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CLIENT ALERT

NYDFS Guidance on Addressing Climate Risk: Upcoming Deadline for New York Domestic Insurance Companies

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The New York Department of Financial Services ("NYDFS") has issued "guidance" on managing climate risks that applies to both domestic insurers and foreign licensed insurers. The domestic insurer guidance includes an expectation that insurers will implement specific governance changes described below with an initial deadline of August 15, 2022.

Background

The topic of climate change, and the need to develop effective regulatory tools to ensure that insurers are managing the associated financial risks, have come under scrutiny by the National Association of Insurance Commissioners, state insurance regulators, such as the NYDFS, and other regulatory agencies. Supervision of climate risk management can be handled to some extent under the states' existing regulatory framework. For example, state insurance regulators can address these risks when reviewing an insurance group's enterprise risk management function and Own Risk Solvency Assessment ("ORSA"). However, there is widespread sentiment among insurance regulators that additional tools and regulatory oversight are needed because "[c]limate-related risks present unique challenges" and "[c]limate change poses wide-ranging and material risks to the financial system, especially for the insurance industry".

Guidance for New York Authorized Foreign Insurers

According to Circular Letter No. 15, dated September 22, 2020 (the "Circular Letter"), the NYDFS expects all New York domestic insurers (each a "Domestic Insurer") and authorized foreign insurers (each a "Licensed Insurer") "to start integrating the consideration of the financial risks from climate change into their governance frameworks, risk management processes, and business strategies" and to develop an approach to climate-related financial disclosure. Licensed Insurers remain subject to these high level expectations, as Domestic Insurers are now subject to additional guidance issued by the NYDFS, as discussed below.

With respect to Licensed Insurers, we note the following: (i) they are subject to the NYDFS' examination process, which now includes questions regarding an insurer's activities in response to climate-related risks; and (ii) similar to Domestic Insurers, they are subject to New York's amended regulation governing enterprise risk management (i.e., Regulation 203), which requires an insurance group's enterprise risk management function to include certain additional risks, such as climate change.

Guidance for New York Domestic Insurers

On November 15, 2021, the NYDFS issued its 'Guidance for New York Domestic Insurers on Managing the Financial Risks from Climate Change' (the "Final Guidance"). Both the Circular Letter and the Final Guidance provide that an insurer's approach to managing material climate risks should reflect its exposure and be proportionate to the "nature, scale and complexity of its business." The Final Guidance contains more detailed expectations, including timelines, although the NYDFS acknowledges that a Domestic Insurer's approach to managing climate risks is expected to "mature" over time as it develops expertise in this emerging area.

Broadly speaking, a Domestic Insurer is expected to manage climate risks through certain concrete actions, such as:

- Using scenario analysis to inform the insurer's business strategies and risk assessment;
- Ensuring that the board of directors understands climate risks;
- Incorporating climate risks into its financial risk management (e.g., enterprise risk management and ORSA);
- Disclosing its climate risks; and
- Considering climate-related factors when making business decisions.

In terms of timelines, the first deadline in the Final Guidance is approaching. As of August 15, 2022, Domestic Insurers should (i) have implemented the board governance changes set forth in the Final Guidance, and (ii) have developed specific plans to implement the organizational structure changes described below.

A. Board Governance

i. Because an insurer's board of directors is responsible for overseeing the management of all risks, the NYDFS expects a Domestic Insurer's board (or a committee thereof) to understand relevant climate risks and oversee the individuals responsible for managing such risks within the company's business strategy and risk appetite.

ii. A Domestic Insurer should designate a director (or a board committee) to be responsible for overseeing the management of climate risks, noting that this can be satisfied at the insurer's group level, provided that certain conditions are met (e.g., the risk appetite developed by the group's board is implemented at the insurer level).

iii. A Domestic Insurer should designate one or more members of its senior management to be responsible for the management of climate risks, noting that "[a]s climate change could impact multiple business units and require expertise from multiple functions, the designated member(s) of senior management may delegate responsibility to those business units and functions, provided that such member or members of senior management continue to oversee any such delegation of duty."

iv. A Domestic Insurer's board should supervise management's progress in terms of meeting the company's climate-related milestones and ensuring that its climate risk strategies are reviewed for effectiveness.

B. Organizational Structure

The NYDFS expects implementation plans to be in place by August 15th, although a Domestic Insurer should meet the following ongoing expectations over time:

i. Use its enterprise risk management functions (e.g., compliance, internal audit, etc.) to manage climate risks.

ii. "Implement reliable risk management processes across lines of business, operations, and [enterprise risk management] functions".

iii. Similar to other material risks, consider climate risks in its risk management processes, such as in enterprise risk reports and ORSA summary reports.

iv. Clearly define roles, responsibilities and accountabilities in its organizational structure.

v. Perform independent and regular reviews of the company's functions and procedures designed to manage climate risks, report findings to the board, and modify any such functions and procedures as necessary.

vi. Develop the expertise and skills needed to manage climate risks at the level of the board and senior management (e.g., through internal training, the use of third-party consultants, etc.).

vii. Consider developing a compensation plan that would align incentives for the company's employees.

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