

P&C PERSPECTIVES

Current Issues in Property and Casualty

Mandatory climate change reporting for insurers

By Jessica Leong, FCAS, MAAA, and Tom Ryan, FCAS, MAAA

Given a variety of nightmarish forecasts available, no wonder climate change is an issue of concern for the insurance industry. Despite all this concern, however, it has been difficult to find quality information regarding specific insurer response to climate change, not to mention reliable information for regulators and insurance consumers. Until now.

In March 2009, the National Association of Insurance Commissioners (NAIC) approved an annual *Insurer Climate Risk Disclosure Survey*, making it mandatory for insurers with annual premiums of \$500 million or more to disclose their risks and strategies relating to climate change. The initial reporting deadline is May 1, 2010. Voluntary submissions from smaller insurers are also encouraged.

The approved survey consists of eight questions that touch upon a wide range of climate change issues:

- the impact of climate change on the company's risk management plan
- the impact on the company's investment management
- the company's internal emissions management program
- any steps taken to engage policyholders and others and encourage them to address the issues of climate change

All eight approved questions are provided in the sidebar to this article. Further details on the reporting requirements can be found at www.naic.org/committees_ex_climate.htm

Evolution of the requirements

As the Earth's climate appears to have undergone change, so too have the NAIC's proposed disclosures. The approved requirements are a compromise from several previous proposals debated within the NAIC's Climate Change and Global Warming Task Force

(CCGWTF). The survey was originally intended to be part of the annual statement, the year-end financial document filed by insurers. Earlier drafts also included more specific questions related to analyses done on the impact of climate change on future liquidity and capital needs, including loss reserves and access to reinsurance.

There was strong negative feedback from many insurance industry groups regarding these early drafts. Specifically, they were concerned about the additional reporting burden of the survey, the quality of the responses that could be provided given the state of climate science, and potential liability to insurers based on responses. Although the approved survey was scaled back from earlier drafts in terms of number and scope of disclosures, some disagreement remains on the value of the survey.

Sample disclosures: Carbon Disclosure Project

Many of the questions in the NAIC survey are similar to those included in the Carbon Disclosure Project (CDP, www.cdproject.net). The CDP is an international, independent, nonprofit

What?

The NAIC now requires insurers to respond to a climate risk disclosure survey each year.

Who?

The survey is mandatory for all insurers with annual premiums of \$500 million or more.

When?

The first reporting deadline is May 1, 2010.

Why?

To help enable the NAIC and the public to better assess the effects climate change may have on an insurer's solvency.

organization that provides a voluntary annual carbon survey for large publicly traded companies. Formed in 2000, it now houses survey responses in the world's largest database of its kind.

Company responses to these carbon surveys can be accessed easily on the Web site, which allows searches by industry sector, country, and year of response. This provides a useful resource for those insurers new to the climate change disclosure process. In the sidebar to this article, we include an outline of sample responses to the NAIC survey questions using insurer responses to similar questions from the CDP.

The need for more disclosure

For an industry heavily exposed to climate change risks, insurers have a poor but improving track record in their disclosure of risks in this area. As cited in *From Risk to Opportunity, Insurer Responses to Climate Change 2008* (an annual publication provided by Ceres, a national coalition of investors, environmental groups, and other public interest organizations), only 15% of U.S. insurers mention climate change in their annual 10-K filings with the Securities and Exchange Commission. This is in comparison with a nearly 100% disclosure rate for the electric utility sector and an 80% rate for the oil industry. In the CDP, the response rate for U.S. insurers asked to participate increased from 13% in 2003 to 69% in 2008. However, nearly 44% of those who did respond declined to make their responses public. The lack of uniform information available from the insurance industry helped drive the creation of the NAIC survey.

The path forward

While the survey responses are due on May 1, 2010, less than one year from now, it is still unclear how they will be analyzed and used by the NAIC. Publicly, the current chairman of the NAIC's CCGWTF has stated that the task force does not foresee any further reporting requirements on this issue. However, depending on the quality of the responses received and the intensity of the climate change debate, this may change.

Insurers may disagree with the need for the survey and the questions included but it is clear that they need to address their exposure to climate change. For those well along the path, the survey provides an opportunity for recognition. For those not far along, the survey provides a necessary stimulus for action.

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Useful resources

www.naic.org/committees_ex_climate.htm
www.cdproject.net
www.ghgprotocol.org
www.climateandinsurance.org

Survey questions and sample disclosures

The eight approved questions from the NAIC survey are provided below. We have also provided an outline of a sample of responses that were taken from a review of current insurer responses to similar questions from the CDP database.

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

- Greenhouse gas (GHG) emission planning, including the voluntary monitoring of GHG emissions (tools for monitoring GHG emissions can be found at www.ghgprotocol.org).
- Reducing the impact of employee travel.
- Recycling and purchasing more eco-friendly products in the office.
- Improving the energy efficiency of offices.
- Educating employees about climate change.

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?

- The company's climate change risk management policy is to assess and act on the risks and opportunities presented by climate change in all operations.
- The company has begun to securitize the risk of its insurance business by issuing catastrophe bonds in the capital markets.
- The company engages a consulting firm to evaluate the impact of climate change on the exposure of its business locations to natural catastrophes.

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.

- There is an internal committee that identifies climate-change-related risks.

- To identify and assess the effect on our property-related business, catastrophe modeling is used. These models rely on historical events. However, because of climate change, we have taken a short-term view of event frequency, which is greater than the long-term historical frequency.
 - To assess the effect on the rest of the company's operations (casualty business, investments, etc.), internal and external research is conducted.
 - Research to improve risk identification and assessment includes:
 - sponsorship of academic research
 - internal studies
 - talks with experts
- 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.**
- Property classes such as energy, marine, and crop are currently at risk because of climate change. Unanticipated changes in the frequency and/or severity of natural catastrophes mean that actual losses may be greater than that assumed to price.
 - Casualty classes are at risk in the longer term because of changes in expectations (e.g., potential directors and officers litigation, litigation against green products that do not perform as promised, liability claims from groups affected by climate change against those who are perceived to have caused it).
 - Life and health classes are at risk because of the potential for disease outbreak to be more prevalent because of changes in the climate.
 - Climate change poses the following management risks:
 - Unpredictability could mean the company is unable to price and risk-manage products
 - Regulatory activity
 - Climate change could affect those enterprises in which the company invests.
 - Climate change also presents a business-interruption risk for the company itself, if it is affected by a natural catastrophe.
- 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.**
- The company recognizes that climate change can impact the return of an investment and, as such, incorporates the risks posed by climate change into investment decisions.
 - The company's investment portfolio is highly diversified by risk, industry, location, and type and duration of security.
- 6. Summarize steps the company has taken to encourage policyholders to reduce the losses caused by climate change influenced events.**
- General education through publications and presentations on topics such as hurricane preparedness.
 - Assisting individual policyholders manage their climate-change-related risks—for instance, in the development of a business contingency plan that will minimize a disaster's effects.
 - Terms, conditions, and premiums of our policies are aligned with risk-reducing behavior.
 - The company finances policyholder loss-reducing improvements, such as post-catastrophe rebuilding with the aim of reducing the impact of future catastrophes.
- 7. Discuss steps, if any, the company has taken to engage key constituencies on the topic of climate change.**
- Participating in the formulation of public policy.
 - Presentations are delivered and/or attended.
 - Forums are held on climate change issues.
 - Funding/assisting academic climate change research.
 - Working with the catastrophe model providers to implement climate change parameters in catastrophe models.
 - Membership in the United Nations Environment Programme Finance Initiative, United States Climate Action Partnership, ClimateResolve, ClimateWise, Corporate Leaders' Group, etc.
- 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.**
- Underwriting management through the development of sound underwriting guidelines and use of terms and conditions differentiating and rewarding those policyholders that pose less climate-change-related risk.

- Management of concentrations of insurance risk, particularly geographic concentrations using catastrophe models with mapping software.
- Capital management through hedging the company's portfolio of catastrophe risk in both the reinsurance and capital markets.
- Management of assets through periodic assessments of concentrations of climate change risks (e.g., geographic concentrations of real property assets).
- Scenarios are analyzed in our enterprise risk management model to see the correlated effects of climate change on the company's assets, liabilities, and operations.
- The company also has its own business continuity plans for potential disasters.

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