Debevoise & Plimpton | Insurance Industry Corporate Governance Newsletter

To Our Clients and Friends,

The last edition focused on implications of the Supreme Court's decision to overturn *Roe v. Wade* in *Dobbs v. Jackson Women's Health* for insurance companies, their policyholders and employees and, in the case of insurers writing health or disability insurance, benefits they provide to third-party employers.

This month, we look at developing disclosure rules regarding climate change risk and investments, and how regulators and shareholders are responding to the growing body of disclosure requirements. These new disclosure rules have wide-ranging implications for the industry and have proven to be an increasing source of potential liability.

Developing Climate Change Disclosure Rules and Risks

NAIC: The NAIC adopted heightened disclosure requirements earlier this year, which 15 states now mandate for insurers with premiums above $100 million annually. The NAIC Climate Risk Disclosure Survey, adopted on April 7, 2022, replaces the existing eight-question survey, with revised questions that are closely aligned with recommendations by the Task Force on Climate-Related Financial Disclosures (the "TCFD").[1] When the proposal for the NAIC Climate Risk Disclosure Survey was publicly discussed, insurers suggested confidential treatment of the survey, but the survey responses will continue to be posted publicly. Though extensions may be granted on an *ad hoc* basis, responses to the new survey questions are due on November 30, 2022.

State Regulatory Developments: In the past year, two state regulators, the New York Department of Financial Services (the "DFS") and the Connecticut Insurance Department (the "CID"), have taken steps to issue guidance to insurers on managing climate risk.

On November 17, 2021, the DFS issued final guidance (the "DFS Guidance") that discusses how New York domestic insurers ("NY Insurers") should manage the financial risks of climate change and the DFS's expectations for NY Insurers in this regard.[2] As one element of the DFS's expectations, the DFS requires NY Insurers to integrate climate risk structures into governance at the board and senior management levels, including (with a deadline of August 2022) designating a member or committee of its board of directors and one or more members of senior management as responsible for the insurer's climate risk management. In addition, the DFS called on NY insurers to enhance transparency of integration of climate risks into its governance and risk management. The DFS is already actively asking pointed questions on climate risk integration in its statutory examinations of insurers, and it is planning to confirm compliance with the DFS Guidance through responses to the NAIC Climate Risk Disclosure Survey and requests for information to smaller NY insurers. For NY insurers responding to the NAIC Climate Risk Disclosure Survey, the DFS requests additional information on governance through an appendix to the survey.

Similarly, on April 22, 2022, the CID released a proposed bulletin for public comment, which aims to align Connecticut insurance practice with climate risk-related developments in Connecticut law, the NAIC initiatives and the DFS Guidance. The CID bulletin is

[1] For further information on the NAIC Climate Risk Disclosure Survey, please *see* our client alert here.

[2] For further information on the DFS Guidance, please *see* our client alert here.

substantially aligned with the DFS Guidance, including in the requirement that domestic insurers designate responsible parties on the board and in senior management for climate risk management.

SEC: The U.S. Securities and Exchange Commission (the "SEC") released its long-awaited proposed rule on the "Enhancement and Standardization of Climate-Related Disclosures for Investors" (the "Proposed SEC Climate Disclosure Rule") on March 21, 2022. The extended comment period for the rule ended in June, and the final version of the rule is expected later this year.[3] Under the Proposed SEC Climate Disclosure Rule, which would apply to any insurers that are SEC registrants or public companies, there would be new, often prescriptive, climate-related disclosure requirements added to Regulation S-K, which primarily governs qualitative disclosures, and Regulation S-X, which governs financial statements and other financial disclosures. In general, these disclosures would address various climate-related risks to the registrant's business, operations and financial condition, including disclosure of a registrant's greenhouse gas emissions and its management of physical and transition risks. It is worth noting that the final version of the Proposed SEC Climate Disclosure Rule, when it is issued, will be subject to challenge in the U.S. federal courts. The outcome of such challenge is difficult to predict. However, the U.S. Supreme Court's recent decision in *West Virginia v. Environmental Protection Agency*, wherein the Court invalidated EPA rulemaking related to limiting greenhouse gas emissions on grounds that the EPA exceeded its delegated authority, could provide additional ammunition to challengers of the SEC's rulemaking.[4]

In addition to the Proposed SEC Climate Disclosure Rule, the SEC proposed an additional rule relating to ESG practices by registered funds and investment advisors relating to investment advisor and fund disclosures (the "Proposed SEC ESG Funds Rule") on May 25, 2022.[5] The Proposed SEC ESG Funds Rule, which may apply to insurers' affiliated registered investment advisors, would create additional disclosure requirements in fund prospectuses, annual reports and adviser brochures for certain registered investment advisers, advisers exempt from registration, registered investment companies and business development companies ("BDCs") that offer investors products that consider ESG factors in their investment processes.

Shareholder Litigation and Regulatory Enforcement Actions. The growing body of disclosure requirements related to climate change, layered over growth in ESG-focused funds, sustainability and social responsibility programs, and investor campaigns for stronger disclosure and cleaner underwriting and investment, is giving rise to an increasing risk of shareholder litigation and regulatory investigation and enforcement. Early litigation and regulatory actions have focused on greenwashing claims. Most recently, news broke of an SEC investigation into whether two funds held investments that conflicted with climate change disclosures in the funds' marketing materials, and the SEC entered into a $1.5 million settlement with BNY Mellon Investment Adviser Inc. over allegations that some of the funds failed to meet ESG quality review commitments they had publicly disclosed.

Historically, the strongest defenses to these kinds of cases has been that climate change disclosures are aspirational and not specific enough to be actionable, but as the regulations become more detailed and require fuller public disclosure, the risk presented by these cases is likely to increase. Cases may be harder to dismiss if a plaintiff can point to specific regulations that were not followed or to disclosures made about climate change risks or investments that are not true. In addition, with regulatory requirements that individual directors and senior management be responsible for climate risk, those designated individuals may fall subject to claims with respect to their role managing such matters by shareholders, regulators or other stakeholders. Against this backdrop, Chubb CEO Evan Greenberg spoke publicly about Chubb's reluctance to set net zero emissions targets, explaining his view that such statements present growing litigation risk because, in Greenberg's words, tools to measure the carbon footprint of "all your insureds collectively" across the globe do not exist yet.

For insurers, litigation damages and regulatory fines for greenwashing claims against their policyholders could give rise to increased claims on D&O, E&O and other liability insurance policies, and consequently a need to evaluate policy terms and limits.

[3] For further information on the Proposed SEC Climate Disclosure Rule, please *see* our webcast here and client alerts here and here.

[4] For further information on the Court's *West Virginia v. EPA* decision, please *see* our client alert here.

[5] For further information on the Proposed SEC ESG Funds Rule, please *see* our client alert here.

What Companies Should Do Now

Identification, quantification and mitigation of climate risks are essential next steps for all insurers in this changing environment. 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 likely that they will maximize solvency, liquidity and profitability and avoid shareholder suits and potential regulatory action.

With that in mind, insurers should expeditiously (and, in the case of New York domestic insurers, by this August for governance issues) develop and maintain a framework that ensures climate change risks are effectively embedded in all decision-making, including:

- Refresh governance documents and risk policies to explicitly integrate climate change risk into existing risk analysis and decision-making processes;
- Identify board members and key management responsible for overseeing climate change risk identification, mitigation and disclosure, and put climate risks on board and executive meeting agendas regularly;
- Charge senior executives in risk and legal functions with oversight of climate change disclosures in social responsibility publications and financial statements and regulatory filings, enhancing transparency and complying with developing statutory requirements;
- Consider climate change expertise in board appointments and executive hires, to build out necessary internal expertise;
- Engage external experts to cover internal gaps, including consultants versed in climate change metrics and outside counsel versed in climate change disclosure matters;
- Carefully craft ESG-related public statements, including accompanying forward-looking statements with cautionary language, balancing less favorable information with positive statements about ESG efforts, and providing concrete, precise examples;
- Review coverage under existing insurance policies for greenwashing claims and other climate-related liability and consider expansions or reductions of coverage in light of the developing regulations; and
- Monitor ongoing developments in the climate-related legal and regulatory environment, including those of the SEC, which may require prompt action as new requirements are adopted.

Conclusion

In a mandatory public disclosure regime, insurers' boards and management will need to focus on potential liability for failure to adequately disclose, false statements and misrepresentations. Shareholder suits are likely to become more prevalent, and regulatory actions are beginning, making strategic governance a key next step.

At the core of corporate governance for insurers in this area lie questions about how to identify, quantify and mitigate risks posed by climate change. The climate risk governance integration recommendations described in this newsletter are intended to help insurers develop a framework for thinking about these issues and to understand the tools available as they undertake that critical exercise.

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