

Deloitte.



The FIO calls on states, NAIC to increase their climate-risk capabilities as it preps for more detailed market analysis

Center for
**Regulatory
Strategy
US**

Introduction

At the end of the first week of summer, the Federal Insurance Office (FIO), a division of the US Treasury Department, unveiled its report on climate-related issues and gaps in insurance supervision. The report sets forth a multitude of expectations for state insurance regulators and the National Association of Insurance Commissioners (NAIC) to meet the growing and urgent needs created by climate risk.¹

The physical risks of weather events, their effect on the property casualty market, and their interconnectedness with other financial markets were highlighted both in the report and at the Brookings Institution event launching the report, signaling the special focus of the Biden administration's attention with its *Executive Order on Climate-Related Financial Risk*.² This publication briefly discusses the report's recommendations and the commentary of the panelists following the report's release.

Recommendations on insurance supervision and regulation of climate-related risks

A look inside the FIO report

The report serves up 20 recommendations for the state-based system of insurance, which includes state insurance commissioners in 56 jurisdictions and the standard-setting body, the NAIC, to undertake to fortify the industry and its consumers.

The report calls upon the NAIC to build up and enhance supervisory climate risk standards, conduct analysis through model laws and other expanded standards, create platforms for monitoring, and enhance the use of state accreditation and scenario analysis pilot programs. The FIO emphasizes greater harmonization of the existing disclosure frameworks in use; a push toward more robust collection and use of comprehensive and comparable data; and more detailed, quantitative-based scenario analysis.

While the FIO envisions creating a more robust supervisory overlay for addressing climate risk (the office characterizes the current as in the beginning phases and fragmented), a great deal of work by the NAIC and a few states is already underway.



Key recommendations

The report’s recommendations encourage all parties to roll up their sleeves and dig in. This effort will involve contributions from “state and federal regulators and policymakers, as well as by the private sector and the climate science and research communities” to grasp the implications of climate-related risks for the entire financial system, for its stability, and for the multitude of players and markets involved, from banking and real estate markets to the insurance industry.³

Thematic area	Recommendations
Analysis	<ul style="list-style-type: none"> • State insurance regulators and the NAIC should expand their work on climate-related risks in order to promote increased regulatory uniformity among the states. • State insurance regulators and federal authorities should continue encouraging insurers to capture more granular, consistent, comparable, and reliable data on climate-related risks. State insurance regulators and federal authorities also should continue identifying relevant data that will improve the ability of insurers to quantify climate-related exposures and otherwise fill data gaps.
Prudential supervision and regulation	<ul style="list-style-type: none"> • The NAIC should revise the <i>Financial Analysis Handbook</i> to recommend, and states should require, that financial analysts and lead state analysts integrate climate-related considerations into their analysis. Additionally, the NAIC should provide guidance, and the NAIC and state insurance regulators should provide training, for financial analysts and lead state analysts on how to evaluate assumptions and methodologies used in climate-related forward-looking analysis. • The NAIC should adopt, and state insurance regulators should implement, the proposed enhancements to the <i>Own Risk and Solvency Assessment (ORSA) Guidance Manual</i> and require insurers to incorporate climate-related risks into both the ORSA process and ORSA Summary Reports. • The NAIC should continue to refine the capabilities and role of the Catastrophe (CAT) Modeling Center of Excellence by incorporating climate-related risk considerations so that it can be used more effectively by state insurance regulators to enhance assessment and supervision of insurers’ climate-related risks. To enable sharing of resources among state insurance regulators, the Center should develop a platform for access to models, methodologies, and related data. The NAIC should regularly produce public reports on key findings identified by state insurance regulators using the Center to monitor climate-related risks. • The NAIC and state insurance regulators should prioritize their work on scenario analysis for climate-related risks, initially as a capacity-building exercise for large insurers. Future NAIC work should include developing a pilot analysis with defined scenarios and assumptions for insurers to run and submit to regulators, commensurate with an insurer’s size, complexity, business activity, and risk profile.

Thematic area	Recommendations
<p>Macroprudential supervision and regulation</p>	<ul style="list-style-type: none"> • The NAIC should incorporate climate-related risks in future Macroprudential Risk Assessments, and these assessments should include additional detail on climate-related risks specific to insurer underwriting and investments. • State insurance regulators and the NAIC should increase their work with the National Council of Insurance Legislators (NCOIL), state legislatures, and state guaranty associations to improve their ability to quantify potential climate-related risks for state guaranty funds and to better understand potential exposures from climate-related disasters for insurers, policyholders, and state governments.
<p>Market conduct supervision and regulation</p>	<ul style="list-style-type: none"> • The NAIC, state insurance regulators, the insurance industry, the FIO, the Financial Literacy and Education Commission (FLEC), and other partners should work together to increase consumer education and outreach regarding what climate-related risks are (and are not) commonly covered under personal lines of insurance and take steps to increase public awareness of the nature and magnitude of climate-related risks. They also should continue encouraging consumers to take advantage of educational and outreach programs in markets vulnerable to climate change, including programs relating to the value of, and opportunities for, pre-disaster mitigation investments in property resilience. • The NAIC and state insurance regulators should conduct more post-disaster surveys to assess the claims resolution process, particularly with regard to whether insurers are fulfilling their obligations in a fair and efficient manner.
<p>Disclosure initiatives</p>	<ul style="list-style-type: none"> • The NAIC should consider revising its Climate Risk Disclosure Survey over the next several years to incorporate more prescriptive elements, including around quantitative financial impacts, scenario analysis, and consistent metrics and targets, with the goals of enhancing: (a) transparency about how insurers manage climate-related risks and opportunities, (b) the identification of good practices and vulnerabilities, and (c) the assessment of how climate-related risks are affecting the insurance industry. • The NAIC and state insurance regulators should support efforts to improve climate-related disclosures by the insurance industry, as analytical capabilities and best practices further develop. All state insurance regulators should adopt the NAIC Climate Risk Disclosure Survey. The NAIC should continue monitoring responses to its Climate Risk Disclosure Survey and publish an annual quantitative report summarizing the survey results and addressing how well the survey is fulfilling its six purposes.

North Star or to-do checklist?

Although the FIO acknowledged that there has been progress by the state-based system, specifically “nascent and important efforts to incorporate climate-related risks into state insurance regulation and supervision,” it characterized these efforts as “fragmented across states and limited in several critical ways.” Thus, the FIO, which is not a regulator but is tasked with monitoring the insurance industry, called on the state insurance regulators “to build on their progress.”

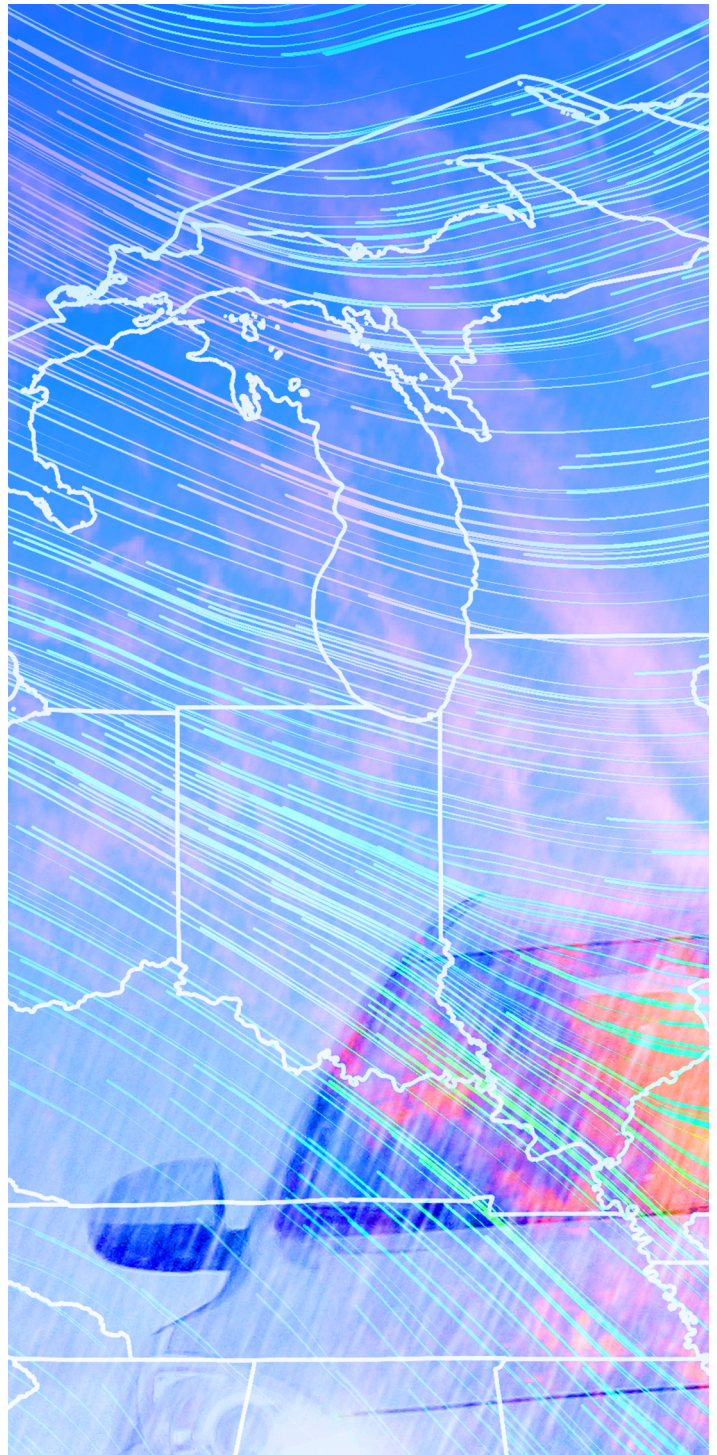
The FIO’s recommendations lean heavily on the NAIC as an organization, which is emphasized for its continued and increased role throughout. The report allows for long-term planning but also is imbued with a sense of urgency to move the insurance regulatory apparatus forward in the face of accelerating climate risk and challenges.

The report and officials summarizing the report at its public unveiling contrasted the increasing significant challenges to the insurance industry from transition, physical, and litigation risks with regulatory efforts to incorporate climate-related considerations into insurance supervision as being at “a preliminary stage.”⁴⁴

“FIO, with its authority, has provided a North Star in this report,” remarked Brookings’ David M. Rubenstein Fellow, Dr. Carlos Martín.

The Treasury’s Assistant Secretary for Financial Institutions Graham Steele set the stage for future work by the states, the NAIC, and the federal government, where he underscored the priorities of the administration against a backdrop of recent climate-related events and the consequences to the industry and consumers.

Steele led off with an outline of the risks and challenges faced by the insurance industry and reiterated the report’s findings that efforts to roll these wide-ranging climate risk considerations into day-to-day insurance oversight are still at the beginning stage.



US weather volatility wreaking havoc for markets and consumer alarms Treasury

Extreme weather events exacerbated by climate change have caused significant damage and disruption to communities, households, and businesses, Steele said.

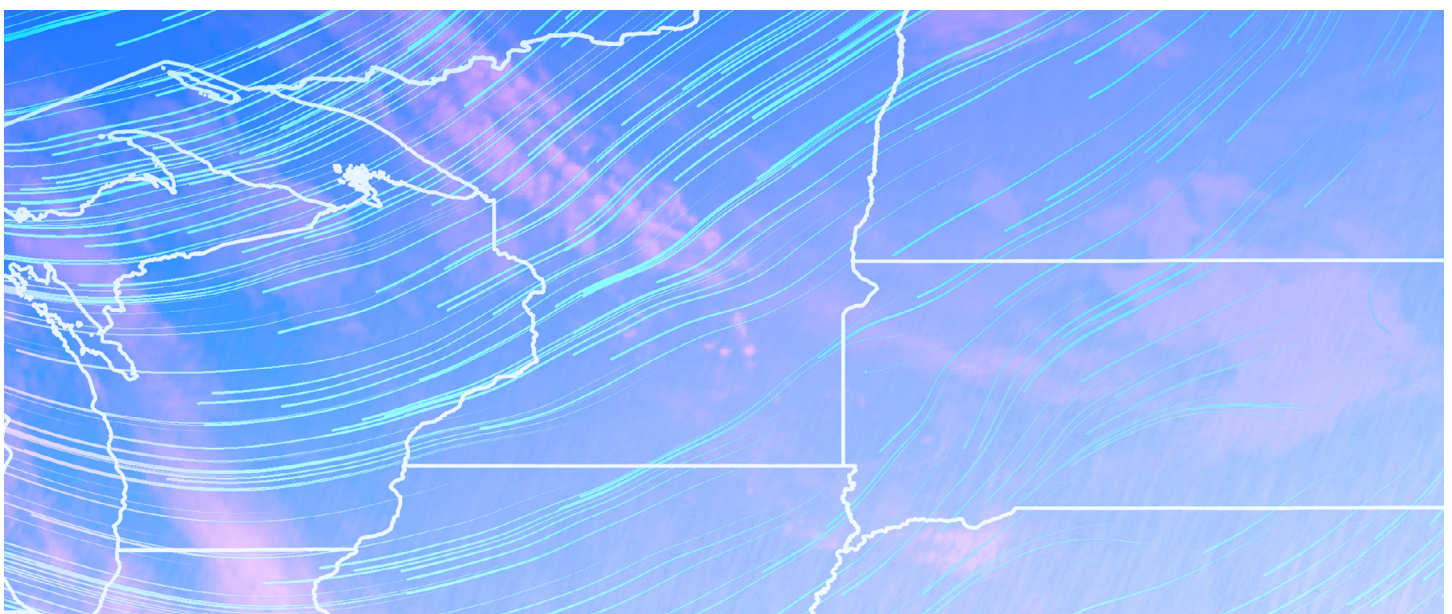
“There’s been at least a fivefold increase in the annual number of billion-dollar disasters in the past five years as compared to the 1980s including when adjusted for inflation,” Steele said.⁵ “Hurricane Ian alone caused at least 157 deaths and almost \$100 billion in damages,” he said, citing industry reports.⁶

Steele pointed to more recent market developments in the insurance sector including the withdrawal of several large insurers from writing new policies in the California homeowners insurance market and the insurer pullbacks in other areas even as climate-related disasters in the United States and around the world increase. Steele also referenced the then-raging wildfires in Canada that have plagued air quality in the United States, including (at the time) in the nation’s capital; severe tornadoes and hailstorms in the central and southern states this spring; historic drought and periods of intense rainfall in the West, and the ravages of Hurricane Ian the prior fall.

In fact, Hurricane Ian has been cited by Treasury Secretary Janet Yellen as a galvanizing factor in the federal government’s need for an increased understanding of US insurance market vulnerabilities. She also cited her announcement of the FIO’s proposed ZIP code–level underwriting data collection from homeowners’ insurers to help assess financial market climate risk and vulnerabilities.⁷

This situation and its grave statistics underpin what Steele referred to as the urgent need for stakeholders “to work together to understand and mitigate the risks from these events.” Steele made it clear that the Treasury is also focusing on financial stability concerns and the insurance sector’s role in them, as they affect the housing and mortgage market as well.

Steele said the report helps to further understand climate’s effect on financial system, including the interaction between the banking markets, insurance, and ultimately homeowners and their property values. The report was published at a critical time, just as the planet recorded its highest temperatures for multiple consecutive days; another insurer said it was capping new homeowner policies in California partially due to increasingly severe weather events (as well as inflation); and “once in a millennium” flooding struck the Northeast, particularly New York.⁸



More targeted involvement from the FIO expected under Biden Climate EO

This dual-pronged approach involves a proposed effort to collect ZIP code-level data on homeowners insurance from property and casualty (P&C) insurers writing above a premium threshold of \$100 million in 2021 homeowners' insurance premiums.

The FIO plans to include additional insurers in order to achieve an 80% market share threshold in each of 10 states that are potentially the most vulnerable to climate-related disasters. The FIO issued a request for comment in October 2022 on the proposed collection of nationwide data.⁹

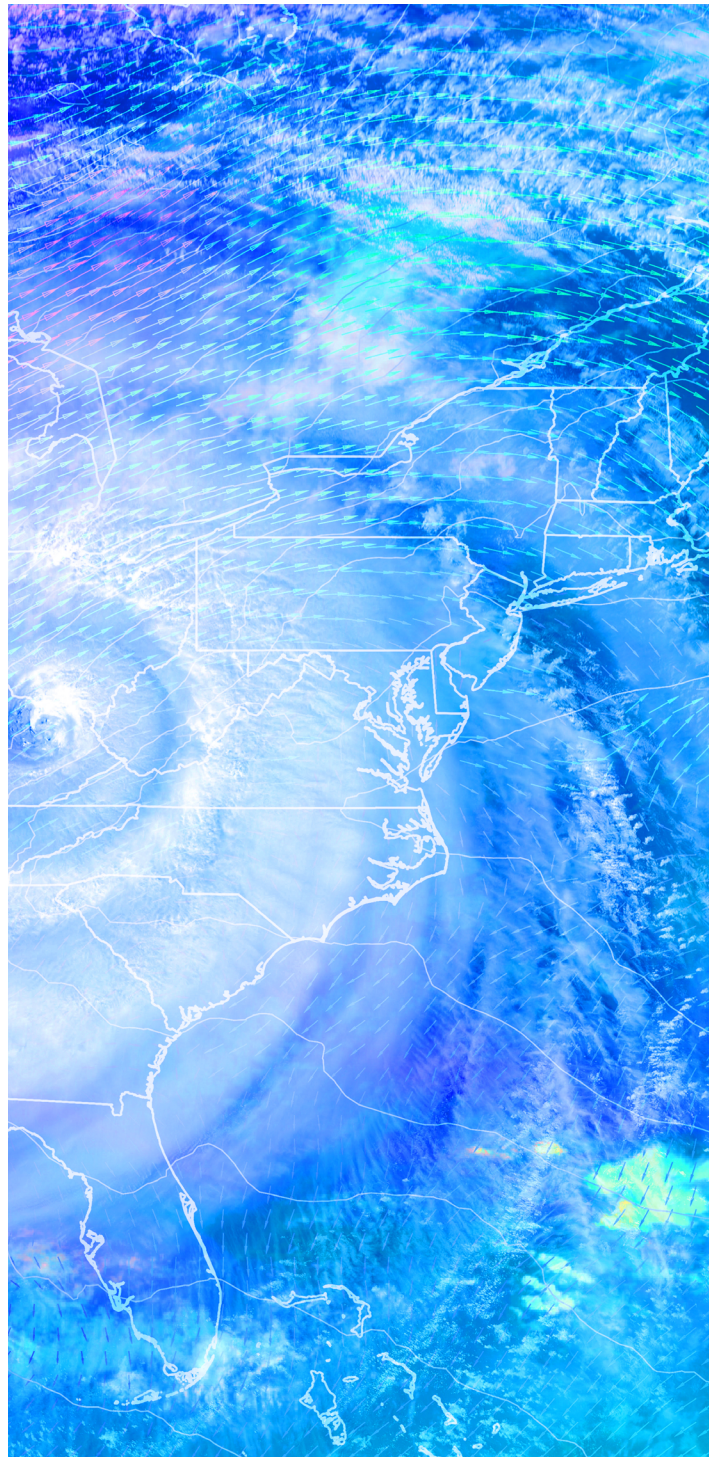
This prompted vociferous comments, including a pointed response from the NAIC to Steele where it argued that the "FIO has failed to demonstrate a good faith effort to engage with state regulators and has exhibited [its] intention to forgo a collaborative effort to identify and collect accurate and useful data."

The NAIC in its letter told Steele "it is likely that any analysis will be misinterpreted and produce fallacious results in trying to identify climate risk." The property insurance market data will likely be coupled with demographic data at the ZIP code level, the NAIC said, but the "average premium and deductible, when combined with other socio-economic data can provide insight into affordability, generally, but will not reflect the impact of climate risk on pricing or underwriting."¹⁰

The FIO has already met with representatives of well over a dozen organizations to further discuss the proposed data call, according to Steele.

Separately, in August at its Summer National Meeting, the NAIC announced a data call of its own.¹¹ Citing the "increasing frequency and severity of weather events, rising reinsurance costs, and inflationary pressures" in localized P&C markets in the United States, the NAIC said that insurance regulators from at least 30 states have begun work to look at availability and affordability issues.

The state regulators will be seeking data they lack and developing a template "to develop a long-term, robust data collection strategy to help regulators more nimbly respond to inquiries related to their property markets versus a one-time data call." How this influences the FIO's proposed data call is still to be determined.



The wheel does not have to be reinvented

The report called out the efforts of some states leading with meaningful climate risk supervision, including:

- New York State Department of Financial Services' (NYDFS) 2021 state insurance regulatory guidance on managing climate-related risks¹²
- Connecticut Insurance Department's (CID) September 2022 bulletin *Guidance for Connecticut Domestic Insurers on Managing the Financial Risks for Climate Change*¹³
- CID's November 2022 four-part sustainable insurance strategy¹⁴
- California, New York, and Vermont's actions to collect data on the investment exposures to climate-related risks of insurers¹⁵

"We did not reinvent the wheel," noted NYDFS Deputy Superintendent Avani Shah, who spoke as a panelist. "We started with international regulator supervisory statements and guidance and tailored it to apply to New York insurers ... minimizing the burden on our companies many of whom are subject to requirements from different jurisdictions all around the world."

The NYDFS guidance is focused on the financial stability of insurers in the face of climate change, and although New York does not require insurers to contribute to the low-carbon transition or make climate commitments to achieve net-zero emissions, it does support insurers' adaptation and mitigation efforts, especially in disadvantaged communities that are disproportionately impacted by climate change.

In fact, the report notes that the state insurance regulatory attention to scenario analysis is advancing as well. It details the work and intentions of the Solvency Workstream of the NAIC Climate and Resiliency Task Force in evaluating scenario analysis and plans to evaluate climate-related stress-testing.

However, the FIO observed that the various agencies and organizations have different metrics on such elements as disclosures. "The NAIC, NYDFS, and CID do not mention either internal carbon prices or executive remuneration, while the TCFD recommends their disclosure when relevant or when climate-related issues are material," the report states. It also found that these state and NAIC disclosure initiatives are aligned at a high level but critiqued the differing level of prescriptiveness and quantification among the frameworks. These discrepancies "can result in different climate-related information being submitted by companies that report under different disclosure frameworks," the report argued.

While the FIO said it appreciates that less prescriptive guidance can be more adaptive to different companies and their profiles and characteristics, it also made clear that more amorphous reporting could "be less effective in enhancing the ability of stakeholders to compare responses across insurers and jurisdictions, thereby limiting the potential usefulness of such disclosures for risk assessment by regulators, stakeholders, and market participants."

NAIC reiterates its commitment and ongoing work

State insurance regulators and FIO Director Steven Seitz continued the discussion on states' efforts.

Virginia Insurance Commissioner Scott White, representing the NAIC as its 2023 secretary-treasurer, stressed the need for consumer education and public and private partnerships, particularly in the area of risk mitigation and resiliency, availability and affordability of insurance, and closing protection gaps. White discussed the NAIC's goals and ongoing work and said that the organization has stepped up its efforts over the past few years but has been focusing on climate risk oversight for more than 10 years.

White underscored the NAIC solvency framework, the foundation of the state-based insurance system, and said the NAIC is very well suited to manage climate risk and educated attendees on the risk-focused examination process, noting there would be further exam enhancements on climate risk. White also explained that the state risk-based capital framework the backbone of our solvency framework.

"We cannot insure our way out of this climate risk issue, and the industry plays a critical role both on the underwriting side and the investment side. On the underwriting side, insuring some of these companies with the renewable strategies or the climate resiliency products, and on the investment side, the investments are very critical ... there's a role for the regulators to play, the industry to play, and policymakers, so collectively, I think the takeaway is we will all have to work together to manage this emerging risk," White said.

Chlora Lindley-Myers, NAIC president and director of the Missouri Department of Commerce and Insurance responded to the report in a press release, noting that "many of the recommendations align with initiatives currently underway at the NAIC and are supported by the ongoing work of the NAIC Climate Risk & Resiliency Task Force."¹⁶

In his comments, Seitz recommended that all states adopt the NAIC climate risk disclosure survey and that the NAIC continue its efforts to monitor responses to the survey and publish an annual report that summarizes results. In his comments, he also briefly touched on other recommendations, including enhancements of day-to-day tools, including updates to handbooks and guidance. Seitz did say efforts were "fragmented across the states and limited in some important ways."

Seitz recommended that all states adopt the NAIC climate risk disclosure survey and that the NAIC continue its efforts to monitor responses to the survey and publish an annual report that summarizes results.

The FIO positioned to continue its work on climate-related risks

The FIO is not taking a break from its climate-related work.

“There’s a lot of work to do—and I think you’ve heard a lot of work being done by the New York Department and a lot of work being done by the NAIC,” Seitz said, echoing the report. In that vein, he said the FIO views its work as being “iterative” and as a capacity-building exercise. “Hopefully today is a foundational step so that the state and federal authorities can take this work forward, meaningfully so,” Seitz concluded.

The FIO is also undertaking new work of its own, in addition to contemplating its proposed data call in consultation with the states.

The FIO will be analyzing insurers’ exposure to climate-related transition risks using the Paris Agreement Capital Transition Assessment (PACTA) methodology. The concern is that US insurance ownership of nearly \$7 trillion in net admitted invested assets—some amount of which could be exposed to climate-related transition risks, which could lead to defaults or impairment—forms the basis of this exposure analysis.

The FIO said it will build upon the work already being done by state agencies such as the NYDFS and the California Department of Insurance to conduct the first nationwide analysis of insurers’ transition exposures, risks, and opportunities.

The FIO said it would continue to work with the Financial Security Oversight Council and the Treasury’s Office of Financial Research to bolster the federal government’s ability to understand and mitigate potential systemic risks and threats to US financial stability that could come from climate-instigated financial distress with insurers, signaling another possible report or analysis.

Endnotes

1. US Department of the Treasury (Treasury) Federal Insurance Office (FIO), [Insurance supervision and regulation of climate-related risks](#), June 2023.
2. President Joseph R. Biden Jr., "[Executive Order on Climate-related Financial Risk](#)," The White House, May 20, 2021.
3. Treasury FIO, [Insurance supervision and regulation of climate-related risks](#).
4. Brookings Institution, "[Assessing insurance regulation and supervision of climate-related financial risk](#)," presentation (Washington, DC), June 27, 2023.
5. National Oceanic and Atmospheric Administration (NOAA) National Centers for Environmental Information (NCEI), "[Billion-Dollar Weather and Climate Disasters](#)," 2023.
6. Treasury FIO, [Insurance supervision and regulation of climate-related risks](#).
7. Treasury, "[Treasury's Federal Insurance Office takes important step to assess climate-related financial risk—seeks comment on proposed data call](#)," press release, October 18, 2022.
8. Angela Fritz and Laura Paddison, "[This week's record-breaking global temperatures are likely highest in 'at least 100,000 years'](#)," CNN, updated July 7, 2023; Becca Habegger, "[Another insurance company has changed how it's doing business in California](#)," ABC10, updated July 6, 2023; Lauren Mascarenhas and Nouran Salahieh, "[Trapped drivers swam out of their cars. A woman died after being swept away by floodwaters. What to know about the heavy rainfall hitting the Northeast](#)," CNN, updated July 10, 2023.
9. Treasury FIO, "[FIO proposed data call instructions](#)," October 14, 2022.
10. National Association of Insurance Commissioners (NAIC), "[FIO climate-related financial risk data collection comments](#)," November 22, 2022.
11. NAIC, [NAIC to Issue Data Call to Help Regulators Better Understand Property Markets](#) August 15, 2023.
12. New York Department of Financial Services (NYDFS), "[Guidance for New York domestic insurers on managing the financial risks from climate change](#)," November 15, 2021.
13. Connecticut Insurance Department (CID), "[Bulletin No. FS-44: Guidance for Connecticut domestic insurers on managing the financial risks for climate change](#)," September 15, 2022.
14. Office of Governor Gavin Newsom, "[California releases world's first plan to achieve net zero carbon pollution](#)," November 16, 2022.
15. Financial Stability Oversight Council (FSOC), [Report on climate-related financial risk](#), October 21, 2021.
16. NAIC, "[NAIC participates in Brookings panel on climate-related financial risk](#)," press release, June 28, 2023.

Get in touch

Rich Godfrey

Principal | Deloitte & Touche LLP

rgodfrey@deloitte.com

David Sherwood

Managing Director | Deloitte & Touche LLP

dsherwood@deloitte.com

Deloitte Center for Regulatory Strategy

Irena Gecas-McCarthy

Principal | Deloitte & Touche LLP

igecasmccarthy@deloitte.com

Jim Eckenrode

Managing Director | Deloitte Services LP

jeckenrode@deloitte.com

Liz Festa

Senior Research Specialist | Deloitte Services LP

lfesta@deloitte.com



Center *for* Regulatory Strategy US

About the Center

The Deloitte Center for Regulatory Strategy provides valuable insight to help organizations in the financial services industry keep abreast of emerging regulatory and compliance requirements, regulatory implementation leading practices, and other regulatory trends. Home to a team of experienced executives, former regulators, and Deloitte professionals with extensive experience solving complex regulatory issues, the Center exists to bring relevant information and specialized perspectives to our clients through a range of media, including thought leadership, research, forums, webcasts, and events.

Deloitte.

This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional adviser.

Deloitte shall not be responsible for any loss sustained by any person who relies on this publication.

As used in this document, "Deloitte" means Deloitte & Touche LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of our legal structure. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2023 Deloitte Development LLC. All rights reserved.