EU-US INSURANCE DIALOGUE PROJECT

CLIMATE RISK FINANCIAL OVERSIGHT WORKSTREAM
June 2023 Summary Report

I. Introduction

The EU-US Insurance Dialogue Project established the Climate Risk Financial Oversight Workstream in 2021 to share knowledge of, and views on: (1) appropriate climate risk disclosures within the insurance sector, including the evolution of the disclosure framework developed by the Task Force on Climate-Related Financial Disclosures (TCFD), how insurance regulators are adapting to those TCFD changes, and what the interrelationships are between them; and (2) other climate-related supervisory reporting and financial surveillance within the European Union (EU) and the United States (US). The workstream began its discussions in January 2022.

This report provides a summary of topics covered by the Climate Risk Financial Oversight Workstream and a summary of developments in members' jurisdictions during 2022.

II. Summary of Discussed Topics

The Climate Risk Financial Oversight Workstream members shared information and discussed the relevant laws and activities undertaken within their jurisdictions to address climate-related disclosures and reporting.

A. Climate Risk Disclosures

Supervisors in the EU and the US both require certain insurers to make public disclosures regarding how they are addressing climate-related risks.

In the EU, insurers are required to comply with the non-financial reporting requirements set forth in the Non-Financial Reporting Directive (NFRD) and the key performance indicators (KPIs) required by Article 8 of the Taxonomy Regulation. The NFRD requires companies with more than 500 employees to publicly disclose information on the development, performance, position, and impact of their activities, relating to, at a minimum, environmental, social, and employee matters, respect for human rights, anti-corruption, and bribery matters. The EU has also published guidelines on environmental and social matters (2017) and guidelines on climate-related information (2019) to inform companies' non-financial reporting.[1]

[1] European Commission, Guidelines on Non-financial Reporting (Methodology for Reporting Non-financial Information (2017), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017XC0705(01)&from=EN; European Commission, Guidelines on Non-financial Reporting: Supplement on Reporting Climate-related Information (2019), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52019XC0620(01)&from=EN.

The EU has also proposed a Corporate Sustainability Reporting Directive (CSRD)[2] that would amend the Accounting Directive to extend the scope of mandatory non-financial reporting, establish a means to obtain external assurances that the information reported is accurate, allow for digital tagging, and to have the European Financial Reporting Advisory Group (EFRAG) develop sustainability reporting standards. The EU focused on the interconnection between the CSRD and the Sustainable Finance Disclosure Regulation (SFDR).[3] The CSRD would establish reporting requirements for issuers, while the SFDR establishes disclosure requirements for financial market participants, financial advisers, and financial products. The SFDR requires public disclosures on environmental and social materiality at an entity level, including a due diligence statement on principal adverse impacts of investment decisions on sustainability factors and disclosure of engagement with investee companies and alignment with the Paris Agreement.

Sustainability reporting presents both an opportunity and a challenge. The opportunity created by sustainability reporting is that increased transparency and reliable, standardized information can improve the financial market's evaluation of an insurer's or reinsurer's business, positively affecting business valuations and stock prices. The challenge posed by sustainability reporting is getting high quality, comparable, and relevant disclosures given that implementing new processes and gathering data can be costly.

In the US, the NAIC first adopted the Climate Risk Disclosure Survey in 2010. In April 2022, the NAIC approved a revised Climate Risk Disclosure Survey aligning it to the TCFD framework.[4] The redesign focuses on required narrative questions based on the TCFD framework and voluntary closed-end questions that support quantification of results. States participating in the Survey require insurers licensed to do business within the state and annually writing at least $100 million direct written premium to complete the Survey. In 2021, for the 2020 reporting year, 14 states and the District of Columbia participated and over 1,300 insurers reported, representing nearly 80% of direct written premium annually in the US.[5] According to the NAIC, much of the remaining 20% represent insurers that do not meet the reporting requirement. Because of the Survey's new format

---

[2] The European Parliament approved the CSRD on 10 November 2022 and the European Commission is to adopt the first set of standards under the CSRD by June 2023. European Parliament, Sustainable Economy: Parliament Adopts New Reporting Rules for Multinationals (10 November 2022), https://www.europarl.europa.eu/news/en/press-room/20221107IPR49611/sustainable-economy-parliament-adopts-new-reporting-rules-for-multinationals#:~:text=The%20Corporate%20Sustainability%20Reporting%20Directive,their%20societal%20and%20environmental%20impact.

[3] Regulation (EU) 2019/2088 of the European Parliament and of the Council on Sustainability-related Disclosures in the Financial Services Sector (27 November 2019), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32019R2088.

[4] NAIC, Proposed Redesigned NAIC Climate Risk Disclosure Survey (2022), https://content.naic.org/sites/default/files/inline-files/2022ProposedClimateRiskSurvey_0.pdf. Prior to 2022, the survey contained eight questions that asked an insurer to discuss how it addresses a range of issues regarding how climate change affects its business. Beginning in 2020, the participating states began to encourage insurers that produced a TCFD report to file it in lieu of the 8-question survey.

[5] Illinois Department of Insurance (IDOI), "IDOI Calls on Insurers to Disclose Climate-Related Risks," press release, October 13, 2022, https://idoi.illinois.gov/news/press-release.25558.html#:~:text=IDOI%20issued%20Company%20Bulletin%202022,NAIC%20Climate%20Risk%20Disclosure%20Survey. For the 2022 reporting year, 16 jurisdictions (California, Connecticut, Delaware, the District of Columbia, Illinois, Maine, Maryland, Massachusetts, Minnesota, New Mexico, New York, Oregon, Pennsylvania, Rhode Island, Vermont, and Washington) will require the Survey.

for the 2021 reporting year, insurers required to complete the survey had until November 2022, to submit their survey responses. Individual company responses to the survey are public and posted annually on the California Department of Insurance website.

In November 2021, New York State Department of Financial Services (NYDFS) issued guidance to New York domestic insurers describing its expectations on the approach insurers should take for managing financial risks from climate change.[6] New York developed this guidance after reviewing NAIC Climate Risk Disclosure Survey responses, insurers' enterprise risk reports, Own Risk and Solvency Assessment (ORSA) summary reports, and other voluntarily filed disclosure materials, including TCFD materials.[7] It gave close consideration to the comments it received on the proposed expectations from various stakeholders that included industry trade groups, insurance companies, consumer advocates, and other relevant parties before issuing the final guidance. New York also rated the insurers by their level of progress based on their responses to the NAIC Climate Risk Disclosure Survey. The ratings indicated whether an insurer had yet to start, was at an early stage, was making progress, or was making good progress on managing financial risks from climate change. New York will use an insurer's climate risk disclosures to: (1) understand insurers status in managing climate risks; and (2) identify good practices to share with the industry. Insurers' ratings will only be used for New York's supervisory purposes and will not be publicly disclosed. New York's guidance required insurers to implement the expectations relating to board governance and to have specific plans in place to implement the expectations relating to organizational structure by August 15, 2022. Around the time that the NAIC Climate Risk Disclosure Survey was sent out to the insurers, NYDFS also issued a "Request For Information" (RFI) to all the insurers domiciled in the state to assess their compliance with the expectations that had the August 15, 2022 deadline. It has since received responses from most of the relevant insurers and is currently evaluating the level of compliance with the expectations.

B. Other Supervisory Reporting and Other Financial Surveillance

Supervisors in the EU and the US also have established, or are considering establishing, some prudential standards for certain climate-related risks and have provided guidance for how climate-related risks should be reported to supervisors.

The EU's supervisory reporting and financial surveillance for climate-related risks is focused on three areas: (1) prudential reporting and disclosure requirements under Solvency II; (2) supervisory expectations on the undertakings' ORSA; and (3) climate risk assessment at the sector level. There are no current EU requirements for insurers to report environmental, social, and governance (ESG)

[6] New York State Department of Financial Services (NYDFS), Guidance for New York Domestic Insurers on Managing the Financial Risks from Climate Change (November 15, 2021), https://www.dfs.ny.gov/system/files/documents/2021/11/dfs-insurance-climate-guidance-2021_1.pdf.

[7] NYDFS, New York Domestic Insurers' Management of the Financial Risks from Climate Change: An Analysis of NAIC Climate Risk Disclosure Survey Responses and Other Reporting (July 2021), https://www.dfs.ny.gov/system/files/documents/2021/09/naic-survey-analysis-report-2021_final_0.pdf. In July 2022, NYDFS released an updated analysis of insurers' survey responses that had been submitted in 2021. See NYDFS, 2021 Update on New York Domestic Insurers' Management of the Financial Risks from Climate Change - An Analysis of NAIC Climate Risk Disclosure Survey Responses and Other Reporting (July 2022), https://www.dfs.ny.gov/system/files/documents/2022/07/2021_Update_Insurers_Management_of_Climate_Risks_202207.pdf.

standards or climate-related risks or impacts to supervisors. The EU has amended the Solvency II Level 2 Regulation to require reporting on climate-related risks on investments.[8] Starting as of financial year 2023, reporting insurance undertakings will need to report on: (1) a new template that would capture climate change risk to investments; (2) the share of an insurer's investments exposed to climate change-related transition and physical risk; and (3) the share of an insurer's investments exposed to transition risk.

Regarding EIOPA's supervisory expectations for ORSA, Solvency II regulation requires undertakings to assess sustainability risks as part of their ORSA and requires short- and long-term assessments as well as scenario analysis for material climate risks. EIOPA has provided guidance on how to assess the materiality of climate risks in the ORSA. Companies will need to explain why they consider climate risks to not be material. If companies have determined that climate risks are material, they will then need to apply long-term climate scenarios.[9]EIOPA will conduct in 2024 a coordinated, bottom-up and top-down EU-level climate change stress test across the financial sectors to assess the resilience of the financial sector to reducing GHG emissions targets by 2030,[10] building on the initial analysis on transition or physical risk that EIOPA conducted in 2021 and 2022.

In the US, the work of the NAIC and state insurance regulators regarding supervisory reporting and financial surveillance for climate-related financial risks covers five areas: (1) risk-based capital (RBC) catastrophic risk charges; (2) ORSA requirements; (3) financial exam guidance; (4) investment stress scenarios; and (5) other financial oversight. The Total Catastrophic Risk (Rcat) includes capital charges for hurricanes and earthquakes. The primary reason the NAIC adopted these capital charges was to address the tail risk in these particular perils more directly, which were previously picked up more indirectly through the higher industry loss ratios where these types of losses were embedded. The NAIC adopted these capital charges in 2012, although they were only for informational purposes from 2012 to 2016. The charges became requirements in 2017. These charges added $25 billion to the industry aggregate RBC requirement. At the Spring 2022 NAIC Meeting, the NAIC adopted a similar requirement for wildfires. The reason that wildfire charges are currently being reported for informational purposes only is to monitor and measure the

---

[8] Commission Implementing Regulation (EU) 2023/894 of 4 April 2023 laying down implementing technical standards for the application of Directive 2009/138/EC of the European Parliament and the Council with regard to the templates for the submission by insurance and reinsurance undertakings to their supervisory authorities of information necessary for their supervision and repealing Implementing Regulation (EU) 2015/2450, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32023R0894.

[9] Material climate change risks should be subject to at least two long-term scenarios, where appropriate:

- a climate change risk scenario where the global temperature increase remains below 2°C, preferably no more than 1.5°C, in line with the EU commitments; and
- a climate change risk scenario where the global temperature increase exceeds 2°C.

[10] This one-off scenario exercise will be conducted jointly by the European supervisory authorities, the European Central Bank, and the European Systemic Risk Board in accordance with the Communication from the European Commission of 6 July 2021 "Strategy for Financing the Transition to a Sustainable Economy." For more information on this Communication, see Directorate-General for Financial Stability, Financial Services and Capital Markets Union, European Commission, "Strategy for financing the transition to a sustainable economy" (6 July 2021), https://finance.ec.europa.eu/publications/strategy-financing-transition-sustainable-economy_en.

accuracy of the modeled expected loss amounts against actual loss experience. The NAIC is considering RBC updates for other perils such as severe convective storms.

The NAIC ORSA Guidance Manual requires insurers to present all material and relevant risks but does not require insurers to address specific risks. While it does not require specific stress tests and specific capital calculations, it does require information on both risks in stressed environments as well as the capital needed for the (re)insurance companies to run its existing business plan.

The ORSA Guidance Manual has two goals: (1) foster an effective level of enterprise risk management (ERM) within insurers; and (2) provide an insurer level perspective on risk and capital, which supplements existing legal entity views. Currently there is no explicit ORSA requirement to discuss climate risk. Most property and casualty insurers identify catastrophe risk exposures and present modeled scenario results in their ORSA summary reports. Most insurers discuss asset risks as material and present various stress scenario results, although they generally do not expressly discuss climate risks. The NAIC is considering enhancements to ORSA that include: (1) a description of how climate risk is addressed through the risk management framework; (2) a discussion of the exposure of assets to transition/physical risks if climate change has the potential to materially impact the insurer's asset portfolio; (3) a discussion of the exposure of liabilities to transition/physical risks if climate change has the potential to materially impact the insurer's liabilities; and (4) a discussion of the material medium and long-term impacts of climate change risk on the company's near-term risk appetite, asset management, underwriting, and business strategy, as well as efforts to limit the impact on near-term solvency.

State insurance regulators conduct financial condition exams to review and evaluate an insurer's business processes and controls. All insurers are subject to such exams every three to five years. The examination interview template (Exhibit Y) includes optional climate-related questions that an examiner may ask to a company. The examiner should tailor the interview questions to those that are relevant for the company being examined. The NAIC is considering enhancements to the financial condition examination questionnaire (Exhibit B) and Exhibit Y and adding climate as a new critical risk category in Exhibit DD of the financial condition examination.

The NAIC has applied the International Association of Insurance Supervisors' climate scenario analysis and stress testing methodology to U.S. insurer investments. The NAIC plans to continue to run these scenarios.

In 2022, the NAIC approved the creation of a Catastrophe Modeling Center of Excellence. Among other things, it will provide model documentation and education and training to state insurance regulators to improve their understanding of the CAT modeling technologies used by insurers and reinsurers.

The NAIC is also considering updates to its Financial Analysis Handbook and the Climate Change and Risk-Focused Examination Course developed in 2014 with CERES.

During 2022, FIO advanced its three climate-related priorities through work that addresses supervisory reporting and monitoring of climate-related financial risks in the insurance industry.[11] FIO's priorities are guided by President Biden's Executive Order on Climate-related Financial Risk, Exec. Order No. 14030 (EO 14030), that tasked FIO "to assess climate-related issues or gaps in the supervision and regulation of insurers, including as part of the [Financial Stability Oversight Council's] analysis of financial stability, and to further assess, in consultation with States, the potential for major disruptions of private insurance coverage in regions of the country particularly vulnerable to climate change impacts."[12] In response to the first tasking in EO 14030, FIO began preparing in 2022 a report that analyzes climate-related issues and gaps in insurance supervision and regulation within the United States. This report will be published in 2023.

In response to the second tasking in EO 14030, FIO issued in October 2022 a request for comment on a proposed data collection from certain property & casualty insurers regarding their current and historical underwriting data on homeowners' insurance. The proposed data collection will assist FIO's assessment of climate-related exposures and their effects on insurance availability for policyholders, including whether climate change may create the potential for any major disruptions of private insurance coverage in regions of the country particularly vulnerable to climate change impacts.

III. Next Steps

The presentations during the workstream's meetings have led to engaging discussions that have identified common practices and challenges. The workstream has also provided an opportunity for members to gain additional insights from each other regarding ways to address the challenges being faced.

As both the EU and US move forward with their respective climate initiatives, both can learn from each other's experiences to address common challenges and identify best practices.

In terms of potential topics for 2023/2024, the workstream will continue to assess global developments relative to climate/sustainability disclosures on the insurance sector and how climate-related financial risks have been incorporated into their existing supervisory frameworks as well as consider examining how supervisors are currently using or considering using stress testing, scenario analysis, and sensitivity analysis to assess climate-related financial risks and the challenges posed by such analyses. The workstream will focus on:

---

[11] FIO's climate-related priorities are: (1) **Insurance Supervision and Regulation**: Assess climate-related issues or gaps in the supervision and regulation of insurers, including their potential impacts on U.S. financial stability; (2) **Insurance Markets and Mitigation/Resilience**: Assess the potential for major disruptions of private insurance coverage in U.S. markets that are particularly vulnerable to climate change impacts; facilitate mitigation and resilience for disasters; and (3) **Insurance Sector Engagement**: Increase FIO's engagement on climate-related issues; leverage the insurance sector's ability to help achieve climate-related goals. Federal Insurance Office Request for Information on the Insurance Sector and Climate-Related Financial Risks, 86 FR 48814 (August 31, 2021), https://www.federalregister.gov/documents/2021/08/31/2021-18713/federal-insurance-office-request-for-information-on-the-insurance-sector-and-climate-related.

[12] Executive Order on Climate-related Financial Risk, E.O. No. 14030, 86 FR 27967 (May 20, 2021), https://www.federalregister.gov/documents/2021/05/25/2021-11168/climate-related-financial-risk.

- Assessing how climate-related financial risks have been incorporated into macroprudential and market conduct elements of their supervisory frameworks.
- Continuing the discussions on global developments relative to climate/sustainability disclosures on the insurance sector, as appropriate.
- Understanding how the terms – stress testing, scenario analysis, and sensitivity analysis – are used in different jurisdictions and by the insurance industry.
- Exploring how stress testing, scenario analysis, and sensitivity analysis may be applied to address climate-related risks in different insurance markets.
- Discussing supervisory expectations for using stress testing, scenario analysis, and sensitivity analysis, such as part of an insurer's ORSA.