating Increase in 2021 on the Risk Management Process Question
Examples of Good Practices
More advanced insurers have already taken actions that are aligned with DFS’s expectations as set forth in the Guidance.
Good Practices in Risk Culture and Governance

**DFS Expectation** – Board and senior management structure for climate risks

**Example 1**

- **Board committees** designated:
  - Risk, Finance, Investment, Audit, Nominating and Governance

- **Senior management** functions designated:
  - Chief Risk Officer - Helps to embed responsibility within ERM function
  - Chief Investment Officer for Life insurers
Example 2 – Cross Functional Committee Structures

- A health group manages climate risks through the **ERM Committee**, led by its Chief Risk Officer.

- A multiline group established an Emerging Risk Forum

- A medium-sized life insurer established a Sustainability Working Council

- Another medium-sized life insurer established a Climate Risk Working Group
Example 3

- A P&C group identifies and assesses climate risk through its ERM program
  - Enabling holistic management of key risks and incorporation of risk and return management into its business model.
- A small P&C group incorporates climate risk into emerging risk processes.
- A medium-sized life group launched effort to enhance enterprise-wide assessment of climate risk.
Good Practices in Business Models & Strategies

DFS Expectation – Address climate risks and opportunities strategically

Example 4 – Environmental, Social, Governance (ESG) Policy Informs Investment Strategy

• A midsized life group established an ESG risk framework and policy setting investment criteria and standards for engagement.

• Another midsized life group believes that integrating ESG factors “leads to better decisions with respect to the sustainability of an investment and its risk and return profile.”
Example 5 – Climate-Related Opportunities in Underwriting Product Development

• A P&C group expanded product lines
  • Insuring clean tech companies; renewable energy products
  • Enhancing or adding products aimed at increased climate-related regulation

• A multiline group expanded its "Climate Change Resilience Services" advisory team of climate experts.
Good Practices in Risk Management

**DFS Expectation** – Address climate risks through existing ERM functions

**Example 6**

- A health group identifies and assesses its top enterprise risks including climate risks and opportunities as part of the periodic ERM updates.

- A multiline group uses risk dashboards, risk capital allocation and limit consumption reports to identify when climate aspects become material.

- A medium-sized life group’s ERM committee is updated quarterly on current and emerging risks including climate change.
DFS Expectation – Risk Identification and Prioritization

Example 7

- A multiline group’s ERM function helps identify, assess, quantify, manage, monitor, report and mitigate risk exposures through:
  - **Integrated bottom-up risk identification and assessment** by product;
  - **Annual top-down risk assessment** to identify top risks and assign risk owners

- A health group’s risk identification process includes an **enterprise risk framework and risk catalog**.
DFS Expectation – Integration of Control Functions & Three Lines of Defense

Example 8

One multiline group addresses climate risk through an overarching qualitative and quantitative risk reporting and controlling framework:

• First Line of Defense: business managers
• Second Line of Defense: independent oversight functions
• Third Line of Defense: independent Audit function
DFS Expectation – Consider Climate Risks in the ORSA

Example 9

• A P&C group adapted climate scenarios from Network for Greening the Financial System to reflect own risk profile.

• A small life group conducted top-down climate stress and scenario testing over 50 years to:
  • Illustrate potential exposure to balance sheet
  • Evaluate potential effects on strategic and financial position
  • Identify options for managing identified risks and opportunities
Good Practices on Modeling and Scenario Analysis

**DFS Expectation** – Use scenario analysis to inform strategic planning; determine the impact of climate risks on risk profile and business strategy

**Example 10**

- A small P&C group partnered with academic and insurance experts to incorporate assessment of climate risks into modeling.

- A medium-sized life group assessed physical and transition risk impacts over short, medium, and long-term time horizons for its investments.

- A health group consider multiple qualitative and quantitative scenarios.
Good Practices on Metrics and Targets

DFS Expectation – Apply quantitative tools and metrics and qualitative statements to help establish boundaries

Example 11

• Set **time-bound targets for investments** and disclosed metrics:
  - $ invested in climate solutions
  - Carbon footprint of investment portfolio (in tons of CO$_2$/$)
  - Implied warming potential of the investment portfolio
  - Transition risk cost as % of revenue under various scenarios
  - Loss in real asset portfolio due to physical risks (in % or $)
  - Climate Value at Risk
  - ...

• Membership in **Net Zero Asset Owner Alliance**
Good Practices on Metrics and Targets

- Set **time-bound targets for underwriting** and disclosed metrics:
  - Threshold of revenue generated from underwriting fossil fuel businesses,
  - Revenue generated from sustainable solution products,
  - Number of sustainable solution products.
  - …

- Membership in [Net Zero Insurance Alliance](#)
Conclusion

• On average the industry was in the “Making Progress” category, but progress varied across and within lines of businesses.

• Process for verifying compliance with Aug. 15 deadline:
  • 2022 Survey response/ Response to RFI
  • Due Date: November 30, 2022

• DFS will continue to evaluate and support insurers’ progress on climate risk management.
Questions?
Feedback?

Contact: climate@dfs.ny.gov