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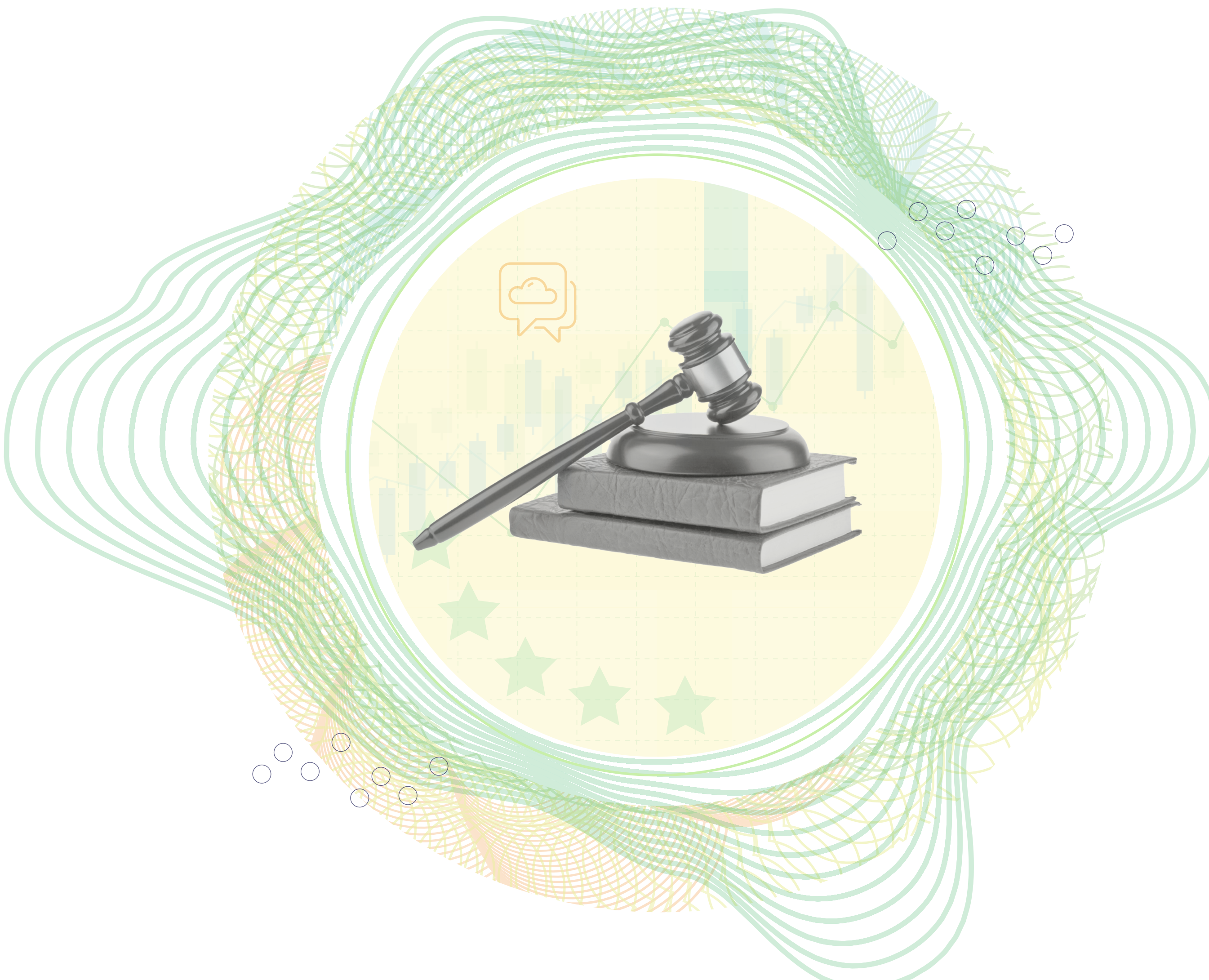

World of insurance climate disclosure

SEC proposed rules and NAIC Climate Risk Disclosure Survey

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Climate risk is firmly on the agenda of insurance regulators and standard-setters and is already expected to be addressed at the board level. Understanding the potential effects of climate risk on an insurance company's business is important, and reflecting those impacts through new disclosure requirements—as laid out by regulators such as the United States Securities and Exchange Commission (SEC) and state insurance departments—is increasingly likely to be required.

This year has already been particularly active on the regulatory front. On March 21, 2022, the SEC released a proposed rule to regulate the disclosure of climate-related risks across public companies.[1] The rule requires public insurers to include climate-related disclosures in certain of their SEC filings, including climate-related risks that are reasonably likely to have a material impact on the business, results of operations, or financial condition. The requirements would include disclosure of greenhouse gas (GHG) emissions.[2] The SEC proposed disclosure requirements are similar to those in broadly accepted disclosure frameworks from the Task Force on Climate-related Financial Disclosures (TCFD) and the Greenhouse Gas (GHG) Protocol.

In April 2022, the Executive (EX) Committee of the National Association of Insurance Commissioners (NAIC) approved revisions to the NAIC's annual Climate Risk Disclosure Survey (CRDS) to better align with the TCFD disclosure framework, which references the GHG Protocol.[3] Even though only 15 states have adopted the CRDS,[4] much of the industry may be impacted by the need to respond to multiple stakeholder demands and expectations. The situation becomes even more complex and challenging for those insurers that do business outside the United States.

Deloitte has been following developments within the insurance industry to prepare for these regulatory changes. This paper offers observations, analyses, and considerations for insurers as they expand climate disclosures to the SEC proposed rules and NAIC Climate Risk Disclosure Survey. Insurers should consider the impact of these changes, as adopted, on their businesses.

SEC proposed rules

The proposal defines climate-related risks as the actual or potential negative impacts of climate-related conditions and events on a registrant's consolidated financial statements, business operations, or value chain. Under the SEC proposed rule, a registrant must disclose information about:

1. **Governance of climate-related risks,** how identified climate-related risks have or are likely to have a material impact on a company's strategy; business model; outlook over the short-, medium-, or long-term; and risk management processes.
2. **Climate-related financial statement metrics** (e.g., disaggregated climate impacts on financial statement line items) and **impact of climate-related physical events and transition activities** on estimates and assumptions.
3. **GHG emissions,** including Scope 1 and Scope 2 (and Scope 3 phased in if material or if registrant has Scope 3 target).
4. **Reasonable assurance,** phased in for accelerated and large accelerated filers over certain GHG emissions disclosures; limited assurance precedes.
5. **Information about climate-related targets** and transition plans.

The proposed timing of filing requirements is set out in the table below. Public insurers should consider the impact of the proposed rule changes:

<table>
<tr><th colspan="4">2022</th><th colspan="4">2023</th><th colspan="4">2024</th><th colspan="4">2025</th><th colspan="4">2026</th><th colspan="4">2027</th></tr>
<tr><td>Q1</td><td>Q2</td><td>Q3</td><td>Q4</td><td>Q1</td><td>Q2</td><td>Q3</td><td>Q4</td><td>Q1</td><td>Q2</td><td>Q3</td><td>Q4</td><td>Q1</td><td>Q2</td><td>Q3</td><td>Q4</td><td>Q1</td><td>Q2</td><td>Q3</td><td>Q4</td><td>Q1</td><td>Q2</td><td>Q3</td><td>Q4</td></tr>
<tr><td rowspan="6">Proposal release</td><td rowspan="6">Comment period through June 17</td><td rowspan="6"></td><td rowspan="6"></td><td colspan="20">All disclosures (including Scope 1 and Scope 2 GHG emissions), except Scope 3</td></tr>
<tr><td colspan="4">Large accelerated filer</td><td colspan="4">Accelerated and nonaccelerated filer</td><td colspan="4">Smaller reporting company (SRC)</td><td colspan="4"></td><td colspan="4"></td></tr>
<tr><td colspan="20">Scope 3 GHG emission disclosures (SRC is exempt)</td></tr>
<tr><td colspan="4"></td><td colspan="4">Large accelerated filer</td><td colspan="4">Accelerated and nonaccelerated filer</td><td colspan="4"></td><td colspan="4"></td></tr>
<tr><td colspan="20">Attestation on Scope 1 and Scope 2 GHG emission disclosures (not required for nonaccelerated and SRC)</td></tr>
<tr><td colspan="4"></td><td colspan="4">Large accelerated filer – Limited assurance</td><td colspan="4">Accelerated filer – Limited assurance</td><td colspan="4">Large accelerated filer – Reasonable assurance</td><td colspan="4">Accelerated filer – Reasonable assurance</td></tr>
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*Disclosure date depends on fiscal year-end reporting for each company.

Climate change disclosure requirements

The proposed rule requires a registrant to disclose both qualitative and quantitative information inside and outside the financial statements.[5] An example of quantitative information is GHG emissions (with attestation for Scope 1 and Scope 2 disclosures), including metrics both by disaggregated constituent greenhouse gases and in aggregate, and in absolute and intensity terms. If material or if a registrant has a GHG emissions target that includes Scope 3, a registrant would be required to disclose GHG emissions from upstream and downstream activities in its "value chain" (Scope 3). The proposed rule regarding GHG emissions disclosures seeks to provide investors with decision-useful information to assess a registrant's exposure to, and management of, climate-related risks and transition risks.

Additionally, the proposed rules require public insurers to provide:[6]

1. Climate-related disclosures in its registration statements and Exchange Act annual report;
2. Mandated climate-related disclosures in a separate, appropriately captioned section of its registration statement or annual report, or alternatively to incorporate that information in the separate, appropriately captioned section by reference from another section, such as the Management's Discussion and Analysis ("MD&A"); and
3. Mandated climate-related financial statement metrics and related disclosures in a note on the registrant's audited financial statements.

Insurance sector challenges

The SEC proposed rule requirements will require insurers to increase analysis of and disclosure for climate-related risks. Public insurers may identify the following:

1. Increased exposure to the negative impacts of climate event, such as increases to insurance claims due to the increase in frequency and intensity of wildfires or hurricanes;
2. Increased needs for data surrounding not only GHG emissions but detail surrounding their upstream and downstream affiliates and third parties worked with including investment managers, power providers, and others;
3. Identify increased scrutiny surrounding commitments to carbon neutrality and the timelines associated with meeting those goals.

Additionally, public insurers may face increased pressure to appropriately define the value chain activities performed by the registrant in Scope 3 and the applicability to the insurer's policyholders. Insurance companies should consider the magnitude and probability of those risks over the short-, medium-, and long-term when considering their materiality threshold.

NAIC revised insurer Climate Risk Disclosure Survey

In April 2022, the NAIC Executive (EX) Committee revised its Climate Risk Disclosure Survey. The NAIC action represents a significant step in aligning the US regulatory and supervisory environment to increasingly accepted international standards. The revised Climate Risk Disclosure Survey will be phased in with existing survey responders having their August 31, 2022, deadline for submission extended to November 30, 2022.[7] In 2023, filing of the survey will revert to August 31.

The Climate Risk Disclosure Survey was created by the NAIC in 2010 and is administered by the California Department of Insurance. Beginning in 2022, 14 states and the District of Columbia require insurers licensed in the state to complete the NAIC Climate Risk Disclosure Survey.[8] The 14 states include California, Connecticut, Delaware, Maine, Maryland, Massachusetts, Minnesota, New Mexico, New York, Oregon, Pennsylvania, Rhode Island, Vermont, and Washington. The 14 states and Washington, DC represent almost 80% of the US insurance market based on direct premiums written.[9]

The survey sets out to accomplish six goals:[10]

1. **Enhance transparency** about how insurers manage climate-related risks and opportunities.
2. **Identify good practices and vulnerabilities.**
3. **Provide a baseline supervisory tool** to assess how climate-related risks may affect the insurance industry.
4. **Promote insurer strategic management** and encourage shared learning for continual improvement.
5. **Enable better-informed collaboration and engagement** on climate-related issues among regulators and interested parties.
6. **Align with international climate risk disclosure frameworks** to reduce redundancy in reporting requirements.

The revised NAIC survey is organized around the four TCFD focus areas including: governance, strategy, risk management, and metrics and targets:[11]

1. **Governance:** An organization should disclose its governance around climate-related risks and opportunities including the board's oversight and management's role in assessing and managing climate-related risks and opportunities.
2. **Strategy:** An insurer should disclose material, actual, and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning. This includes describing the resilience of the strategy considering different climate-related scenarios.
3. **Risk management:** An insurer should consider the disclosure of the metrics and targets used to assess and manage relevant material climate-related risks and opportunities.
4. **Metrics and targets:** An insurer should disclose the metrics used in line with its strategy and risk management process; disclose Scope 1, Scope 2, and if appropriate, Scope 3 GHG emissions and related risks; and describe targets used by the insurer and performance against targets.

TCFD recommends an insurer provide climate-related financial disclosures in its public annual financial filings. For strategy as well as metrics and targets, TCFD recommends providing the information in annual filings when the information is material.

Organizations exposed to climate-related risks should consider:

1. Using scenario analysis; and
2. Disclosing how resilient their strategies are to a range of plausible climate-related scenarios.

Those with more significant exposure to transition risk and/or physical risk should undertake detailed qualitative and potentially quantitative scenario analysis for key drivers and trends impacting operations.

The New York Department of Financial Services (DFS) is driving expectations and released guidance for New York domestic insurers in November 2021. That release may be a guide for other states. Although TCFD only recommends quantitative scenario analysis, New York expects its licensed insurers to quantify risks.[12] This expectation may be indicative of a trend toward insurers having to quantify risks.

Additionally, New York expects an insurer to:[13]

1. Integrate consideration of climate risks into governance structure;
2. Consider the current and forward-looking impact of climate-related factors;
3. Incorporate climate risks into existing financial risk management;
4. Establish a climate risk policy approved by the governance structure;
5. Use scenario analysis to inform business strategies and risk assessment and identification; and
6. Disclose climate risks and engage with TCFD and other initiatives when developing disclosure approaches.

An insurer should take a proportionate approach to reflect its exposure to climate risks and the nature, scale, and complexity of its business. Although not all insurers have the same level of resources, all insurers are expected to analyze climate risks relative to both insurance underwriting and investments.

Scenario testing

The revised NAIC CRDS suggests that an insurer should consider using scenario analysis in disclosing climate risks regarding strategy, risk management, and metrics and targets.[14] In New York, insurers should look to qualitatively analyze the impact of climate risks on relevant risk factors (e.g., credit, legal, liquidity, market, operational, pricing and underwriting, reputational, and strategic risks) for their business lines and assets.[15] Scenario testing should include a spectrum of potential societal transitions, or lack thereof, related to fossil fuel-based energy versus more sustainable sources, including:

1. An orderly transition that phases out fossil fuel-based energy and transportation with minimum financial market disruption and a limited increase in natural disasters;
2. A disorderly transition with a large financial market disruption and a limited increase in natural disasters;
3. A disorderly transition with a drastic increase in natural disasters; and
4. No transition with a drastic increase in natural disasters.

The scenarios should include a short- to medium-term assessment and quantification of the insurer's exposure within the existing business planning horizon.[16] The scenario should also include a long-term assessment, based on the current business model and for business decisions requiring a long-term horizon. Clearly insurers will need to consider how they respond to an assessment of climate scenarios and the impact on their business.

Materiality

The revised NAIC survey has a materiality requirement for the reporting areas of strategy and metrics and targets, excluding the Scope 1 and Scope 2 GHG emissions sections.[17] While those disclosures related to strategy and metrics and targets must be reported only if material, disclosures related to governance and risk management reporting must be disclosed regardless of materiality. The revised NAIC survey materiality requirement looks to the *Financial Condition Examiners Handbook* and the SEC definition of materiality.[18] Alternatively, in New York, a climate risk is material if it meets the *New York Handbook's* materiality benchmarks (e.g., 5% of surplus or one-half of 1% of total assets) adjusted by professional judgment and circumstances, or if there is knowledge that the risk could influence the decisions of an insurer's board, management, regulators, or other relevant stakeholders.[19]

Analysis of SEC proposal and NAIC action

Both the SEC and NAIC chose to follow the TCFD framework, which allows for consistency in reporting. If an organization is subject to both the SEC and the revised NAIC CRDS, then consideration should be given to consistency across the organization to increase transparency and gain stakeholder trust. Below is a comparison of some of the key considerations between the SEC proposed rules and the revised NAIC CRDS.

	SEC proposed rules	Revised NAIC CRDS
TCFD framework used as guidance	Yes	Yes
First reporting deadline	In 2023, large accelerated filers must provide all disclosures (including Scope 1 and Scope 2 GHG emissions), except Scope 3. In 2024, accelerated and nonaccelerated filers must provide the same information, and in 2025, SRC follows.	November 30, 2022. In years following 2022, the reporting deadline is August 31.
Materiality requirement	Information is material if there is a substantial likelihood that its disclosure would have been considered significant by a reasonable investor.[20]	Governance and risk management reporting must be disclosed regardless of materiality, while strategy and metrics and targets is subject to the materiality standard. Information is material if: • The dollar amount above which the examiner's perspective of the company's financial position will be influenced, and/or[21] • It meets the SEC definition of material.
Scope 3 emissions	Except SRCs, all public company insurers will need to analyze and disclose Scope 3 GHG emissions.	Scope 3 GHG emissions are not required. Disclose Scope 3 if appropriate.

Next steps

Insurers should consider the impact of the proposed and adopted regulatory changes. Forward-looking insurers are focusing on the implications for their business models as well as the strategic risks and opportunities that climate risk brings, going to the very heart of what these disclosure standards are driving toward.

Contacts

Bryan Benjamin
Advisory partner
Deloitte Services LP
+1 718 508 6064
bbenjamin@deloitte.com

Matt Martinez
Audit & Assurance partner
Deloitte & Touche LLP
+1 312 486 1781
matmartinez@deloitte.com

Donna Szatkowski-Zych
Audit & Assurance partner
Deloitte & Touche LLP
+1 212 436 6139
dszatkowski@deloitte.com

Kedar Kamalapurkar
Consulting managing director
Deloitte Consulting LLP
+1 202 460 6311
kkamalapurkar@deloitte.com

David Sherwood
Managing director
Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
+1 203 423 4390
dsherwood@deloitte.com

Ashlee Bartlow
Audit & Assurance senior manager
Deloitte & Touche LLP
+1 312 486 1737
ashunt@deloitte.com

James Gordon
Tax senior manager
Deloitte Tax LLP
+1 212 436 6296
jagordon@deloitte.com

Fahad Qayyum
Advisory senior manager
Deloitte Services LP
+1 617 437 3539
fqayyum@deloitte.com

Tom Marazzo
Advisory manager
Deloitte Services LP
+1 212 436 7862
tmarazzo@deloitte.com

Diane Nyemba
Advisory manager
Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
+1 860 725 3428
dnyemba@deloitte.com

Ashley Wells
Advisory analyst
Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
+1 216 589 5470
aswells@deloitte.com

Endnotes

1. US Securities and Exchange Commission (SEC), "SEC Proposed Rule Release No. 33-11042, The Enhancement and Standardization of Climate-Related Disclosures for Investors," 17 CFR 210, 229, 232, 239, and 249.
2. SEC, "SEC proposes rules to enhance and standardize climate-related disclosures for investors," press release, March 21, 2022.
3. National Association of Insurance Commissioners (NAIC), 2022 Spring National Meeting materials, Kansas City, Missouri, April 6, 2022.
4. Including the District of Columbia; see: NAIC, "US insurance commissioners endorse internationally recognized climate risk disclosure standard for insurance companies," April 8, 2022.
5. SEC Proposed Rule Release No. 33-11042, The Enhancement and Standardization of Climate-Related Disclosures for Investors.
6. Ibid.
7. NAIC, 2022 Spring National Meeting Materials, Kansas City, Missouri, April 6, 2022.
8. NAIC, "US insurance commissioners endorse internationally recognized climate risk disclosure standard for insurance companies," April 8, 2022.
9. Ibid.
10. NAIC, 2022 Spring National Meeting Materials, Kansas City, Missouri, April 6, 2022.
11. Task Force on Climate-related Financial Disclosures (TCFD), "Recommendations of the Task Force on Climate-related Financial Disclosures," June 2017.
12. New York Department of Financial Services (NYDFS), "Guidance for New York domestic insurers on managing the financial risks from climate change," November 15, 2021.
13. Ibid.
14. NAIC, "Proposed redesigned NAIC Climate Risk Disclosure Survey," 2022.
15. NYDFS, "Guidance for New York domestic insurers on managing the financial risks from climate change" November 15, 2021.
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18. Ibid.
19. NYDFS, "Guidance for New York domestic insurers on managing the financial risks from climate change," November 15, 2021.
20. Basic v. Levinson, 485 U.S. 224 (1988) and TSC Industries v. Northway, 426 U.S. 438 (1976).
21. NAIC, Financial Condition Examiners Handbook, 2021.