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Note: This comment letter reflects the information submitted by Public Citizen to the New York State Department of Financial Services' Public Consultation on its Proposed Guidance for New York Domestic Insurers on Managing the Financial Risks from Climate Change via its comment submission template.

June 23, 2021

Linda Lacewell
New York State Department of Financial Services
1 State Street
New York, NY 10004

Superintendent Lacewell,

On behalf of Public Citizen, a national public interest advocacy group, and more than 500,000 members and supporters, we welcome the opportunity to comment on the New York State Department of Financial Services' ("DFS") Proposed Guidance for New York Domestic Insurers on Managing the Financial Risks from Climate Change ("the Climate Guidance"). We applaud DFS's leadership in recognizing the risks that climate change poses to insurance markets and consumers, and its willingness to move quickly to begin managing the crisis. But as the climate crisis continues to accelerate, DFS must take an active role in directing insurers' responses, requiring them to take a sufficiently broad view of the risks they face and create and how to address them, and making sure that the solutions do not burden New York residents, including its low-income communities and communities of color.

As society's risk managers and major holders of investments, insurers have an important role to play in an orderly transition to a low-carbon economy. The Climate Guidance is particularly needed because U.S. insurers lag their international counterparts in fulfilling this responsibility. As of 2020, only one major American insurer was among the leaders in the Insure Our Future Scorecard, while six major American insurers, including New York domestic insurer AIG, brought up the rear. Many major U.S. insurers continue to underwrite coal and oil and gas without any restrictions, and every major U.S. insurer supports lobbying organizations that oppose climate action.

New York's domestic insurers are vulnerable to climate change. A recent study by the 2 Degrees Investing Initiative commissioned by DFS shows that carbon intensive holdings in the fossil fuel and automotive sectors make up 17% of all insurer's equity and corporate bond holdings. Life insurers have particularly high, long duration, exposure to these sectors in their corporate bond portfolio. NY insurers are overweight relative to the market in most of these sectors, especially when it comes to coal production. Many insurers have even riskier individual profiles, with one insurer having its entire equity portfolio invested in fossil fuels. This behavior exposes New

York insurance companies to ever-increasing physical, transition, and reputational risks from climate change. Without firm regulatory intervention, these insurance companies are unlikely to reverse course and adopt prudent climate policies.

Unfortunately, U.S. state insurance regulators are also well behind in adapting to climate risk. Only DFS and five other states' insurance regulators administer the National Association of Insurance Commissioners (NAIC) Insurer Climate Risk Disclosure Survey to insurers licensed in those states. And this survey was designed in 2009 and is now outdated. Analysis by the American Academy of Actuaries shows that the current survey format yields only the bare minimum reply from the majority of insurers. The NAIC is in the process of revising the survey, but the revisions will take time and are not guaranteed to yield meaningful improvements in disclosure.

By proposing this guidance, DFS has taken a needed step to catch up with other leaders in climate risk regulation, like the Bank of England's Prudential Regulation Authority and the European Insurance Occupational Pensions Authority. Other states are also following suit and even pushing further. On June 17, 2021 the Connecticut General Assembly adopted implementing budget legislation which included, in Section 364, the first ever direction to a state insurance regulator to not only supervise insurers' climate risk, but to incorporate alignment of their investments and underwriting with science-based emissions targets.

DFS should go beyond catching up to the current leaders and use the Climate Guidance as an opportunity to establish a gold standard in climate risk management among regulators. Only by prioritizing climate risk management can DFS fulfill its responsibilities to safeguard the continued solvency, safety, soundness and prudent conduct of the providers of financial products and services, to encourage high standards of honesty, transparency, fair business practices and public responsibility among insurers, and to protect users of insurance, as required by New York Financial Services Law 201.

First, DFS should explicitly direct insurers not to treat climate change as just another business as usual risk. That attitude will expose New York's consumers and economy to a heightened risk of 2008-style financial shocks. To keep a climate-driven failure from propagating broadly into insurance markets and harming consumers, DFS should instead direct insurers to adopt a precautionary approach when assessing and addressing the risks of climate change. Insurers must recognize that climate risk is different. The Climate Guidance does an excellent job of highlighting that climate risks are "non-linear, correlated, and irreversible." It also emphasizes that DFS is focused on the financial stability of insurers in the face of climate change. DFS should take this perspective to a logical conclusion and remind insurers that they cannot base their response to climate change on models that hedge and diversify risks in ways that maximize shareholder returns.

The lesson of the 2008 financial crisis is that even supposedly sophisticated risk managers, like AIG, cannot engineer away unpredictable threats. The size and uncertainty of damage from climate change will fuel similar or even bigger threats. A business as usual approach will then similarly result in contagion, bailouts, and untold economic harm. The appropriate precautionary approach means taking on less risk than what models suggest is acceptable. It means building larger margins of error into risk management procedures. And it means assuming every part of the business is subject to climate risk, even if it seems implausible, because what is plausible can change quickly as climate change progresses. Only this kind of approach will make insurers resilient to the coming climate shocks and truly safeguard financial stability.

Second, DFS should also focus on reducing insurer's contributions to climate change. Limiting the emissions that underwriting and investments make possible must be part of any prudent insurer's governance and strategy. The 2 Degrees Investing Initiative study found that New York insurers' investments were not aligned with Paris goals, implying instead a production volume of fossil fuels consistent with temperatures rising by 3°C. Temperature increases of this magnitude would have catastrophic impacts on human civilization, let alone financial markets. To avoid drastic and potentially uninsurable physical impacts, global warming must be kept below 1.5°C above pre-industrial levels.

Some may object that reducing emissions goes beyond DFS's mandate and stated focus on financial stability. But DFS's goals include requiring prudent conduct from financial institutions, promoting the prudent and continued availability of insurance products at affordable prices, and encouraging high standards of public responsibility among insurers. The Climate Guidance acknowledges that an orderly, timely transition will be less disruptive to the economy and financial markets than a disorderly transition or one that comes too late. Such a transition will require a 45% reduction of emissions by 2030 and net-zero emissions by 2050. Blowing through those limits will damage insurance markets and threaten financial stability. If current trajectories of fossil fuel investment hold, temperature increases will not just threaten financial stability, they are likely to completely undermine it.

The Climate Guidance recognizes that a strategic response to climate change requires a longer-term view than the typical three to five year planning horizon. This is especially important for life insurers and others with long duration assets and liabilities. By virtue of their role as risk managers, insurers have significant influence over how well the rest of the economy aligns with emissions targets needed to maintain financial stability. DFS should make using this influence to reduce greenhouse gas emissions part of its expectation for what constitutes an insurer's prudent conduct. Otherwise, insurer behavior will increase the long-term risk of global emissions exceeding science-based targets, threatening their own solvency and financial stability. The 2 Degrees Investing Initiative's report recognizes that insurers' tools for managing climate risk include divestiture of existing assets and exclusion of future investments that are incompatible with science-based climate targets. It is firmly within DFS's responsibility and authority to protect financial markets from the harms of climate change by highlighting these tools and requiring insurers to incorporate them into their governance, strategic planning and risk management frameworks.

Finally, DFS should require insurers to assess and mitigate the impact that their risk management strategies will have on consumer markets and especially on low-income communities and communities of color. The Climate Guidance warns that insurers may face reputational risks to the extent they choose to mitigate climate risk by reducing affordability or availability of insurance. It should also recognize that unless insurers plan ahead, they may conclude that increasing premiums or reducing coverage are the only cost-effective options for managing the costs of climate change. Already, in response to unprecedented wildfires in the western United

States over the past few years, property and casualty insurers have been exiting fire-prone regions. Without additional guidance from DFS or legislative intervention, exit by insurers in response to increasing physical risks will threaten the state's economic development and harm vulnerable communities.

If insurers decide to exit vulnerable areas and markets, low-income communities and communities of color will be hit the hardest. The Climate Guidance acknowledges the disproportionate impacts of climate change on these communities. DFS should also recognize that if insurers do begin to raise prices or withdraw from areas that suffer the most from climate change, that will only deepen the damage to these already underserved communities. Beyond making it harder to recover from acute climate impacts like flooding and severe weather, insurer withdrawals will broadly raise the costs these communities face for housing and essential services. Insurers need additional guidance from DFS on how to protect continued affordability and availability. In particular, DFS should review whether planning to manage climate risk by withdrawing from or increasing prices for communities of color violates Section 2606 of the Insurance Law's prohibition on discrimination because of race or color.

DFS can also provide more detail on its encouragement for insurers to avoid needing to withdraw or raise prices by proactively investing in climate resilience and adaptation strategies for vulnerable communities. One step it should recommend is reviewing whether any of the insurer's current investment or underwriting choices are exacerbating climate and other environmental harms. Not contributing to climate risks is an essential early step to mitigating them.. Overall, DFS should clarify an expectation of insurers supporting low-income communities and communities of color as they deal with the climate crisis, not abandoning them at the worst possible moment.

U.S. insurers must prioritize managing climate risk if we are to avoid catastrophic harm to both financial markets and the wider economy. The Climate Guidance is an important step forward, but DFS can build on it, incorporate the recommendations in this comment, and keep learning about new opportunities to address the climate risks that insurance companies face and create. We appreciate your leadership in this area and encourage you to continue to learn quickly and move aggressively to protect consumers and the New York economy from harm.

If you have any questions, please contact David Arkush, Managing Director of Public Citizen's Climate Program (darkush@citizen.org) and Yevgeny Shrago, Policy Counsel in Public Citizen's Climate Program (yshrago@citizen.org).

Sincerely,

Public Citizen
Americans for Financial Reform Education Fund
Businesses for a Livable Climate
CatholicNetwork US
Citizen Action of New York
Earth Action, Inc.
Earth Guardians

Friends of the Earth
Long Island Progressive Coalition
Natural Resources Defense Council New York
New York Communities for Change
New York Youth Climate Leaders
Oil Change International
Partnership for Policy Integrity
People's Climate Movement - NY
The Peoples Hub
Rachel Carson Council
Rainforest Action Network
Rapid Shift Network
Rise and Resist
Sierra Club
Sunrise Project U.S.
Zero Hour
350 NYC
350.org

Section-by-section comments

3. Amendment: Replace “support...in managing” with “guide...in mitigating”

4. Deletion: Remove “based on the industry’s progress . . . .” Climate change is not a new development. It has long been an acknowledged risk to insurers. Given the unpredictable manifestations of physical risk, insurers who are not prepared to address their climate risk are an immediate threat to the stability of insurance markets. DFS should require lagging insurers to make embedding climate risk into their business a top priority by the end of 2021. Significant resources exist to help insurers to start addressing their climate risk, and DFS can encourage sharing of best practices by those insurers who are moving faster.

8. Clarification: State that insurers who mitigate their own climate risk by withdrawing from or raising rates on low income communities and communities of color risk violating Section 2606 of the New York State Insurance Law, especially where those insurers have contributed to creating the problem by investing in and underwriting high emissions activities. Clarify that DFS expects that insurers will find other avenues for managing risk and not rely on withdrawal or rate increases in these communities.

9. Amendment: This description of physical risk should be broadened. The guidance should acknowledge here that as climate change continues, physical risks will become more complex and harder to model, undermining many of the risk management tools that insurance companies use today. It should add that while some business lines appear most vulnerable today, hedges into other lines may become increasingly less useful as climate change’s negative effects reduce lifespans, drive up health care costs, and broadly transform the economy. The upshot of unchecked climate change is not just increasing frequency of natural disasters; it is chronic and

growing stress on infrastructure, health care, and social and economic systems, and the destruction of existing financial markets.

10. Deletion: Remove the last sentence. Major oil and gas companies continue to invest in fossil fuel expansion, and this guidance creates the impression that investing in those companies is acceptable so long as they are also investing in renewable energy, without qualification. Before suggesting that investments in such companies reduces transition risk, DFS should lay out specific guidance on what constitutes an acceptable transition plan and how to evaluate transition claims.

12. Amendment: This section should include a discussion of the precautionary principle. As the guidance acknowledges, climate change is unpredictable and unprecedented. Given those facts, insurers cannot plan for a specific scenario. They should take action that makes them resilient to the full range of worst case scenarios. DFS should also encourage insurers to align their business with science based targets now. Taking this step reduces the risks both of a too little, too late scenario occurring and of the costs that insurers will face from the too little, too late scenario. DFS can clarify that while it does not have a free-standing mandate to fight climate change, reducing financed emissions in line with science-based targets is a fundamental part of the prudent approach to mitigating the financial and consumer risks that climate change poses to insurance markets.

13. Clarification: Due to their level of sophistication and resources, large insurers should devote additional resources to managing climate risks and move faster in developing and implementing appropriate practices. This is particularly important due to the increased scale and complexity of their businesses and the fact that they are better positioned to implement global best practices that can then transmit down to smaller insurers. The risk of a large insurer failing due to unanticipated climate risk is akin to what happened with AIG in 2008, and requires immediate action by insurers and DFS to avoid.

15. Clarification: An insurer should analyze not only its own business performance, but the risk that its investments and underwriting decisions create for insurance markets and financial stability. Part of the NYDFS mandate is to ensure the prudent conduct of providers of financial products. Investing in or underwriting assets in a way that is incompatible with science-based emissions targets puts the entire financial system at risk. Such conduct cannot be prudent.

NY DFS should also clarify that in analyzing the various scenarios listed here, insurers should take a precautionary approach instead of assuming a best-case version of the likelihood and impact of each scenario. We cannot know which scenario will develop or predict the exact contours of the disorderly scenarios. Insurers should not avoid preparing for a scenario by assigning it a low probability or assume that applying existing hedges and business practices will allow them to weather those scenarios. Instead, insurers should develop solutions that are robust to uncertainty, not just risk. This means major reductions in coverage and investment in high transition risk assets and a comprehensive strategy for supporting mitigation of physical risks, especially in low-income and minority communities.

16. Amendment: Remind insurers that exiting markets and raising premiums cannot be the primary tools they use to manage long-term risk, especially when they consider their underwriting of risks in low-income and minority communities. Also note that given the uncertainty of climate change, insurers should not rely on the idea that a risk will only manifest in the medium-term or long-term when developing the timing of their strategic response plans. Because climate change is non-linear and the geography and timing are characterized by substantial uncertainty (and the uncertainties increase at higher levels of specificity), risks that appear to be many years in the future may manifest sooner than expected.

18. Clarification: Given the unpredictability of climate risk, insurers should not be overly reliant on specific quantitative cutoffs and should apply the precautionary principle when making adjustments based on their professional judgment, particularly when those judgments would ordinarily counsel taking on additional risk.

Any materiality determinations should include contributions that the insurer makes to the risk climate change poses to the broader financial system. Underwriting or investing in emissions-intensive activities can create unpredictable risks down the line for both the insurer in question, the broader insurance market, and the financial system. Models today are not sophisticated enough to determine whether such contributions are material. The precautionary approach counsels reducing emissions even if they are not obviously material.

21: Deletion: Eliminate the reference to a carbon tax, as it is too narrow and has the potential to distract from other policy, technological, or economic changes that insurers must account for. The overall point can be made that climate change is highly unpredictable and circumstances can rapidly shift in ways that suddenly make it apparent that an insurer is more vulnerable to climate change than previously thought.

22: Amendment: The risk appetite statement should include appetite for the risks posed by contributing to emissions. These decisions affect the long-term financial interests of the insurer. These statements should reflect a science-based understanding of the likely catastrophic impacts of under-mitigated climate change on insurance markets. It should also include appetite for the reputational risk associated with investing in and underwriting fossil fuel and deforestation projects. This is a meaningful risk and will only grow more serious over time.

25: Clarification: Exposure to a climate-related physical or transition risk includes the risk of reputational or strategic harm coming from continued investment or underwriting of fossil fuel and deforestation projects.

Also, given the uncertainty inherent in climate change, insurers should apply their climate risk management processes across all business units. Insurance companies may not be well positioned to assess how risks will evolve, and the precautionary principle dictates taking a broad view of where climate risk may develop.

30: Clarification: Use of “limits on investment and/or underwriting exposure to sectors or companies exposed to high climate risks” should explicitly include consideration of all companies in high emissions sectors. Limits on investment exposure to geographies with high physical risks should not include pulling coverage or disinvesting from low-income or minority communities.

32: Amendment: Add that reducing concentration of risks should not come at the expense of low-income or minority communities.

33: Clarification: The future impacts of physical and transition risks on customers includes the impact of the insurer's own investments and underwriting on the physical and transition risk that those customers face.

34: Amendment: Add that the compliance function needs to monitor compliance of internal policies and procedures with public climate and environmental stewardship commitments. Failure to comply with these commitments increases both the short-term reputational risk that insurers face and exposes them to increased long-term physical risks.

36. Amendment: Add that not only should the ERM function address all reasonably foreseeable and relevant material risks, but that it also should address relevant uncertainties. These uncertainties should be managed in most, if not all, cases with a precautionary approach.

37: Deletion: Strike the third sentence. Climate change is a sufficiently complex process that it would be unsupported to signal DFS's belief that a particular risk from climate change will be small. It would be more appropriate to state that while it may appear that credit risk is likely to have a small relative impact, large scale changes driven by developing physical risks may create a tipping point that triggers large scale credit risks, including the failure of important counterparties during times of stress.

Amendment: Add that climate-related risks are highly correlated, increasingly the likelihood that climate-related stresses will materialize at similar or the same times among an insurer and its counterparties and reinsurers.

41: Amendment: Add that assets with the highest level of exposure to transition risks are among the most procyclical, making the risks very difficult to hedge or diversify. Insurers should not rely solely on modeled risk in determining the safety and soundness of investments exposed to significant levels of physical or transition risk.

41: Deletion: Remove the "introduction of a meaningful price on carbon" as the triggering event for stranded assets. Many other potential climate policies and technological and economic changes are at play. Insurers should take into account that, with changing consumer sentiments and continued development of low-carbon energy sources, stranded high-emission assets are increasingly likely even in the absence of strong climate policy.

43: Clarification: The encouragement for insurers to consider the timeframe in which climate risks might manifest should note that climate risks are nonlinear and complex and may develop earlier than current expectations predict. It should also note that given the timeframes of fixed income investments, contributions of insurers to climate change will increase the risks to the solvency and security of their own investments.

Amendment: Add that insurers should account for the risk from following credit rating agency methodologies too closely, and conduct appropriate due diligence to avoid risk from mass downgrades. Currently, credit rating methodologies related to climate and other exposures are typically too vague to be used as a basis for a credit rating. Credit ratings firms often inflate initial ratings, which may persist until an event triggers a massive reconciliation, usually in the form of a downgrade. Insurance companies should be aware of this risk and prepare for it appropriately.

44: Clarification: Emphasize that reputational risk will be particularly serious if insurers reduce availability or affordability for hard-hit frontline communities.

45: Amendment: Add that it is not appropriate for insurers to manage pricing and underwriting risk by planning to increase the price or reduce access to coverage for low-income and minority communities.

46: Clarification: It is not only social movements calling for divestment, but a broad and growing segment of society that values companies that are aligned with avoiding the climate crisis.

48. Clarification: Add that beyond competition effects of climate risk response on specific insurers, one major strategic risk is that continued contribution to climate change by insurers puts the entire insurance market at increasing risk, reducing the stability and profitability of all insurance companies.

49: Amendment: Include that managing physical risk on both sides of the balance sheet will be difficult via ordinary hedging activities, as the effects of climate change are unpredictable and may change the correlations among asset classes. Climate risks are also rising in number, intensity, and complexity, increasing the chance that risks that are uncorrelated will nonetheless materialize near in time to one another. Reducing exposure to much better understood transition risks is the most straightforward way to manage this uncertainty.

55: Amendment: Recommend that insurers include a scenario in which their underwriting and investment portfolios align with science-based targets (at least a 45% reduction in emissions and no fossil fuel investments or underwriting by 2030, zero emissions by 2050, with sharply limited reliance on offsets or currently unproven or infeasible technologies). This scenario is necessary so that insurers and supervisors understand how far insurers' current practices deviate from what is needed to avoid climate catastrophe. The Climate Guidance should also emphasize the importance of a precautionary approach in assessing the impact of risks, particularly for medium- and long-term planning. Sophisticated analyses of these risks should go beyond extreme weather and sea level rise and include consideration of large scale migration, shifting agricultural belts and megadroughts leading to global hunger and water scarcity, increased violence, and other catastrophic harms that under-mitigated climate change will cause.

58: Amendment: Note planning on reactive action may not leave sufficient time to consider the impact of asset sales or changes in affordability or availability of coverage on low income and minority communities.

63: Amendment: The Department should add more specific expectations for what insurers disclose, going beyond the NAIC survey. A major challenge of existing voluntary disclosure frameworks is that they do not allow enough comparability across companies and that no framework covers the full range of issues that markets need to see. To the extent that the department values public disclosure, it should adopt further guidance explaining what needs to be disclosed. This should include line item financial metrics that show vulnerability to transition and physical risk. While some will take time to develop, one clear starting point is public disclosure of investments and underwriting of fossil fuels, broken down by asset type. Requiring these disclosures will serve a prudential function regarding climate-related risk. They will enable the public, supervisors, and investors to monitor transition risk and contributions to physical risk; and they will highlight insurers with investments and underwriting that will cause reputational harm. As climate models become more sophisticated and better understood by the public, these reputation risks will increasingly be a proxy for transition and physical risks.

64: Amendment: Add the expected upcoming SEC climate disclosure rulemaking as an important touchpoint and state that private insurers need to provide substantially similar disclosures as their public company counterparts.