

**CORPORATE INSURANCE LAW**

**Expert Analysis**

## Department of Financial Services Surveys Insurers on Climate Risks

In February 2012, in the wake of the recent increase in catastrophic weather events, the New York State Department of Financial Services (DFS)<sup>1</sup> announced a joint initiative with the California Department of Insurance and the Washington State Office of the Insurance Commissioner to survey insurance carriers regarding climate change risks and the actions insurers are taking to study and address those risks. At the beginning of March, the DFS informed insurers that participation in the climate risk survey is mandatory for those insurers licensed in New York that collected direct written premium in excess of \$300 million in 2011. The survey responses are due by May 7, 2012, and will be published on the DFS website.

The insurance industry is perhaps uniquely situated with regard to climate risk. Insurers have the resources to study climate-related impacts and the incentive to do so in support of their business models to determine pricing, forecast risks and develop products. In addition, insurance carriers are subject to the same climate risks to which other businesses and individuals are subject. These risks threaten to impact a wide range of areas including transportation, business operations, real property, both commercial and residential, power and water supply, personnel issues and investments.

By sharing the results of their studies, insurers can educate the public on climate-related issues. By offering insurance products designed to address climate-related risks, insurers can help businesses and individuals plan for and address these risks. Finally, by offering discounts or through preferred underwriting guidelines, insurers can encourage consumers to take steps to minimize their exposure to climate-related risks.

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### Renewed Regulatory Focus

In 2009, the National Association of Insurance Commissioners (NAIC) adopted a climate risk survey similar to the one adopted by the DFS, but participation in that survey was voluntary. While the New York State Insurance Department had previously required some insurers to respond to the NAIC survey, the new survey is mandatory for a wider group of insurers.

Climate risks threaten to impact a wide range of areas including transportation, business operations, real property, power and water supply, personnel issues and investments.

This renewed focus on climate risk follows the Securities and Exchange Commission's issuance of interpretative guidance governing climate change-related disclosure for all public companies, announced in 2010, and is consistent with the growing interest in climate risk demonstrated by regulators as well as investors.<sup>2</sup> The focus on the insurance industry is a reaction, at least in part, to the unprecedented insurance industry losses caused by natural disasters and catastrophic weather events in 2011 and the beginning of 2012. According to *The New York Times*, by late June 2011, the estimated \$27 billion in 2011 losses had

already exceeded the 2010 total.<sup>3</sup> Other sources estimate that total 2011 losses for catastrophic weather events exceeded \$40 billion.<sup>4</sup>

In fact, Washington State's Insurance Commissioner, Mike Kriedler, cited the severe climate trends of recent years as the impetus for the climate risk survey initiative.<sup>5</sup> Benjamin M. Lawsky, superintendent of the DFS, echoed these concerns, explaining that "[g]lobal warming presents unique risks, and it is vital that our insurance industry adequately account for the impacts of climate change."<sup>6</sup>

Key concerns for regulators include insurer solvency, and availability and affordability of property and casualty, life and health insurance to address climate-related risks. The survey responses will aid the regulators in assessing insurance carriers' risk assessment and management efforts as they relate to climate issues.<sup>7</sup>

### Survey Questions

The climate risk survey was created by Ceres, a Boston-based nonprofit group that leads a coalition of investors, environmental organizations and other public interest groups working to address global sustainability issues like climate change and water scarcity.<sup>8</sup> The survey questions are derived in large part from a more comprehensive climate change questionnaire prepared by the Carbon Disclosure Project, a nonprofit organization that collects data concerning carbon emissions and other climate risk-related information from companies and distributes the information to investors.

In the survey, insurance carriers are asked for information concerning their plans and policies with regard to climate change-related risks and issues. The questions address the insurers' own carbon emissions as well as the risks that climate change poses to the insurers' business and investments, and whether and how the insurers consider and manage such risks. The survey also addresses steps taken by the insurers

to encourage policyholders to address climate-related risks.

The survey is divided into eight sections which seek narrative responses to the following questions:

1. Does the company have a plan to assess, reduce or mitigate its emissions in its operations or organizations? If yes, please summarize.

2. Does the company have a climate change policy with respect to risk management and investment management? If yes, please summarize. If no, how do you account for climate change in your risk management?

3. Describe your company's process for identifying climate change-related risks and assessing the degree that they could affect your business, including financial implications.

4. Summarize the current or anticipated risks that climate change poses to your company. Explain the ways that these risks could affect your business. Include identification of the geographical areas affected by these risks.

5. Has the company considered the impact of climate change on its investment portfolio? Has it altered its investment strategy in response to these considerations? If so, please summarize steps you have taken.

6. Summarize steps the company has taken to encourage policyholders to reduce the losses caused by climate change-influenced events.

7. Discuss steps, if any, the company has taken to engage key constituencies on the topic of climate change.

8. Describe actions your company is taking to manage the risks climate change poses to your business including, in general terms, the use of computer modeling.

### Prior Survey Responses

The DFS has published insurer responses to the NAIC climate risk survey issued in 2010 on its website.<sup>9</sup> In September 2011, Ceres published a report that examined climate-related disclosures made by 88 insurers in response to NAIC's 2010 survey. The survey responses that Ceres reviewed included those filed in New York as well as those filed with insurance regulators in New Jersey, California, Oregon, Pennsylvania and Washington.

The Ceres report concluded, based on evaluation of the insurers' disclosures, that insurers' actions to address climate issues have been collectively inadequate given the potential magnitude of the risks, finding that the industry "outside of a handful of the largest insurers, is taking only marginal steps to address an issue that poses clear threats to the industry's financial health, as well as the availability and affordability of insurance for consumers."<sup>10</sup> For example, Ceres reported that only 11 of the

88 responding insurers indicated that it had a formal climate risk management policy in place. In addition, more than 60 percent of the responding insurers had no dedicated management approach for assessing climate risk.

Overall, the primary focus of insurer responses was on risks associated with extreme weather events and in particular coastal storms and flooding and the risk of resulting property damage. The Ceres report took issue with this focus, making the point that weather catastrophes are not limited to coastal areas. Sadly, the recent surge in tornadoes in the Midwest provides ample evidence of that fact.

The Ceres report also expressed concern over insurers' reliance on catastrophe models prepared by third parties and questioned to what extent these models adequately incorporate changing climate trends. Likewise, the report concluded that few insurers were sufficiently considering climate change in connection with their investment strategies.

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This renewed focus on climate risk is consistent with the growing interest in climate risk demonstrated by regulators as well as investors. The focus on the insurance industry is a reaction, at least in part, to the unprecedented insurance industry losses caused by natural disasters and catastrophic weather events in 2011 and the beginning of 2012.

Nevertheless, there are some positives that can be gleaned from the survey responses. First, there was a broad consensus among the responding insurers that climate change will have an impact on extreme weather events. Second, some of the larger insurers have implemented comprehensive climate risk policies and are devoting significant resources to address climate risks in connection with risk management, investments as well as actions to reduce carbon emissions from their own business operations.

For example, in its 2010 survey response, Allianz Group reported that it has developed a long-term strategy intended to address climate risk issues. The objectives of the strategy include reducing the company's own carbon emissions, developing products and services geared to address climate risk issues and participating in research and public policy development related to climate change. Likewise, Zurich American Insurance Company reported

that it has commenced an initiative to study climate-related issues. The objectives of the initiative include developing an understanding and strategy to address weather, financial, regulatory and reputational risks associated with climate change. Chartis Inc. also reported that it was devoting significant resources to address climate change, including the adoption of a sustainability policy with respect to investment strategy. In addition, many of the insurers reported that they were studying their own operations to look for ways to encourage reduction of their carbon footprint.<sup>11</sup>

### Looking Forward

In the two years since the NAIC survey responses were published, it seems as if there has been one catastrophic weather event after another. These events have captured the attention of investors and regulators, both of whom are increasingly interested in ascertaining whether insurers are adequately prepared to address climate risks. At some point after the information is tabulated, the DFS will publish the new climate risk survey responses. Comparison of the insurer responses to the 2012 survey with the responses to the 2010 survey should be very interesting and should shed some light on whether and how much insurance carriers' strategies to address climate risks have evolved.

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1. In 2011, the New York State Department of Insurance became part of the newly formed New York State Department of Financial Services.

2. 75 Fed Reg. 6290-6297 (Feb. 8, 2010).

3. Barringer, Felicity. "Three States to Require Insurers to Disclose Climate-Change Response Plans," *New York Times* (Feb. 1, 2012).

4. <http://www.insurancenetworking.com/news/insurance-climate-change-risk-cers-30007-1.html>.

5. <http://www.insurereinsure.com/?entry=3769>.

6. Barringer, Felicity. "Three States to Require Insurers to Disclose Climate-Change Response Plans," *New York Times* (Feb. 1, 2012).

7. [http://www.dfs.ny.gov/insurance/insurers/climate\\_survey.htm](http://www.dfs.ny.gov/insurance/insurers/climate_survey.htm).

8. Barringer, Felicity. "Three States to Require Insurers to Disclose Climate-Change Response Plans," *New York Times* (Feb. 1, 2012).

9. [http://www.dfs.ny.gov/insurance/insurers/climate\\_survey\\_resp.htm](http://www.dfs.ny.gov/insurance/insurers/climate_survey_resp.htm).

10. "Climate Risk Disclosure by Insurers: Evaluating Insurer Responses to the NAIC Climate Disclosure Survey," (Ceres, September 2011).

11. [http://www.dfs.ny.gov/insurance/insurers/climate\\_survey.htm](http://www.dfs.ny.gov/insurance/insurers/climate_survey.htm).

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