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Creating a climate of change digest

Climate risk regulatory developments in the financial services industry

Leading off

The National Association of Insurance Commissioners (NAIC) submitted a letter to congressional leaders on September 13, 2024, advocating for long-term reauthorization of the National Flood Insurance Program (NFIP). The association asserted this would help policyholders prepare for flood disasters.[1]

The existing NFIP regulation had an expiration date of September 30, 2024. Renewal of the NFIP by Congress is needed to extend its statutory authority to issue new flood insurance contracts. The NAIC letter urged Congress to implement a long-term reauthorization of the NFIP before its expiration.

The NAIC letter advocated against a temporary extension of the NFIP because it would impair consumers' ability to plan ahead. Additionally, it noted that most flood insurance policies do not take effect until 30 days after purchase.

The letter suggested the following for NFIP reauthorization:[2]

- Measures to encourage investment in prevention and preparedness
- Inclusion of mitigation discounts to persons who build, rebuild, or retrofit their properties to better resist flood events
- Measures to ensure that state-based disaster mitigation grants receive the same federal tax exemptions as federal mitigation

grants (by inclusion of legislation, such as the Disaster Mitigation and Tax Parity Act of 2023)

- Legislative reforms to ensure accurate flood mapping and increased transparency around developing and updating flood maps
- Strategies to increase flood insurance take-up rates

On September 26, 2024, President Biden signed legislation passed by Congress that extended the NFIP's authorization to December 20, 2024.[3]

On September 16, 2024, in response to a recent congressional letter, the NAIC leadership sent a letter to Congress regarding the state insurance regulators' long-standing and latest efforts to address climate-related financial risks.[4]

The NAIC letter sought to underscore the strength of the US state-based insurance regulation system, highlighting its flexibility to employ diverse strategies tailored to unique risks and market developments. This adaptability is complemented by the commitment of regulators to take collaborative action, gather and share data, promote leading practices, and address national issues through the NAIC, the organization said. The letter noted how state insurance regulators are actively involved before, during, and after natural disasters and pointed out how they work closely with policyholders to explain coverage and assist in rebuilding lives and businesses.

The letter highlighted several initiatives undertaken by state insurance regulators to address climate-related risks. Some of these are laid out below:[5]

- **Property & Casualty Market Intelligence (PCMI) data call:** Collection and analysis of ZIP code-level data covering more than 80% of the US property insurance market by premium volume.
- **Climate Risk Disclosure Survey:** Requires insurers to publicly disclose their governance, strategy, and risk management practices, as well as how they measure and monitor climate-related risks.
- **Catastrophe Modeling Center of Excellence (COE):** Created to evaluate catastrophe model usage and provide regulators with technical training and expertise regarding catastrophe models and information on their use within the insurance industry.
- **NAIC's Financial Analysis Handbook and Financial Condition Examiners Handbook:** Revisions to these handbooks to appropriately consider transition risk and physical risk in ongoing financial surveillance.
- **NAIC's Risk Based Capital filing:** Includes the addition of climate risk scenario analysis requirements.
- **National Climate Resilience Strategy:** Adoption of the first-ever National Climate Resilience Strategy for Insurance to protect the nation's property insurance markets and to focus on reducing losses and speeding recovery from natural disasters.

The letter mentioned that property insurers have experienced several challenging years of underwriting performance with a combined ratio over 100% and with the mix of elevated risks and elevated costs due to inflation being felt directly by policyholders. The letter emphasized that insurance alone is not going to address the national response to the increasing frequency and severity of weather events.

NAIC leaders concluded the letter by urging members of Congress to pass the Disaster Mitigation and Tax Parity Act of 2023 (S. 1953 and H.R. 4070), which excludes from gross income, for income tax purposes, any qualified catastrophe mitigation payment made under a state-based catastrophe loss mitigation program. This could allow consumers to use state-provided mitigation grants to fortify their homes without facing federal taxation—a benefit already afforded to similar federal grants.[6]

On September 20, 2024, the Commodity Futures Trading Commission (CFTC) approved final guidance[7] regarding the listing for trading of Voluntary Carbon Credit (VCC) derivative contracts.

The guidance does not establish new obligations for designated contract markets (DCMs), but rather is intended to assist DCMs in addressing existing obligations when designing and listing VCC derivatives. DCMs must address certain core principle requirements in the Commodity Exchange Act (CEA) and CFTC regulations that are relevant to the listing for trading of VCC derivative contracts. The guidance provides factors for DCMs to consider related to their various core principle compliance obligations when listing VCC derivative contracts for trading on their markets.

The guidance provides "VCC commodity characteristics" that are to be taken into consideration when designing a VCC derivative contract and addressing in the contract's terms and conditions the underlying VCC. VCC commodity characteristics should be considered when addressing the following criteria in the design of a VCC derivative contract.[8]

- **Quality standards** – A DCM should consider (i) transparency, (ii) additionality, (iii) permanence and risk of reversal, and (iv) careful quantification when addressing quality standards in connection with the design of a VCC derivative contract.
- **Delivery points and facilities** – When addressing delivery procedures in connection with the design of a physically settled VCC derivative contract, a DCM should consider the governance framework and tracking mechanisms of the crediting program for underlying VCCs, as well as the crediting program's measures to prevent double counting.
- **Inspection provisions** – Any inspection or certification procedures for verifying compliance with quality requirements or any other related delivery requirements for physically settled VCC derivative contracts should be specified in the contract's terms and conditions.

The guidance reflects insight the CFTC gained from public comment on the proposed guidance[9] and marks the culmination of more than five years of collaboration with a diverse group of market participants.

On September 20, 2024, the International Auditing and Assurance Standards Board (IAASB) approved the International Standard on Sustainability Assurance 5000 (ISSA 5000), General Requirements for Sustainability Assurance Engagements, the first set of rules for audits of corporate sustainability statements.[10]

The IAASB has approved ISSA 5000 in its efforts to establish a consistent global framework for sustainability assurance. The issuance of ISSA 5000 involved a series of activities, such as initial development and consultation, release of exposure draft of ISSA 5000, invitations for public comments and industry feedback, revisions, and integration of feedback, and subsequent finalization and approval of the standards. ISSA 5000 is designed as an overarching standard for sustainability engagements, so practitioners do not need to apply International Standard on Assurance Engagements 3000 (ISAE 3000) when performing these engagements.

Below are some highlights of the standard:

1. **Differentiated levels of assurance:** ISSA 5000 specifies requirements for both limited and reasonable assurance engagements. It uses a dual-column format to distinguish specific procedures and reporting requirements for each level to help practitioners apply appropriate procedures for each type of engagement.
2. **Applicability and flexibility:** ISSA 5000 is developed for all types of sustainability information, not depending on how it is presented, whether as part of an annual report, stand-alone, or integrated into other documents. ISSA 5000 is adaptable across entities of various sizes and complexities. The standard also aligns with growing sustainability frameworks and regulatory requirements including the International Sustainability Standards Board's (ISSB) International Financial Reporting Standards (IFRS®) S1 and S2 and the Global Reporting Initiative's standards so that the standard can meet varying jurisdictional demands. S1 refers to direct greenhouse gases emitted by the reporting company, and S2 refers to indirect emissions from use or purchase.[11]
3. **Material misstatement:** ISSA 5000 requires practitioners to identify and assess risks of material misstatements arising from fraud or error. Practitioners are required to respond to these risks by designing procedures that align with the level of assurance, whether limited or reasonable. For reasonable assurance, practitioners assess material misstatement risks at a more granular "assertion level" for disclosures; whereas, in limited assurance, they assess risks at the broader "disclosure level."
4. **Professional skepticism and responding to fraud and noncompliance:** Practitioners should build an attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to error or fraud, and a critical assessment of evidence. In addition, the practitioners are required to stay alert to potential fraud or noncompliance with laws related to sustainability matters, setting down specific actions if such instances are suspected.

The standard sets detailed requirements for engagement on sustainability information, defining the necessary practitioner competencies, ethical considerations, assurance levels, and reporting boundaries. ISSA 5000 is scheduled to become effective for engagements on sustainability information for periods beginning on or after December 15, 2026, with early application permitted.

On September 25, 2024, the IFRS Foundation at New York Climate Week published a guide for preparers on voluntarily applying ISSB standards. The guide aims to support companies as they start to apply ISSB standards voluntarily as well as helping them communicate their progress to investors.[12]

The IFRS guide focuses on the voluntary application of IFRS S1 and S2 disclosure standards issued by the ISSB, in disclosing sustainability-related financial information. These standards focus on providing a global baseline for climate and sustainability disclosures and help investors in decision-making by improving the comparability and reliability of information.

Below are the primary features of the guide:

1. **Compliance pathway:** When an entity requires full compliance, it must meet all the IFRS S1 and S2 standards. However, companies may start with partial disclosures and progressively enhance the transparencies, especially if jurisdictional requirements allow for phased adoption.
2. **Transition reliefs:** Transition reliefs help entities coping with initial application stages and relate to:
    - Climate-first reporting: Initially, companies can report only climate-related information.
    - Delayed reporting: Sustainability disclosures can be reported after financial statements in the first reporting year.
    - Comparative data: Comparative sustainability data is required only from the second year.
    - Greenhouse Gas (GHG) protocol: Alternative GHG measurement methods are permitted in the first year.
    - S3 GHG emissions: Disclosure of S3 emissions is optional in the first year.
3. **Proportionality mechanisms:** Proportionality mechanisms help companies to disclose information using reasonable, supportable data without incurring undue costs or effort. This approach includes qualitative disclosure options when quantitative data is difficult to obtain, especially for companies with limited resources.
4. **Alignment with existing frameworks:** IFRS S1 and S2 incorporate elements from established standards like the Sustainability Accounting Standards Board (SASB), Task Force on Climate-related Financial Disclosures (TCFD), Climate Disclosure Standards Board (CDSB), and the Integrated Reporting (IR) framework. Companies already using these frameworks are well advanced on the path to compliance, wherein added

requirements involve industry-specific information and broader connectivity across sustainability data.

5. **Communicating partial application:** Companies that are not fully compliant are encouraged to transparently communicate the extent of their application, the reasons for phased disclosures, and their intended path to compliance.
6. **Assurance and investor confidence:** The guide suggests that third-party assurance for partial applications can enhance investor trust by clarifying the basis of reported sustainability information.

The guide is designed as a roadmap for companies as they start using the ISSB standards, with a focus on transparency, phased reporting, and alignment with existing frameworks to support global sustainability disclosures.

On September 27, 2024, California Governor Gavin Newsom signed into law California State Senate Bill (SB)-219,[13] which amends portions of Sections 38532 and 38533 of the California Health and Safety Code that were established upon the passage of California SB-253[14] and SB-261.[15]

Newsom's administration had proposed[16] that the implementation of California's mandatory climate disclosure laws relating to GHG emissions (SB-253) and climate-related risks (SB-261) be delayed for two years. The two-year delay sought by Governor Newsom was rejected. SB-219 retains most of the provisions in SB-253 and does not change the reporting deadlines under SB-253 and SB-261.

The amendments brought forth by SB-219 are summarized below:[17]

- Reporting entities are allowed to consolidate emission disclosures at the parent-company level.
- The deadline for the California Air Resource Board (CARB) to develop and adopt regulations for the reporting of GHG emissions has been changed from January 1, 2025 to July 1, 2025.
- Entities are required to disclose their S3 emissions on a schedule specified by CARB rather than 180 days after the disclosure of S1 and S2 emissions.
- While reporting entities are required to pay a filing fee, they are not mandated to pay the fee at the time of filing the disclosure.
- CARB is authorized, rather than required, to contract with an emissions reporting organization to develop a reporting program to receive GHG emissions disclosures.

SB-219 offers some flexibility, time, and discretion for CARB to adopt the regulation, develop the reporting program, and determine the timeline for S3 emissions disclosures in 2027.

Additional Deloitte US perspective on climate risks

For additional insights, please see our ongoing series on how climate risks are shaping US financial regulatory initiatives and the impact these developments may have on the financial services industry and the broader economy:

- Deloitte 2024 CxO Sustainability Report
- 2025 financial services industry outlooks
- Ingraining sustainability in the next era of ESG investing
- The CIO's call to action: Driving an environmentally sustainable tech agenda to accelerate organizational change
- Climate and Financial Risk Digest | Deloitte US | Deloitte US
- Center for Regulatory Strategy - Sustainability, Climate & Equity | Deloitte US

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Endnotes

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13. California Legislative Information, "SB-219, Greenhouse Gases: Climate Corporate Accountability: Climate-related Financial Risk," September 30, 2024.
14. California Legislative Information, "SB-253 Climate Corporate Data Accountability Act," October 9, 2023.
15. California Legislative Information, "SB-261 Greenhouse Gases: Climate-related Financial Risk," October 9, 2023.
16. State of California Department of Finance, "2024–25 Proposed Budget Trailer Bill Language RN 24 17560 – Climate Corporate Data Accountability Act/Climate Related Financial Risk Implementation," June 21, 2024.
17. Ibid.

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