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Combatting Climate Change: The Push for More Robust Disclosures from Insurers

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As heat waves spike, wildfires rage, droughts languish, and storms become more severe, the climate crisis has been thrown into stark relief.[1] It is against this backdrop that investors are now pushing insurance companies for more robust climate disclosures, part of a larger environmental, social, and governance (ESG) effort, and regulators are taking action, with a final ruling from the SEC on a pending proposal to require publicly registered insurance companies to provide extra information about direct and indirect greenhouse gas emissions they produce expected at the end of 2022 or in early 2023. The insurance industry's investments in, and insurance policies issued in connection with, fossil fuel assets give the industry a unique position from which to consider adopting more sustainable business practices. For example, in California, the biggest property and casualty insurance market in the country, insurers had almost $540 billion invested in fossil fuel assets in 2019.[2] As climate change and climate disasters drive record losses and amid an increasing sense of social-consciousness in our culture,[3] shareholders are identifying a potential need for a change in the way the industry does business and an interest in ensuring that insurers are not underwriting pollutants (such as coal and tar sands).

Insurance is essential for consumers and businesses, but the industry faces increasing risk in continuing to invest in the fossil fuel and other greenhouse gas emitting industries given those industries' contributions to the quickly warming climate. Those industries are also expected to decline as the country transitions from carbon use to alternative energy sources and those assets could become stranded.[4] Insurers are likewise exposed to additional risk on property and casualty underwriting as they face mounting pressure from extreme weather events intensified by climate change.[5] For example, in 2020, the United States experienced 22 extreme weather and climate-exacerbated disasters that each had losses in excess of $1 billion.[6] The push for greater disclosure is thus framed as a means to manage these risks and hold insurers accountable for combatting climate change through their business practices.

Regulator Actions

The push for more information from insurers, and greater accountability for their role in addressing climate change, has followed significant development of current and proposed regulations related to climate risk in the insurance industry.

Leading the way at the state level, California's Insurance Commissioner from 2011 to 2019, Dave Jones, was the first financial regulator to evaluate insurance companies' reserve portfolios for climate-related risk.[7] As Commissioner, Jones asked insurers to voluntarily divest holdings in thermal coal based on economic indicators that projected its decline. He mandated that insurers within the state of California disclose investments in oil, gas, coal, or utilities that are more than 50 percent derived from those sources.[8] The New York Department of Financial Services (NYDFS) subsequently followed suit, becoming the first insurance regulator to issue climate-related risk guidance for insurers domiciled in New York state. The NYDFS issued guidance on November 15, 2021, on the impact of climate change on financial risk to provide insurers direction for developing a strategic road map to address climate-related risk. The initial steps of the guidance focused on board governance and putting a strong organizational structure in place. Compliance with the initial steps of the guidance was expected by August 15, 2022, with full implementation required within three to five years.[9]

At the national level, the National Association of Insurance Commissioners (NAIC) revised its Climate Risk Disclosure Survey (the NAIC Survey) in April 2022 to adopt a new climate risk disclosure standard that aligns with the Task Force on Climate-Related Financial Disclosures' (TCFD) disclosure framework.[10] This bipartisan group of state insurance regulators was led in this effort by current Insurance Commissioners Ricardo Lara of California and David Altmaier of Florida. Insurers with premiums of more than $100 million in 14 states (California, Connecticut, Delaware, Maine, Maryland, Massachusetts, Minnesota, New Mexico, New York, Oregon, Pennsylvania, Rhode Island, Vermont, and Washington) and the District of Columbia are required to complete the NAIC Survey and submit a TCFD-compliant report by November 30, 2022. The new standard is expected to increase the list of insurance companies that provide TCFD-compliant reports to roughly 400 insurers, compared to the 28 TCFD-compliant reports provided by insurers in 2021.[11] The revised NAIC Survey is structured around the four TCFD-focused areas: governance, strategy, risk management, and metrics/targets. Additionally, the NAIC Survey includes voluntary closed-ended questions that individual states can choose to include to support the narrative responses to the four TCFD-focused areas.

Following the NAIC's revisions to the NAIC Survey, the California Insurance Commissioner Ricardo Lara said that "Our global climate crisis affects every state, requiring us to reach across partisan divides to find solutions that protect all people. By holding insurance companies to this global standard for climate disclosure, insurance regulators are showing the power of united leadership in our efforts to address climate change and reduce the negative impacts on insurance consumers."[12]

In addition to the NAIC's efforts, a March 2022 proposal from the Securities and Exchange Commission (SEC) would require publicly registered insurance companies to provide extra information about direct and indirect greenhouse gas emissions they produce. The proposal would create new requirements for the disclosure of climate-related risks and impacts based on the same TCFD disclosure framework, including information about material impacts of climate risk on a company's business, and information about a company's governance, risk management, and strategy related to climate risk. It would also include a requirement to disclose a company's financial statements disaggregated metrics on climate-related impacts, expenditures, and estimates and assumptions, and require the disclosure of a company's greenhouse gas emissions, drawing on the Greenhouse Gas Protocol (GHG Protocol).[13] The proposed rule changes would require a registrant to disclose information about:

1. The registrant's governance of climate-related risks and relevant risk management processes;
2. How any climate-related risks identified by the registrant have had or are likely to have a material impact on its business and consolidated financial statements, which may manifest over the short-, medium-, or long-term;
3. How any identified climate-related risks have affected or are likely to affect the registrant's strategy, business model, and outlook; and
4. The impact of climate-related events (severe weather events and other natural conditions) and transition activities on the line items of a registrant's consolidated financial statements, as well as on the financial estimates and assumptions used in the financial statements.[14]

Comments have been received on the proposed rule, and it is likely that the SEC will publish a final climate change risk disclosure regulation at the end of 2022 or in early 2023.[15]

Investor Advocacy

Chubb[16] and Travelers[17] are two insurers that have faced proposals from shareholders that would require the insurers to produce detailed reports on their plans to meet climate goals (*e.g.*, limiting global warming to 1.5 degrees Celsius above pre-industrial levels) and to reduce greenhouse gas emissions associated with their business activities, with an eye toward the 2050 net-zero carbon emissions goal established in 2021 by the International Energy Agency.[18] In April 2022, the SEC decided that Chubb and Travelers could not exclude the proposals from their annual meetings, but both Travelers and Chubb fought against putting the shareholders' proposals to a vote. Each argued that the proposals concerned matters of their ordinary business operations, making them excludable under SEC Rule 14a-8, which concerns what shareholder proposals companies must include in proxy statements. Chubb, in particular, recommended that its investors reject the proposal, claiming that it had reduced underwriting for certain sectors like coal, but also needed to balance its interests.[19]

This sort of shareholder activism has proven effective. Chubb's shareholders voted in favor of the proposal in May 2022—72.2% of votes cast at the company's meeting were in support of the proposal for greater disclosures on whether and how the company intends to measure, disclose, and reduce the greenhouse gas emissions associated with its underwriting, insurance, and investment activities in alignment with the goal of limiting global warming to 1.5 degrees Celsius above pre-industrial levels and requiring net-zero emissions.[20] By contrast, Travelers shareholders did not vote to implement the proposal, with only 13.2% voting in favor.[21]

These shareholder strategies have also been effective outside of the insurance industry. CalSTRS, California's public teacher retirement fund, for example, said that it would vote against directors at the largest 1,900 global companies if those companies did not produce reports compliant with the TCFD disclosure framework. In 2020, CalSTRS voted to replace the entire ExxonMobil board after the company did not meaningfully respond to collaborative efforts to improve climate policies and failed to adopt investor proposals, a campaign that resulted in three independent board members being selected for Exxon.[22] In addition, Blackrock, the largest asset management company in the world by assets under management, has published guidance concerning its expectations with respect to climate-related disclosures, stating that "climate risk—physical and transition risk—presents one of the most significant systemic risk[s] to the long-term value of our clients' investments."[23] Earlier this year, Blackrock voted for two shareholder proposals requiring Berkshire Hathaway Inc. to issue disclosures addressing how the company is managing climate risk, noting that the company "is not adapting to a world where environmental, social, governance (ESG) considerations are becoming much more material to performance."[24] Though neither proposal was approved, Blackrock's dissatisfaction with Berkshire Hathaway's lack of ESG disclosures prompted other institutional investors to express their discontent with Berkshire Hathaway, increasing pressure on the company to modify its approach.[25]

Moving Forward

New guidance, possible regulations, and calls from investors demonstrate that the insurance industry may need to start assessing risk holistically to consider investment risk (*i.e.*, Does the investment policy currently consider investments that are environmentally unsustainable or located in areas prone to physical risks? What are the transition risk drivers that could result in investment losses? Are there opportunities to invest in new energy and has the investment committee considered the potential impact of such a transition?) and reputational risk (*i.e.*, What are the company's strategic goals related to net-zero carbon emissions? Is the company forecasted to meet the goals?). This includes adopting ESG as part of the insurer's strategy for growth and sustainability, tracking ESG metrics, assessing controls, and ensuring complete and accurate ESG reporting.[26]

The insurance industry will be asked to assess and address climate risk, as well as to be upfront and candid about what insurers are underwriting and where insurers have invested. And these adaptions in the insurance industry will be on a short fuse. As the most recent former California Insurance Commissioner advised: "If I were an insurance company CEO, I wouldn't wait until my regulator told me that I need to seriously address these risks, I would start doing it now."[27]

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