STATE OF CONNECTICUT

INSURANCE DEPARTMENT

BULLETIN NO. FS-44
September 15, 2022

TO: ALL DOMESTIC INSURANCE COMPANIES, DOMESTIC HEALTH CARE CENTERS, AND DOMESTIC FRATERNAL BENEFIT SOCIETIES AUTHORIZED TO DO BUSINESS IN THE STATE OF CONNECTICUT

RE: GUIDANCE FOR CONNECTICUT DOMESTIC INSURERS ON MANAGING THE FINANCIAL RISKS FOR CLIMATE CHANGE

Pursuant to June Special Session, Public Act No. 21-2, Section 312, ("PA 21-2") the Connecticut Insurance Department ("Department") is to file biannually a report with the Connecticut General Assembly disclosing the Department's progress toward addressing climate-related risks within the insurance industry along with regulatory and supervisory actions to bolster the resilience of insurers to the physical impacts of climate change.

This bulletin, which provides guidance for Connecticut domestic insurers on managing the financial risks of climate change, is consistent with the objectives of PA 21-2 and is based upon ongoing dialogue with the insurance industry over the past few years along with initiatives taken by the National Association of Insurance Commissioners ("NAIC")[1] and other state insurance regulators.[2]

I. OVERVIEW

As explained in more detail below, the Department expects insurers to take a strategic approach to managing climate risks that considers both current and future risks and identifies actions necessary to manage those risks in a manner proportionate to the nature, scale, and complexity of insurers' businesses. Specifically, an insurer should:

A. Integrate the consideration of climate risks into its governance structure at the group or insurer entity level. The insurer's board should understand climate risks and maintain oversight over the management team responsible for managing climate risks. The roles of the board and management should be reflected in the company's risk appetite and organizational structure.

B. Incorporate climate risks into the insurer's existing financial risk management. This should include embedding climate risks in its risk management framework and analyzing the impact of climate risks on existing risk factors.

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[1]Climate and Resiliency (EX) Task Force

[2]New York Department of Financial Services Guidance for New York Domestic Insurers on Managing the Financial Risks from Climate Change, published November 15, 2021.

C. Appropriately disclose its climate risks and engage with the Task Force on Climate-Related Financial Disclosures (“TCFD”), the NAIC Climate Risk Disclosure Survey, and other initiatives when developing its disclosure approaches.

D. Ensure compliance with the NAIC’s Own Risk and Solvency Assessment (“ORSA”) Guidance Manual[3], if applicable, and be prepared to discuss the content in relation to climate risks with the Department at the insurer’s annual meeting, or as requested by the Department. Annual meeting topics will include, but not be limited to, strategy around investment and underwriting activity.

E. Use scenario analysis to inform business strategies and risk assessment and identification. Scenarios should consider physical and transition risks, multiple carbon emissions and temperature pathways, and short-, medium-, and long-term horizons.

II. EXPECTATIONS

Proportionate Approach

The Department expects all domestic insurers to take a proportionate approach to managing climate risks that reflects its exposure to climate risks and the nature, scale, and complexity of its business. Climate change may affect each insurer in different ways and to different degrees depending on the insurer’s size, complexity, geographic distribution, business lines, investment strategies, and other factors. In addition, not all insurers have the same level of resources to devote to managing climate risks and some insurers may take longer than others to develop and implement appropriate practices though many insurers have done this already. As an insurer’s expertise and understanding of climate risks develop, the Department expects the insurer’s approach to managing these risks to mature. The Department also notes that smaller insurers are not necessarily less exposed to climate risks because they may have concentrated business lines or geographies that are highly exposed to climate risks without the benefit of diversification available to larger insurers.

An insurer that is part of a group may utilize policies, procedures, and processes developed at the group level for managing climate risks if: (1) the risks considered at the group level include those facing the insurer; (2) the policies, procedures, and processes developed at the group level are implemented at the level of the insurer and address the insurer’s material climate risks; and (3) the insurer has appropriate access to relevant climate-related resources and expertise centralized at the group level. If these conditions are met, references in this guidance to an insurer’s board can also mean the board of the group of which the insurer is a part. If an insurer’s policies, procedures, or processes differ materially from those of the group, the insurer should document and provide a justification for those differences in its internal risk management reports.

Materiality

The guidance provided in this bulletin, which includes several references to materiality or to material risks or exposure, is intended to address material climate risks faced by insurers. The quantification of climate risks is an evolving area with uncertain or,

[3] The most recent version of the manual can be found at https://content.naic.org/sites/default/files/legacy/documents/prod_serv_fin_recievership_ORSA-2014.pdf

in some cases, unavailable data and models. The uncertainty of the risk does not preclude insurers from making informed judgments about the significance of climate risks to their businesses. For insurers early in the process of managing climate risks or with limited resources, a materiality assessment may be based on qualitative information, and on an analysis of portfolio exposure to certain sectors or geographies in underwriting or investments. Over time, when qualitative analyses demonstrate the probability of material climate risks, this assessment should include quantitative analyses.

The NAIC Financial Condition Examiners Handbook 2020 ("Handbook") provides guidance for determining materiality in the examination context. When assessing the materiality of climate risks, insurers may use the Handbook's materiality benchmarks as guidance (e.g., 5% of surplus or one-half of 1% of total assets), subject to adjustment based on professional judgment and circumstances. A risk may also be considered material where knowledge of the risk could influence the decisions or judgment of an insurer's board, management, regulators, or other relevant stakeholders.

Insurers should regularly assess their materiality assumptions. Depending on the nature, scale, and complexity of its business, an insurer should conduct this assessment at least annually, or in the event of a significant change.

III. Risk Culture and Governance

Board of Governance

An insurer's board of directors is ultimately responsible for overseeing the management of all risks, including climate risks. The Handbook lays out the components of an effective corporate governance program. Consistent with the Handbook, the Department expects an insurer's board of directors (or appropriate committee(s) thereof) or, if there is no board, the governing entity ("board"), to understand current and evolving relevant climate risks and oversee their management within the insurer's overall business strategy and risk appetite. The board's approach should reflect an understanding of the distinctive nature of climate risks as well as their long-term impact beyond any standard business planning timeframe. As such, it may be appropriate for an insurer to have a board member with climate related expertise.

The Department expects each insurer to designate a member or committee(s) of its board as being responsible for the oversight of the insurer's management of climate risks. If an insurer is a part of a group, this may be done at the group level, provided that the designated board member or committee(s) at the group level has appropriate access to the insurer's board or management and the risk appetite, processes, and framework developed by the group's board are implemented at the insurer level.

The Department also expects each insurer to designate one or more members of its senior management as being responsible for the insurer's management of climate risks. As climate change could impact multiple business units and require expertise from multiple functions, the designated member(s) of senior management may delegate responsibility to those business units and functions, provided that such member or members of senior management continue to oversee any such delegation of duty.

An insurer may determine, after a thorough assessment, that climate risks are not currently material to its business. However, because of the evolving nature of climate risks, the insurer should still designate a member or committee(s) of its board as responsible for overseeing the insurer's management of climate risks. The board and senior management should stay abreast of evolving climate risks, and regularly assess the assumptions and materiality of, and the company's exposures to, those risks.

Risk Appetite

The Department expects an insurer to have a written risk policy adopted by its board describing how the insurer monitors and manages material climate risks in line with its risk appetite statement. This 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.

In addition, the impact of climate change on the insurer's risk tolerance levels and limits can be reflected in existing risk factors. While quantifying these factors may currently be challenging, insurers should nevertheless start the process beginning with qualitative assessments and eventually moving towards quantitative assessments over time.

Organizational Structure

Utilizing a proportional approach, the Department expects insurers to:

a. Manage climate risks through their existing enterprise risk management functions, including risk assessment, compliance, internal control, internal audit, and actuarial functions (collectively, "control functions").
b. Ensure that their organizational structure clearly defines and articulates roles, responsibilities, and accountabilities, and that such 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.
c. Implement reliable risk management processes across lines of business, operations, and control functions, with clear steps to ensure the effectiveness and adequacy of climate risk integration.
d. Explicitly consider climate risk, if determined to be a material risk, in risk management processes, including in enterprise risk reports and ORSA summary reports, and in the decision-making processes of senior management.
e. Conduct objective, independent, and regular internal reviews of the functions and procedures for managing climate risks, report the findings of the reviews to the board, and adapt insurers' functions, procedures, roles, and resources for managing climate risks as necessary.
f. Develop the skill, expertise, and knowledge required for the assessment and management of climate risks at the level of the board and employees, including senior management.

IV. Risk Management and Controls

The Handbook describes the key principles of an effective risk management framework that should be applied when assessing climate risks. Insurers and other entities that are required to have enterprise risk management ("ERM") functions are expected to:

a. Address climate risks through their existing ERM functions and in line with their board-approved risk appetites, including considering how climate risks affect the branded risk factors set forth in the Handbook;

b. Identify, assess, monitor, manage, and report on their exposure to these risks in a manner that is appropriate for the nature, scale, and complexity of the risk and their businesses;

c. Document in their written ERM and board risk reports the material climate risks considered and update existing risk management policies to reflect climate risks if needed;

d. Manage and monitor these risks using time horizons that are appropriately tailored to the type of insurer, the insurer's activities, and the business decisions being made, and review their analysis on a regular basis. The Department expects a review of assumptions based on the insurers forward-looking analysis; and

e. Climate scenario analysis should be exploratory, focus on understanding potentially material climate risks, and avoid creating a false sense of security and precision in the results. Available technology should be used to assist in quantitative assessments of the resilience of investment portfolios to transition and physical risks under a range of scenarios.

Managing risks, including climate risks, is an ongoing ERM activity, operating at many levels within the organization, which requires a collaborative, enterprise-wide approach. If the impacts of climate risks are determined to be material, the Department expects insurers to demonstrate how they will mitigate those risks and to develop a credible plan or policies for managing those risks, including reducing their concentration. If climate risks are determined to be immaterial, insurers should document their assessment of immateriality, along with its qualitative and, if applicable, quantitative basis.

The Department expects an insurer's control functions, including risk management, information technology, compliance, internal audit, and actuarial functions, to be integrated for purposes of managing climate risks, to report climate risk issues in a coordinated manner, and to have the appropriate resources and expertise to support their consideration of climate risks. The control functions should identify, measure, monitor, and report on the insurer's climate risks, assess the effectiveness of the insurer's risk management and internal controls, and determine whether the insurer's operations, business results, and climate risk exposures are consistent with the risk appetite statement approved by the board.

Insurers should also consider developing plans to mitigate their climate risks. In addition, insurers should also consider expanding engagement on mitigation and resilient initiatives in the broader economy

Risk Reporting and Communication

The Department expects insurers to provide their boards with information regarding their exposure to material climate risks, mitigating actions, and the time frame within which they propose to take these actions. The information should enable the board to understand, discuss, and challenge the insurer's management of climate risks as part of the board's oversight.

V. **Public Disclosure**

The Department expects all domestic insurers to publicly disclose their climate-related risks. Public disclosure ensures that market participants have adequate insight into financial institutions' risk exposures, risk assessment processes, and capital adequacy. Publicly-traded insurers or companies with insurance businesses are subject to annual and other general disclosure requirements by the U.S. Securities and Exchange Commission. In addition, Connecticut, along with fourteen other states and the District of Columbia, requires insurers with annual country-wide premiums above $100 million to respond to the NAIC Climate Risk Disclosure Survey. The Department views public disclosure through the survey as an appropriate form of public disclosure if the responses satisfy the expectations and guidance set forth in this bulletin. For insurers not currently covered by the survey, appropriate public disclosure should be made on their websites or by augmenting public general-purpose financial reports with relevant climate risk information. Disclosure at the group level is appropriate if it specifically addresses practices at the insurer level.

The Department expects insurers to engage with the NAIC Climate Disclosure Survey via the TCFD guidance, and other similar initiatives, including the tools and case studies that they provide, in developing their approach to climate-related financial disclosures.

VI. **Timeline for Implementation**

Implementing the expectations and guidance set forth in this bulletin may involve varying levels of difficulty and effort. The Department expects domestic insurers to implement its expectations relating to board governance and to have specific plans in place to implement the expectations relating to organizational structure by January 1, 2023. The Department understands that more complex expectations, such as those relating to risk appetite and public disclosure, may take longer to implement. Consistent with the objectives of PA 21-2, the Department may issue further guidance on the timing for implementation of these more complex expectations but encourages insurers to start working on them now.

For more information regarding this Bulletin, please contact cid.financial@ct.gov.

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