Regulatory Alert

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Insurance Risks: Compliance with NY DFS climate guidance

Consistent with issuances from the U.S. financial services regulators, and informed by international frameworks and regulations, the NY DFS climate guidance focuses insurers on climate-related governance, risk management, scenario analysis, and disclosure, inclusive of higher expectations in areas like stress testing, portfolio/sector analysis, due diligence, and integration across all risk pillars. While not specifically denoted in the guidance, insurers should be prepared to demonstrate compliance to this guidance through well-documented and established policies, governance structures, program, and control documentation. The guidance is to address current and evolving material climate risks, and insurers should make informed judgments regarding the significance of climate risks to their business.

Although the guidance is specific to domestic insurers under the supervision of New York state, all insurers and other financial services companies should assess and enhance their own climate risk management programs accordingly.

As of August 15, 2022, New York domestic insurance companies will be expected to have implemented certain measures as outlined in the New York Department of Financial Services' (NY DFS) November 2021 guidance on managing the financial risks from climate change. Specifically, this deadline pertains to the regulator's expectations regarding board governance and implementation plans for imbedding climate risk into their organizational structure. Highlights of the expectations for each of these measures follow.

Board governance

NY DFS states that an insurer's board of directors is ultimately responsible for overseeing the management of risks, including climate risk. The board is expected to understand the relevant climate risks and oversee climate risk management within the business' overall strategy and risk appetite, giving consideration to the "distinctive nature of climate risks as well as their long-term impact beyond the standard three- to five-year business planning horizon." Additionally, the guidance states that insurers are expected to:

— Designate a member or committee(s) of the board to be responsible for the oversight of the insurer's management of climate risks, even in cases where the insurer determines that climate risks are not currently material to their business.

— Evaluate whether having a board member who specifically has climate expertise is necessary.

— Designate one or more members of senior management to be responsible for the oversight of the insurer's management of climate risks.

— Require the board to oversee management's progress toward meeting any announced climate commitments and ensure that "related strategies are being employed and evaluated for effectiveness."

— Ensure that material climate commitments with meaningful impact on capital spending are built into the business' risks and controls systems and are clearly reflected in its financial statements.

Implementation plans

NY DFS expects insurers to have specific plans in place to implement the organizational structure, including:

— Manage climate risks through existing enterprise risk management control functions, including risk assessment, compliance, internal control, internal audit, and actuarial functions.

— Clearly define and articulate roles, responsibilities, and accountabilities, and ensure that the "organizational structure is reinforced by a risk culture that supports accountability in risk-based decision-making in setting climate risk limits and overseeing their implementation."

— Implement reliable risk management processes across lines of business, operations, and control functions, including "clear steps to ensure the effectiveness and adequacy of climate risk integration."

— Explicitly consider climate risks in risk management processes, including enterprise risk reports and ORSA summary reports, as well as senior management's decision-making processes.

— Conduct "objective, independent, and regular" internal reviews of functions and procedures aligned to the management of climate risks, report findings to the board, and adapt functions, procedures, roles, and resources as necessary.

— Develop necessary skills, expertise, and knowledge required for the assessment and management of climate risks throughout the business (including board, senior management, and staff) through internal training, new hires, and/or external consultants and to allocate sufficient resources.

— Implement remuneration policies to "align incentives with the strategy for managing climate risks and with performance against climate metrics."

Under this guidance (though outside the August 15, 2022, date), applicable insurers will also need to put in place a **written climate risk policy**. The policy must be adopted by the board and describe how material climate risks are monitored and managed in line with its risk appetite statement. The policy should include the insurer's risk tolerance levels and limits for financial risks, and consider factors beyond market conditions, regulatory changes, and technological advancements, such as:

— How decisions could affect the insurer's long-term financial interests and future financial risks

— Results of scenario analysis and potentially stress testing for short-, medium-, and long-term horizons

— Uncertainty around the timing and channels through which climate risks may materialize

— Sensitivity of assets and liabilities to changes in key climate risk drivers

Future guidance

NY DFS stated that an insurer's approach to implementing the guidance should be proportionate to its climate risk and business and that its approach should mature over time. Further, an insurer's "analysis of climate risks and assessment of materiality for its business should shift from a qualitative approach to an approach that is both qualitative and quantitative for risks that can be quantified." NY DFS stated that it intends to monitor insurers' progress in implementing the expectations in the guidance and that, over time, its approach would shift from supporting insurers' progress in implementing its supervisory expectations to active supervision against those expectations.

When the guidance was released, NY DFS stated that it would issue future guidance on the implementation timeline for "more complex expectations" including those relating to "risk appetite, impact analysis of climate risks on existing risk factors, reflection of climate risks in the ORSA, scenario analysis, and public disclosure." So far, no additional guidance has been made available; the regulator encourages insurers to begin evaluating these areas.

Relevant KPMG Thought Leadership:

— KPMG Regulatory Insights POV: Operationalizing climate risks

— KPMG Regulatory Alert: New Executive Actions on Climate

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