June 23, 2021

INSTITUTE OF INTERNATIONAL FINANCE

Ms. Linda A. Lacewell
New York State Superintendent of Financial Services
Dr. Nina Chen
Sustainability and Climate Initiatives Director
New York State Department of Financial Services
One State Street
New York, NY 10004-1511

Re: Proposed Guidance for New York Domestic Insurers on Managing the Financial Risks from Climate Change

Dear Superintendent Lacewell and Dr. Chen:

The Institute of International Finance (IIF) and its insurance members are pleased to respond to the Department's Proposed Guidance on Managing the Financial Risks from Climate Change that was issued on March 25, 2021 for public comment (the Proposed Guidance). We agree that the unprecedented nature of climate-related risks presents unique challenges and requires a strategic response by the insurance industry. We applaud the Department's proportionate and incremental approach to climate risk management, which recognizes that the quantification of climate risks is still a developing area with, in many cases, low data availability and quality, and a high degree of modeling uncertainty.

We appreciate the Department's acknowledgement of the importance and benefits of supervisory collaboration and coordination on climate risk issues. We encourage the Department to continue to collaborate with global bodies that are addressing climate-related risks in the insurance sector (as well as in the financial services sector more broadly), including the International Association of Insurance Supervisors (IAIS), the Sustainable Insurance Forum (SIF) and the Financial Stability Board (FSB). There is considerable value in striving for alignment in approaches to climate risk at the global level, as well as at the national level through the National Association of Insurance Commissioners (NAIC), while recognizing that regulatory approaches ultimately should be tailored to the companies and markets within the purview of the regulator.

The IIF has conducted a significant amount of work on the topic of climate risks. Earlier this year, we published an IIF Paper, *Prudential Pathways: Industry Perspectives on Supervisory and Regulatory Approaches to Climate-related and Environmental Risks* (the IIF Prudential Pathways Paper), a copy of which is attached to this response. This paper reflects the perspectives of the IIF's broader membership of financial services firms including insurers and banks. We would be pleased to follow up with you on the observations and recommendations contained in the IIF Prudential Pathways Paper as it relates to the insurance sector. Among other considerations, we note that the insurance business model differs substantially from banking and other financial services business models, and these differences need to be considered in adopting a framework for insurance climate risk. Moreover, the materiality and impact of climate-related risks can vary substantially among insurers and among insurance markets.

Specific Comments on the Proposed Guidance

Financial Risks from Climate Change

We fully agree with the Department's characterization of the physical and transition risks to insurers from climate change. We appreciate that, absent robust risk management, climate risk may be a significant source of financial risk that could negatively impact policyholders and insurance markets. The potentially non-linear, correlated and irreversible impacts of climate risk heighten the need for robust risk management. However, given that the science around climate risk is rapidly evolving, we encourage the development of principles-based risk management guidance and practical, proportionate, dynamic and sequential supervisory approaches to risk management that are data-driven, risk-based and science-based and informed by expert advice and judgment.

We encourage the Department to work with its fellow financial services regulators, supervisors and global standard setters to develop a common global climate risk taxonomy. This taxonomy should be designed to be dynamic, in order to reflect the evolving understanding of climate-related risks and economic and technical changes over time.

Proposed Detailed Guidance

Proportionate Approach

We appreciate the Department's recognition that all insurers will need to analyze their potential exposure to climate risk regardless of size. We understand that an insurer's approach to climate risk management should mature over time as its expertise and understanding of these risks matures (Paragraph 14). While quantitative analyses and risk modeling can be enhanced over time, considerable qualitative and judgment elements will continue to be necessary for a complete risk analysis, as is the case for the management of any risk. Further comments regarding risk management are reflected below in the section entitled *Risk Management*.

With respect to the appropriate time horizon for analyzing financial risks and opportunities related to climate change (Paragraph 16), we believe that this is a decision best made by the company's senior management based on the activities and risk profile of the firm and the types of assessments and scenarios that are the most decision-useful for the board and senior management. The design of scenario analyses should be industry-driven, providing firms with the flexibility to develop scenarios (or adapt publicly available scenarios such as those developed by the Network for Greening the Financial System) that best reflect their business models and risk profiles. Climate risks do manifest over longer time horizons than many other risks but the decreasing reliability of results over a longer time horizon should be acknowledged, as this should influence the way in which the results of longer-term scenario analyses are used by insurers and supervisors.

The Department should consider that robust scenario analysis may rely on data which is not currently available, such as certain forward-looking data from counterparties. Consultation with the industry on the parameters and assumptions used in scenario analysis exercises can be useful in identifying data gaps and avoiding unrealistic expectations regarding the results of these exercises.

Materiality

We agree that the standard financial materiality benchmark of 5 percent of surplus or 0.5 percent of total assets may not be appropriate for the assessment of the materiality of climate risk for all insurers. While these benchmarks are useful as a rule of thumb, they do need to be adjusted based on professional judgment, as the Proposed Guidance states.

Risk Culture and Governance

We agree that all insurers should have a member or committee of the board, as well as a member of senior management with risk oversight accountability that includes climate risk. Whether this needs to be a dedicated board member, board committee and senior manager should depend upon the materiality of climate risk to the company and its specific governance approaches. Insurers should have the flexibility to address climate risk at the group and parent board level if it is consistent with the insurer's overall approach to risk management. Group-level management of climate (and other) risks can be an efficient and effective risk management technique, particularly where multiple entities are engaged in similar lines of business.

We appreciate that the materiality of climate risk to an insurer can change over time and potentially rapidly. As with other aspects of risk management, the insurer's governance structure should allow for the necessary flexibility to respond in a timely manner to a change in circumstances.

We encourage some added flexibility in Paragraph 22, which discusses the insurer's written risk policy. We agree that a climate risk policy is an important element of effectively managing climate risks but the adoption of hard limits for financial risks may not always be the optimal approach.

Paragraph 24 appears to stipulate the establishment of control structures dedicated to climate risk. We encourage the Department to provide the flexibility to insurers to consider climate risk as one of many relevant risks within existing control structures. In addition, with respect to subparagraph h. of Paragraph 24, we encourage the Department to refer to remuneration policies for key individuals with direct responsibility for risk management. We do not believe that the remuneration of employees with no responsibility for or control over climate risk management should be impacted by how effectively those risks are managed by senior risk managers.

Business Models and Strategies

Section 3.4 should incorporate to a greater extent the principle of proportionality and a sequential, incremental approach to the development of business strategies. Regardless of the size of the insurer, this Section would benefit from a statement that climate risk strategies, risk appetites, and risk management and compliance frameworks are evolving over time and will need to be developed in parallel in a holistic manner. Firms' existing risk management frameworks can be leveraged as a baseline for assessing climate risks as they have been for other emerging risks over the years.

Risk Management

Section 3.5, as currently drafted, is overly detailed and prescriptive and does not adequately reflect the evolving nature of climate risk management. We acknowledge that climate risk has an impact on a wide range of existing risk factors but the analysis of how physical and transition risks from climate change could materialize for each of these risk factors is an enormously complex task that is just beginning for many insurers. This Section of the Proposed Guidance would benefit from an explicit acknowledgement that the supervisory expectations in this Section reflect a future state of most insurers' risk management. Consistent with our comments above, this Section should provide insurers with the flexibility to address climate risk at the group and parent board level if it is consistent with the insurer's overall risk management. Section 3.5 would benefit from a discussion of climate risk mitigation strategies and techniques. In addition, the regular renewing of P&C and reinsurance policies should be noted.

Paragraph 29 provides that information from all reasonably foreseeable and relevant material risks, including climate risks, should be systematically gathered and maintained, identified and prioritized, documented and reported to senior management and periodically reviewed by the board. While we appreciate that the Department expects that insurers will develop their risk identification and prioritization capabilities over time, these statements do not adequately reflect the serious climate data shortcomings and lack of data consistency that limit the decision-usefulness of this information and that could render undue reliance on this information to inform risk tolerances and limits misleading.

Paragraph 30 provides specific examples of quantitative measures that could be used; many of these measures are, at present, imprecise or subject to different levels of quantification depending upon the source or the need to employ a significant element of judgment (e.g. the amount of investments in fossil fuel companies that do not have a credible transition plan). Supply chain analysis can be very complicated and dependent on factors unrelated to climate risk (e.g. geopolitical risk).

The proposed direction to insurers to understand the potential current and future impacts of physical and transition risks on their customers, counterparties, investees and potential investees (Paragraph 33) depends on information that may or may not be available from those parties or, even if available, may not always be reliable. As noted in Section 3.3 of the *IIF Prudential Pathways Paper*, insurers and banks face significant challenges related to obtaining high quality, consistent, decision-useful, quantitative disclosures from third parties. The burden and cost of attempting to proxy this data from public sources or external experts should not be underestimated. Over time, greater recognition and incorporation of climate risk into financial asset prices should help mitigate investment risks.

Scenario Analysis

Paragraph 29 calls upon insurers to use scenario analysis and stress testing to inform the risk identification and prioritization process and to understand the short- and long-term climate risks to their business models. We encourage the Department to recognize the important differences between stress testing and scenario analysis and to focus supervisory attention on the latter as part of an insurer's climate risk management framework. Given the early stage of climate scenario analyses, these analyses should be focused on understanding potentially material climate risks, exploratory in nature, and balanced between quantitative and qualitative data and observations, in order to produce reasonably reliable outputs that are decision-useful and that avoid creating a false sense of security and precision in the results.

With respect to Paragraph 53, we reiterate our call for flexibility to address climate risk at the group and parent board level when it is consistent with the insurer's overall risk management.

Paragraph 56 states that an insurer's long-term scenario analysis should be "in the order of decades." We encourage the Department to revisit this expectation or at least to emphasize the need to rely on qualitative, judgment-based analyses given the inherent challenges of conducting climate scenario analysis over multiple decades.

Public Disclosure

We agree with the call for enhanced transparency of climate risk management in insurers' public disclosures and the benefit of more quantitative disclosures over time as data and modelling capabilities develop. We would welcome a globally harmonized approach to climate-related disclosure that would provide useful and consistent data to investors.

We would refrain from specifying a particular deadline for the transition to more quantitative disclosures (Paragraphs 63 and 64), as the development of key metrics[1] and targets, as well as the underlying data, may not be sufficiently mature in the two- to three-year timeframe specified in the Proposed Guidance. A careful and iterative approach to disclosure expectations would help to mitigate insurers' exposures to legal risks, as would a specific climate reporting safe harbor for any statements that must rely on data from third parties that are outside of the insurer's control.

We encourage the Department to coordinate with the Securities and Exchange Commission and listing authorities when designing and developing any disclosure guidance and in light of the need for a specific climate reporting safe harbor. Guidance should reflect the principle of proportionality and should focus on the financial risks that are material and decision-relevant for investors and counterparties, recognizing that materiality is company-specific. Insurers should be encouraged to highlight not only risks but also opportunities that arise from the transition to a low-carbon economy.

We appreciate the opportunity to comment on the Proposed Guidance and we would welcome further discussion of our response or of the *IIF Prudential Pathways Paper* with Department leadership and staff.

Respectfully submitted,

Mary Frances Monroe

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[1] We understand that additional TCFD guidance is expected later this year. The Department could consider issuing further guidance based on that work.