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Creating a climate of change digest

Climate risk regulatory developments in the financial services industry

Leading off

On February 21, 2024, the National Association of Insurance Commissioners (NAIC) adopted the NAIC Statement on Environmental, Social, and Governance (ESG) Policies for the insurance sector.[1]

NAIC members, comprising the chief insurance regulators of all 50 states, the District of Columbia, and the five United States Territories, unanimously adopted the Statement on ESG policies, which clarifies the applicability of ESG policies to the US insurance sector and its supervision.

Highlights:[2]

- The NAIC does not anticipate developing regulatory policy to require or prohibit insurance companies from adopting ESG policies that govern insurers' underwriting, investing, or other business decisions.
- The NAIC encourages insurers, regulatory bodies, standard setters, and policymakers to consider the reliability of metrics and the impact of ESG policies on the financial condition of insurers and the availability and affordability of insurance products and services, if adopting such policies.

- The NAIC invites and encourages legislators, policymakers, and stakeholders to contact state insurance regulators when considering ESG-related legislation or executive action to discuss the potential impact of proposals on the solvency and financial stability of the insurance sector.

The NAIC recognizes that it has extensive work underway on climate risk to the extent that it directly pertains to NAIC's responsibility to protect policyholders and supervise the financial health of insurers.

The International Federation of Accountants (IFAC), the American Institute of Certified Public Accountants (AICPA), and the Chartered Institute of Management Accountants (CIMA) released a report designed to support evidence-based discussion and analysis of current market practice and trends in sustainability disclosure and assurance.[3]

The report, titled *The state of play: Sustainability disclosure and assurance*,[4] is a benchmarking study that captures and analyzes the extent to which companies are reporting and obtaining assurance over their sustainability disclosures, which assurance standards are being used, and which companies are providing the assurance service.

The report stresses the need for global companies to transition toward a universal system of sustainability disclosure requirements. Encouragingly, more than half of the companies are using the Sustainability Accounting Standards Board (SASB) standards and the Task Force on Climate-related Financial Disclosures (TCFD) framework. This adoption is expected to aid the transition to the International Sustainability Standards Board (ISSB) standards that were introduced last year.

Report highlights:[5]

- The number of companies reporting some sustainability information increased to 98% in 2022, from 91% in 2019.
- The use of stand-alone sustainability reports declined by 27 percentage points in the past three years, with only 30% of companies using them in 2022.
- The number of companies obtaining assurance on some of their sustainability disclosures rose to 69% in 2022, from 51% in 2019.
- The number of assurance engagements related to sustainability conducted by accountancy firms slightly increased to 58% in 2022, from 57% in 2021. However, some markets, notably the United States, fell well below 50%.
- Most companies (60%) that obtained assurance over greenhouse gas (GHG) emissions did so over all three scopes (scopes 1, 2, and 3).

Sue Coffey, the CEO of Public Accounting at AICPA and CIMA, observed that companies that employ accounting firms for sustainability assurance are likely to choose the same firm they use for their financial audits. This is based on the expectation that the level of confidence and reliability on sustainability disclosure should be equivalent to financial information. It is expected that more companies will recognize that accounting firms are the most suitable for this vital work.

The Science Based Targets initiative (SBTi) has published two new reports to support the design and implementation of beyond value chain mitigation (BVCM) strategies.[6]

BVCM is a mechanism by which companies go above and beyond value chain abatement and it occurs outside of company value chains. BVCM activities and investments are not accounted for in the company's scope 1, 2, or 3 GHG inventory and therefore do not count toward achieving value-chain emission reduction targets.

BVCM is one of the four key elements that make up a corporate net-zero target as per SBTi's Corporate Net-Zero Standard Framework.[7] SBTi's two reports, titled *Above and beyond: An SBTi report on the design and implementation of BVCM*[8] and *Raising the bar: An SBTi report on accelerating corporate adoption of BVCM*[9] provide strategies and tools to speed up progress toward global net-zero and facilitate corporate adoption of BVCM, respectively.

The *Above and beyond* report[10] provides step-by-step recommendations for designing and implementing high-integrity and high-impact BVCM strategies. It presents the business case for companies to adopt BVCM, outlines the steps for making a BVCM pledge, and provides examples to illustrate the implementation of BVCM in various sectors.

The second report, *Raising the bar,*[11] complements the first report and explores the incentives for BVCM that the broader climate ecosystem can influence. This ecosystem includes civil society, academia, policymakers, standard setters, advocacy organizations, and multilateral organizations. Drawing from SBTi's research, the report summarizes the barriers and incentives for BVCM adoption in the private sector. It also provides a toolbox for accelerating and incentivizing the corporate adoption and implementation of BVCM and provides recommendations for different actors across the climate ecosystem.

On March 5, US Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) released final rules on key provisions in the Inflation Reduction Act (IRA) to expand the reach of the clean energy tax credits and help build projects more quickly and affordably, which will create good-paying jobs and lower energy costs for families.[12]

The Treasury and IRS have jointly released final rules and guidance aimed at expanding the utilization of clean energy tax credits, as per the provisions of the IRA. These rules introduce innovative mechanisms like elective pay and transferability to extend the reach of incentives and facilitate the participation of various entities in clean energy projects.

The IRA established elective pay and transferability to enable state, local, and tribal governments; nonprofit organizations; and other entities to access clean energy tax credits. Elective pay allows tax-exempt and governmental entities to receive payments for a range of clean energy tax credits, while transferability permits businesses to transfer credits to third parties for immediate funds, particularly beneficial for entities lacking sufficient tax liability. This addresses previous limitations in which many entities were unable to fully benefit from these tax credits.

The finalized rules provide clarity and guidance for eligible entities to understand the requirements for accessing clean energy tax credits through elective pay. Additionally, a Notice of Proposed Rulemaking (NPRM) has been issued to offer further clarity and flexibility, particularly for entities co-owning clean energy projects and seeking to utilize elective pay. Proposed regulations also offer pathways for entities treated as partnerships for federal tax purposes to access elective pay through joint ownership arrangements.

In parallel, guidance has been provided on the Investment Tax Credit (ITC) under Section 48 of the Internal Revenue Code to support the investment boom triggered by the IRA. The NPRM addresses eligibility criteria for various components of clean energy projects, including offshore wind and battery storage, reflecting critical provisions in the IRA to support renewable energy development.

To ensure effective implementation, the Treasury and IRS are open to receiving written comments on the NPRM, with a comment period extending for 60 days. Additionally, the IRS has developed the Energy Credits Online (ECO) platform to streamline the process for eligible entities to receive direct payments or transfer clean energy credits. This platform facilitates pre-file registration, ensuring efficient access to benefits while safeguarding against improper payments.

Overall, the combined efforts of the Treasury and IRS, in conjunction with the measures specified in the IRA, strive to promote clean energy projects. These initiatives aim to stimulate economic expansion and improve environmental sustainability across the country.

On March 6, 2024, the US Securities and Exchange Commission (SEC) published its adoption of amendments to rules under the Securities Act of 1933 and Securities Exchange Act of 1934. The final rules will require information about a registrant's climate-related risks that have materially impacted, or are likely to have an impact on, its business strategy, results of operations, or financial condition.[13]

The rules aim to enhance transparency by requiring companies to disclose climate-related risks, impacts, and strategies in annual reports and registration statements. This ensures investors receive consistent, comparable, and useful information for decision-making to better assess potential financial impacts and promote proactive climate risk management. The rules reflect several key differences from the proposed rule. Companies won't have to provide scope 3 GHG emission disclosures, and their financial statement disclosure requirements will be less extensive, with more time allotted for implementation. Below are the key points outlining the new SEC requirements for climate-related disclosure.

Financial statement disclosures
Registrants must disclose:

- Specific financial effects of severe weather events and natural conditions in footnotes.
- Carbon offsets, renewable energy certificates (RECs), and impacts on financial estimates due to climate-related factors.

Disclosures outside of financial statements
Large accelerated filers and accelerated filers must disclose:

- Material scope 1 and 2 GHG emissions.
- Governance and oversight of climate-related risks, impact on strategy and business model, risk management processes, and climate targets.
- Consistent, comparable information to investors.
- Clear reporting requirements to issuers.

Key changes from proposed rule

- Establishing materiality thresholds for GHG emissions and allowing delayed disclosure.
- Flexible determination of organizational boundaries for emissions.
- Eliminating scope 3 GHG emission disclosure and changing the financial statement impact evaluation method.

Location, timing, materiality, and safe harbor

- Disclosure timing varies for different types of registrants and filings.
- Materiality aligns with Supreme Court standards.
- Safe harbor provided for certain disclosures related to transition plans, scenario analysis, internal carbon pricing, and targets.

Affected companies and transition provisions

- All registrants (except asset-backed issuers) must provide disclosures.
- Exemptions for smaller reporting companies, emerging growth companies, and non-accelerated filers from GHG emissions disclosure.
- Compliance dates vary, with phased adoption timelines.

These requirements aim to enhance transparency, comparability, and reliability of climate-related disclosures, aiding investors in assessing a company's exposure to climate risks and making informed decisions.

On March 15, 2024, the United States Court of Appeals for the Fifth Circuit granted an administrative stay[14] of the final rule ("The Enhancement and Standardization of Climate-Related Disclosures for Investors")[15] that was recently adopted by the SEC.

The administrative stay of the rule was granted in response to a petition filed on March 6, 2024,[16] by two oil field services companies, which argued that the rule is "arbitrary and capricious," that it violates the First Amendment of the US Constitution, and that it seeks to cripple the traditional energy sector. This petition was one of nine petitions that were challenging the rule in six different circuits.

The litigation challenging the rule also includes petitions from environmental groups, which argue that the rule has scaled back on important disclosures and can do more to provide investors with information they need to manage climate-related financial risks.[17]

The SEC requested consolidation of the petitions in a single court of appeals. On March 22, 2024, the United States Judicial Panel on Multidistrict Litigation, by lottery, selected the US Court of Appeals for the Eighth Circuit as the venue to consolidate the multi-circuit petitions against the rule for review. The Fifth Circuit ordered the transfer of the petition from the oil field services companies to the Eighth Circuit and the dissolution of the administrative stay.[18]

With the pending litigations against the rule, its implementation timeline remains unclear.

On March 8, 2024, the Treasury, in collaboration with state insurance regulators and the NAIC, advanced its efforts toward the collection of homeowners insurance data to better understand the impacts of climate-related financial risks on the insurance sector.[19]

In October 2022, the Treasury's Federal Insurance Office (FIO) had announced the collection of climate-related data directly from insurance companies to assess climate-related financial risk across the United States. This proposed effort has now been replaced with the collaborative effort toward data collection.

The NAIC and the state insurance regulators have agreed to provide FIO with timely data comparable to its proposed collection and to help mitigate reporting burdens on relevant insurance companies.[20] The state insurance regulators together have issued a comprehensive, multistate data call coordinated by the NAIC to collect and analyze data covering more than 80% of the US property insurance market by premium volume.[21] The largest homeowner insurers will be asked to submit ZIP code-level data across the United States on premiums, policies, claims, losses, limits, deductibles, nonrenewals, and coverage types.

The NAIC has agreed to begin sending the collected data to FIO in June 2024 and to provide the final data to FIO in late September 2024.

On March 14, 2024, Insurance Commissioner Ricardo Lara announced the next phase of the Sustainable Insurance Strategy to safeguard Californians' access to insurance.[22]

Commissioner Lara released the catastrophe modeling regulation[23] as the next phase of the Sustainable Insurance Strategy. Currently, the California Department of Insurance (Department) allows the use of catastrophe models for earthquake losses and fires following an earthquake. The proposed regulation expands the allowable use of catastrophe models to include wildfire, terrorism, and flood lines for homeowners and commercial insurance lines.

Highlights of the proposed regulation:

- The regulation requires any catastrophe model to incorporate the best available scientific information on risk mitigation at the property, community, and landscape scales, including risk mitigation initiated by local and regional utility companies.
- The regulation creates a new review process for models by a panel of experts overseen by the Department—before insurance companies can use them in a rate filing and meet the stringent transparency requirements under Proposition 103.

The proposed regulation includes the following expected benefits:[24]

- **More reliable rates:** Insurance consumers will have more stable costs than costs under current regulations, which have resulted in sudden and steep increases for those at higher risk of wildfire.
- **Greater availability of insurance:** Insurance companies will increase their writing because they can better anticipate future losses, rather than making abrupt decisions to not renew higher-risk policyholders, pause writing, or rapidly increase rates.
- **Stronger oversight:** The Department will have strong public oversight of modeling, which is already being widely used by insurance companies outside of ratemaking and across the nation. The Department will have access to models and build expertise, which will help California continue to take the lead on consumer protection.
- **Safer communities:** Catastrophe models can capture efforts taken by federal, state, and local governments; property owners; communities; and utility companies to mitigate the exposure of communities to catastrophic events—encouraging and rewarding those efforts.

The Department had a public workshop scheduled April 23, 2024, to take inputs on the proposed regulation before it is submitted for approval to the Office of Administrative Law.

The NAIC held an Executive Committee meeting on March 17, 2024, addressing various critical topics such as private equity in health care and regulatory frameworks, emphasizing consumer protection and fair practices within the insurance industry.[25] In this meeting, the Executive Committee adopted the NAIC National Climate Resilience Strategy (Strategy).[26]

The Strategy outlined by the NAIC is a framework aimed at regulating insurance marketing, safeguarding consumer interests, and fostering fair practices within the industry. It includes various critical elements such as prohibiting misrepresentation and false information, defamation, coercion, and ensuring compliance with regulatory requirements. Additionally, it addresses unfair financial planning practices, prohibited group enrollments, and marketing practices, emphasizing transparency, fair competition, and consumer protection.

The Strategy prohibits misrepresentations in insurance policies, dividends, and financial conditions of insurers, as well as false or misleading statements in advertising. It mandates the maintenance of accurate marketing records to ensure transparency and compliance. Defamation of insurers' financial conditions and acts of coercion or intimidation leading to unreasonable restraints or monopolies are also prohibited, underlining the importance of fair competition and ethical conduct.

From a climate perspective, the Strategy's implications for environmental sustainability and climate change mitigation are significant. The NAIC raised concerns about the lack of protections for consumers regarding surprise bills for ground ambulance

services, affecting access to emergency medical services during climate-related emergencies. Regulatory guidance is deemed necessary for shipping insurance to ensure accountability and sustainability in the shipping industry, particularly regarding environmental risks associated with transportation.

The provision allowing insurers to offer value-added products or services related to insurance coverage has implications for promoting sustainability and resilience. These products can contribute to environmentally friendly practices and behavioral changes to reduce environmental impact, and support post-loss services in climate-related events.

In conclusion, the Strategy strives to regulate insurance practices, ensure consumer protection, and promote transparency and fairness within the industry. Its implications for climate change underscore the importance of addressing climate-related challenges, promoting sustainability, and fostering resilience within the insurance sector.

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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:

- 2024 financial services industry outlooks
- *Deloitte 2023 CxO Sustainability Report*
- 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 change and financial risk digest | Deloitte US
- Center for Regulatory Strategy - Sustainability, climate & equity | Deloitte US

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