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New York Regulator Issues Final Guidance for Domestic Insurers on Climate Change Risks

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The New York State Department of Financial Services (DFS) released final regulatory guidance to domestic insurers regarding their management of climate change risk, incorporating public comments DFS received on its initial draft released on March 25, 2021. The guidance aims to assist insurance companies in increasing their resilience to climate change by incorporating climate change adaptation and mitigation into their risk management framework and governance practices.

As the guidance notes, climate change poses both significant risks and opportunities for the insurance industry. On the one hand, climate change presents physical and transition risks that have the potential to affect both the assets and liabilities on an insurer's balance sheet and may impact an insurer's entire business model. On the other hand, climate change offers opportunities for insurers to assist in the management of climate risks by "helping communities be more resilient through inclusive and affordable insurance, contributing to climate change adaptation and mitigation, and enhancing the insurability of climate-related risks."

The guidance issued by DFS is part of a wider push by the National Association of Insurance Commissioners' Climate and Resiliency (EX) Task Force and other state regulators to make sure the insurance industry is adequately prepared for the effects of climate change. The guidance articulates that DFS "expects insurers to take a strategic approach to managing climate risks" by considering current and forward-looking risks and identifying proportionate actions required to manage those risks.

Per the final guidance, a New York domestic insurer should:

1. Incorporate the analysis of climate risk into its governance structure at the group or insurer entity level by ensuring that the applicable boards adequately understand and retain oversight of the management responsible for overseeing such risks.
2. Consider current and forward-looking climate impact when making any business decisions.
3. Incorporate climate risk into its risk management framework, including in the insurer's own risk and solvency assessment (ORSA).
4. Use climate scenario analysis to inform business decisions, and consider physical and transition risks, multiple carbon emissions and temperature pathways, and short-, medium- and long-time horizons.
5. Include climate risks in any applicable disclosures, and consider the recommendation of DFS's task force on climate-related financial disclosures.

The final regulatory guidance expands upon the draft guidance published in March. For example, the final guidance requires that a domestic insurer designate a member or committee of the board who is responsible for the oversight of the insurer's management of climate risk. The board is also now explicitly responsible for ensuring that the insurer makes progress toward meeting any announced climate commitments. This board requirement, as well as any other requirements established through the regulatory guidance, may be implemented at the group level.

The final guidance also contains new sections clarifying that the time horizon for climate risks will go beyond the standard three-to-five-year short-term time horizon to a five-to-10-year medium-term horizon and ultimately a 10-to-30-year long-term horizon, with time horizons specifically tailored to each insurer's business and activities. The final guidance recognizes that although there may be uncertainty and data gaps concerning climate change, such uncertainty does not justify inaction. Notwithstanding any such uncertainty, every insurer must consider the full range of potential climate outcomes when formulating their climate change policies. The guidance advises that insurers "can proactively contribute to reducing uncertainty and filling data gaps by collecting data from their customers, requesting or requiring climate disclosure from the companies in which they invest, and collaborating with peers, academics, and regulators on the subject of climate risks."

DFS expects insurers to implement policies relating to board governance and organizational structure by August

15, 2022. DFS plans to issue further guidance for the remaining, more complex items that may take more time to implement, such as those relating to risk appetite, analysis of the impact of climate risks on existing risk factors, reflection of climate risks in the ORSA, scenario analysis and public disclosure.

DFS will host a one-hour webinar on November 22, 2021, at 9:30 am EST to provide an overview of the major changes made to the proposed guidance issued for public comment, as well as the rationale for those changes. If you have any questions related to the new guidance, please reach out to a member of the Cooley insurance team.

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