Debevoise & Plimpton

Insurance Industry Corporate Governance Newsletter

To Our Clients and Friends,

The last edition of our Insurance Industry Corporate Governance Newsletter covered how the Department of Labor's (the "DOL") proposed revision to the definition of an investment advice fiduciary under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), could impact insurance companies and agents in their sales of annuities to retirement investors.

This month's edition focuses on climate-related disclosure requirements applicable to public and private insurance companies, including the recently adopted (and long-awaited) final U.S. Securities and Exchange Commission (the "SEC") rule for climate-related disclosures (the "SEC Rule"). The SEC Rule adds to a growing list of climate risk regimes with which U.S. insurance companies may be required to comply.

As we discuss below, there is meaningful overlap between the various climate risk regimes. Still, key differences may complicate compliance for companies that are subject to the requirements of several regulators.

What Are the Climate Disclosure Regimes and Why Do They Matter?

The various climate risk disclosure regimes have a common goal of increasing transparency for stakeholders regarding the disclosing companies' exposure to, preparation for and management of climate-related risks. There are significant similarities in the disclosure approaches, as many of the disclosure rules were influenced by the same international climate-related disclosure standards, such as the Greenhouse Gas Protocol ("GHG Protocol") and the Task Force on Climate-Related Financial Disclosures ("TCFD") recommendations.

SEC Climate Disclosure Rule

Insurance companies that are SEC registrants may be subject to the newly adopted SEC Rule as soon as fiscal year 2025 for certain filers. On March 6, 2024, the SEC adopted the long-anticipated SEC Rule, which requires all SEC registrants, including foreign private issuers, to disclose climate-related information in their registration statements and periodic reports, on a phased-in timeline. The rule is based in part on TCFD recommendations and the GHG Protocol. The SEC Rule is available here, our initial summary of the SEC Rule is available here, and our in-depth analysis is available here.

As of March 21, 2024, challenges filed in six different federal circuits were consolidated into a single case before the U.S. Court of Appeals for the Eight Circuit.

California Climate Disclosure Laws

Companies doing business in California may also be subject to GHG emissions and climate risk disclosure requirements. The Climate Corporate Data Accountability Act (the "CCDAA") requires companies doing business in California with total annual revenues of $1 billion or more to annually disclose their full value chain GHG emissions. The Climate-Related Financial Risk Act (the "CRFRA") requires California companies with annual revenues of $500 million or more to disclose climate-related financial risks as well as mitigation and adaptation measures. The CRFRA does not apply to insurance companies regulated by the California Department of Insurance or any other state regulator. However, the CRFRA may still be applicable to insurance companies' affiliates or subsidiaries that are not themselves licensed insurance companies. For additional information on the CCDAA and CRFRA, our updates are available here and here.

NAIC Climate Risk Disclosure Survey

Insurance companies may also be required to respond to the NAIC Climate Risk Disclosure Survey (the "NAIC Survey"). Insurance regulators in over a dozen U.S. jurisdictions administer the annual survey to insurance companies licensed in their jurisdiction that write more than $100 million in direct premiums nationwide, accounting for the lion's share of the U.S. insurance market. The NAIC Survey was revised in 2022 to better align with the TCFD recommendations. Survey responses are publicly available on the California Department of Insurance website. The latest NAIC Survey questions are available here, and our update on the revisions is available here.

NYDFS and CID Climate Guidance

Insurance companies domiciled in New York and Connecticut are also subject to prescriptive guidance on management of climate risks including public disclosure expectations. The New York Department of Financial Services guidance on climate risk (the "NYDFS Guidance") and the Connecticut Department of Insurance bulletin on climate risk (the "CID Bulletin") set forth the regulators' expectations that domestic insurers publicly disclose climate risks and engage with the TCFD recommendations in developing such disclosures. For both regulators, this requirement may be satisfied by responses to the NAIC Survey, to the extent such responses are consistent with the NYDFS Guidance or CID Bulletin, as applicable. For New York or Connecticut domestic insurers that are not subject to the NAIC Survey, such disclosures may be made public on the insurer's website or by including relevant climate risk information in other public financial disclosures.

Beyond the disclosure requirements, both the NYDFS Guidance and CID Bulletin describe practices that New York and Connecticut domestic insurers, respectively, are expected to implement to manage climate-related risks (e.g., integrating climate risk into governance structures at the board and in senior management, embedding climate risks in the company's existing risk management framework and using scenario analysis to evaluate climate risks on different time horizons).

For more information, the NYDFS Guidance is available here and the CID Bulletin is available here. Our update on the NYDFS Guidance is available here.

Disclosure Regimes Outside the United States

Insurance companies with operations outside the United States are also likely subject to other disclosure regimes, including the European Union's Corporate Sustainability Reporting Directive ("CSRD"). The CSRD is the EU's ambitious scheme for corporate sustainability reporting, which will require in-scope companies to include sustainability information in their annual reporting, combined with external "assurance" of the information provided. Starting in 2028, EU companies that are in scope of the CSRD, and whose ultimate parent company is incorporated in a "third country," will be required to produce a sustainability report at the group level of the ultimate parent company. For more information on the CSRD, our update is available here.

What Is the Materiality Standard?

Some disclosure requirements faced by insurance companies under the various regimes are qualified by materiality, providing important potential relief from certain disclosure burdens. Because materiality is a fact-specific determination that may change over time, insurance companies should have in place proper governance policies and procedures to support materiality determinations.

The disclosures required by the SEC Rule, the NAIC Survey, the NYDFS Guidance and the CID Bulletin are generally qualified by materiality. Disclosures required by the CCDAA are not qualified by materiality.

The NAIC Survey defines materiality by reference to the standards in the NAIC Financial Condition Examiner's Handbook (the "Handbook") and SEC Staff Accounting Bulletin No. 99 ("SAB No. 99"). The 2023 edition of the Handbook offers a few indicative benchmarks of materiality: 1% to 5% of capital and surplus, 5% of pretax gain from operations or 0.05% of total assets. SAB No. 99 notes that numerical thresholds may be helpful preliminary indications of materiality but cannot be conclusive because the materiality of a particular fact is ultimately determined by whether there is a substantial likelihood that a reasonable investor would view that fact as important to an investment or voting decision, or as something that significantly alters the "total mix" of available information.

Like the NAIC Survey, the NYDFS Guidance and CID Bulletin point to the Handbook's materiality benchmarks for initial guidance, but both also indicate that materiality is a mixed quantitative and qualitative determination that may be adjusted depending on professional judgment and individual circumstances. Both regulators expect their domestic insurers to regularly assess materiality assumptions.

The SEC Rule also generally determines materiality by whether there is a substantial likelihood that a reasonable investor would consider the information important to an investment or voting decision. Materiality under the SEC Rule is generally a fact-specific determination that depends on both qualitative and quantitative considerations. However, not all disclosures in the SEC Rule are qualified by materiality. For example, with respect to the financial impact of severe weather events and other natural conditions, the SEC Rule proposes a disclosure threshold at 1% of the absolute value of stockholders' equity or deficit at the end of the relevant fiscal year (for capitalized costs and charges) or 1% of the absolute value of income or loss before taxes for the relevant fiscal year (for expenditures and losses).

What GHG Emissions Disclosures Are Required?

Insurance companies may be required to make GHG emissions disclosures under the various regimes, subject to materiality qualifiers in certain cases.

The SEC Rule and the CCDAA both require disclosure of Scope 1 and Scope 2 GHG emissions from all covered companies; however, under the SEC Rule, disclosure is only required to the extent that those Scope 1 and Scope 2 GHG emissions are material. The NAIC Survey requires disclosure of Scope 1 and Scope 2 GHG emissions, regardless of any materiality assessment.[1]

The CSRD, the CCDAA and (when appropriate and material) the NAIC Survey require disclosure of Scope 3 GHG emissions. The SEC Rule does not require the disclosure of Scope 3 GHG emissions.[2]

In addition to disclosure of GHG emissions, the CCDAA and SEC Rule require that covered companies engage independent assurance providers to provide assurance on the companies' GHG emissions disclosures (after a phase-in period).

Neither the NYDFS Guidance nor the CID Bulletin expressly requires disclosure of Scope 1, 2 or 3 GHG emissions. But both require engagement with the NAIC Survey and TCFD recommendations, which require disclosure of Scope 1, Scope 2 and, if appropriate, Scope 3 GHG emissions.

[1] "Scope 1" GHG emissions include direct GHG emissions from operations that are owned or controlled by a given company; "Scope 2" GHG emissions cover indirect GHG emissions from the generation of purchased electricity, steam, heating and cooling consumed by that company.

[2] "Scope 3" GHG emissions include all other indirect GHG emissions that occur in the upstream or downstream activities in the given company's value chain, including purchased goods and services, employee commuting, processing and use of sold products and investments.

What Steps Should Insurance Companies Take Now?

Identification, quantification and mitigation of climate risks continue to be essential first steps for all insurers in light of the increasingly prescriptive requirements by insurance regulators and their disclosure regimes. The better that insurers are able to identify and quantify these risks, structure effective mitigation measures and properly disclose those risks and mitigation efforts, the more protected they will be against potential shareholder suits or regulatory action.

With that in mind, insurers should expeditiously refresh governance and risk management policies and procedures to comply with insurance regulatory requirements with respect to climate risk, and charge senior risk, legal and other executives with oversight of climate risk and related disclosures. Insurance companies should identify and compare the disclosure regimes applicable to their business and be prepared to comply with all applicable disclosure requirements, including by implementing new and updated disclosure controls and procedures. Insurance industry participants should also review their current climate-related disclosures to ensure accuracy and consistency and review (or, if necessary, adopt) internal processes and policies for climate-related disclosures and reporting to ensure robust internal controls.

Insurance companies that are SEC registrants or insurance company affiliates that qualify as doing business in California should take steps to begin collecting GHG emissions data, to the extent not already doing so. Insurance companies should also determine the level and timeline for assurance requirements they may be subject to, and then determine an appropriate plan of action. In particular, insurance companies should identify an assurance firm appropriate for the insurance industry to review emissions data and disclosures.

Conclusion

The continued focus on climate disclosures by state and federal regulators highlights the importance of incorporating climate risk management into corporate governance and risk management structures. The general consensus around the TCFD recommendations is helpful for insurance companies that are subject to multiple disclosure rules. Insurance companies should continue to allocate appropriate resources to ensure consistent compliance with all applicable disclosure rules. While the SEC Rule and CCDAA are facing legal challenges, insurance companies should nevertheless plan to comply fully with either or both disclosure regimes (if applicable) during the pendency of such challenges, and they should remain attentive to any resulting changes to the applicable disclosure requirements.

Eric Dinallo
Partner
+1 212 909 6565
edinallo@debevoise.com

Eric T. Juergens
Partner
+1 212 909 6301
etjuergens@debevoise.com

Nicholas F. Potter
Partner
+1 212 909 6459
nfpotter@debevoise.com

Brita M. Siepker
Counsel
+1 212 909 6263
bsiepker@debevoise.com

Ulysses Smith
ESG Senior Advisor
+1 212 909 6038
usmith@debevoise.com