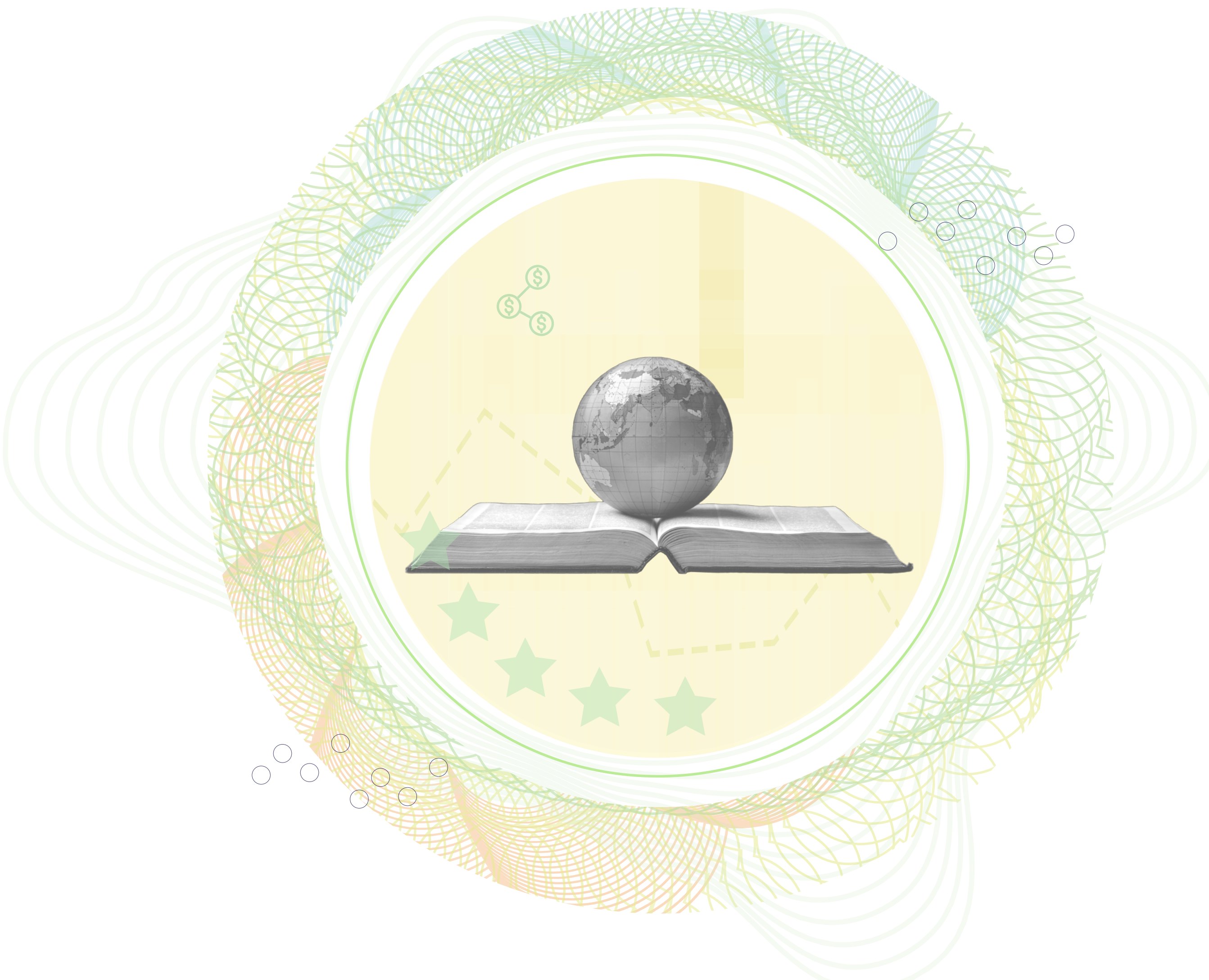
Deloitte.



How can insurers prepare for the SEC proposal on climate-related disclosures?

Contents

Establish or refine climate governance	**4**
Include people with the appropriate skill set	**6**
Build reporting agility	**7**
Establish controls over climate-related data	**8**
Think strategically	**9**
Identify climate risks and opportunities	**11**
Be transparent	**12**
Getting started	**13**
Contacts	**13**
Endnotes	**14**

On March 21, 2022, the Securities and Exchange Commission (SEC) released a proposed rule to regulate the disclosure of climate-related risks across public companies.[1] The rule requires public insurers to include climate-related disclosures in their registration statements and reporting, including climate-related risks that are reasonably likely to have a material impact on the business, results of operations, or financial condition. This would include disclosure of greenhouse gas (GHG) emissions.[2] The SEC proposed rule builds on the disclosure frameworks from the Task Force on Climate-related Financial Disclosures (TCFD) and the GHG Protocol.

While the comment period is closed, the SEC received more than 10,000 comments related to the proposed rule.[3] With this high response rate, the discussion of the rule is prevalent throughout the industry. If passed, it may lead to greater consistency and comparability of emissions and climate-related data across companies, industries, and locations. For most public companies, complying with the disclosure requirements will require considerable effort. Companies are asking Deloitte: How do we prepare?

This paper offers considerations to help insurers prepare for this regulatory change. On the following pages, we provide seven steps an insurer can take when contemplating the SEC proposed rule on climate change or TCFD compliance.

1. Establish or refine climate governance

Identify board and management oversight on climate-related matters; and define clear roles, responsibilities, and charters.

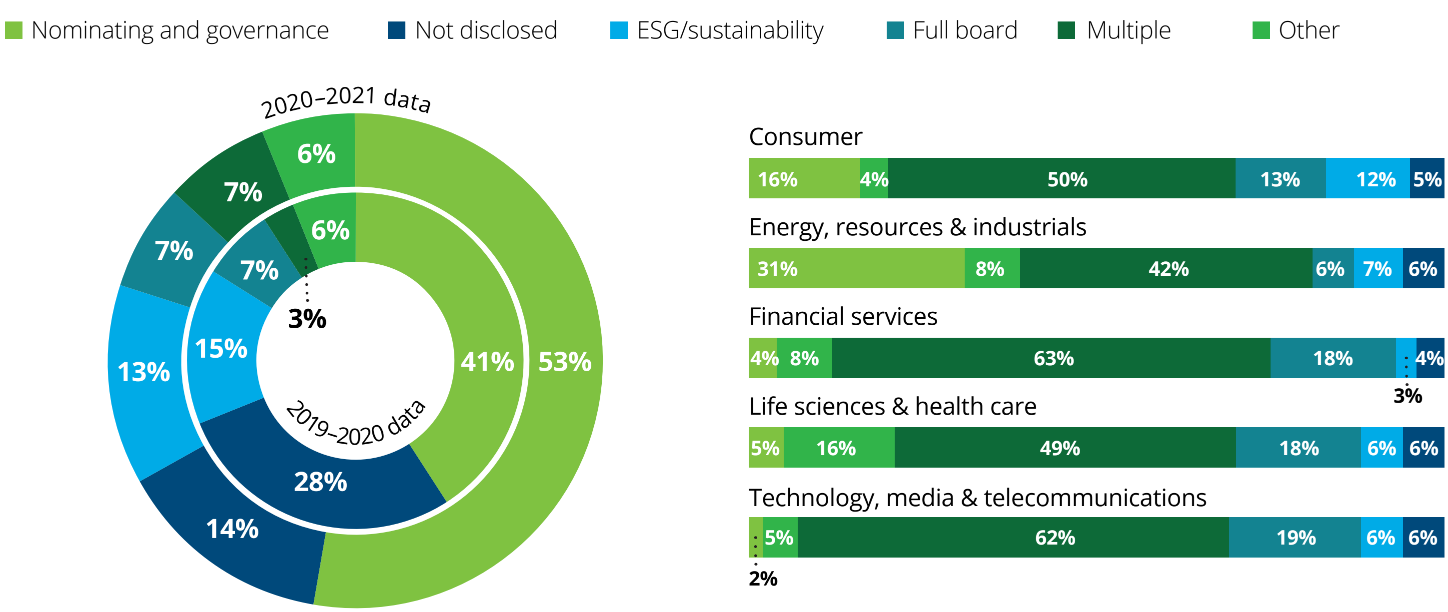
As a part of this journey, governance bodies will play a pivotal role in establishing top-down accountability mechanisms to support the SEC proposed rule on climate change. Organizations should treat this as a large-scale change by establishing a robust plan that highlights key timelines, internal and external stakeholders, and interdependencies to allow them to manage the various projects. Having a strong governance structure will facilitate effective decision-making and assist in balancing competing priorities.

Insurance companies typically have an existing committee or individuals dedicated to the effects of climate-related activities as it relates to underwriting and results. For insurers, climate-related risks and opportunities are a key topic affecting the industry's core business. The scientific consensus is that a continued rise in average global temperatures will have a significant effect on weather-related natural catastrophes and will account for an increasingly large share of natural catastrophe losses.[4] For example, property and casualty companies that write business relating to catastrophes will have a heightened focus on the impacts of climate-related risks. With the SEC proposed ruling, we are now seeing insurers broaden the lens beyond climate-related activities and utilize that information to focus more broadly on environmental, social, and governance (ESG) matters.

As the management infrastructure takes shape, there's a high degree of emphasis on the board's role and how the board is monitoring progress against goals and targets for climate-related issues. A significant question that we are discussing with many client boards is "How do I really equip myself to execute on my fiduciary and oversight responsibilities relating to ESG?"

We conducted research to identify where boards are today in terms of organizing and assigning responsibility for ESG.

Figure 1. ESG oversight on the board



ESG oversight on the board and board committees in 2020–2021 and 2019–2020 for S&P 500 companies

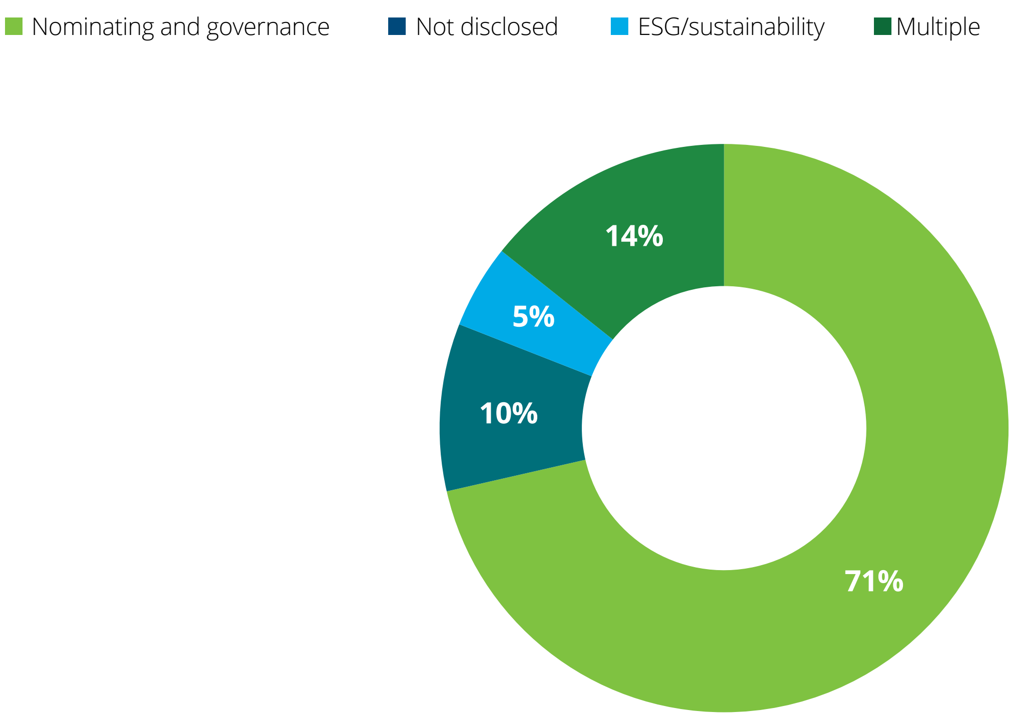
Board committees primary oversight of ESG by industry for S&P 500 companies

There was a significant increase in the percentage of S&P 500 companies disclosing the primary committees overseeing ESG within their proxies: up to 86% of companies in 2021, compared to 72% in 2020. Despite the overall increase in proxy disclosure, there continues to be significant variation in the committees that oversee ESG. Figure 1 includes data for all S&P 500 companies, and figure 2 includes data specific to insurance companies in the S&P 500.

Based on the results of figures 1 and 2, the nominating and governance committee at this point has been the central committee where oversight has been assigned. Based on the proposed ruling, we're seeing this head in the direction of allocating that oversight responsibility to relevant areas of ESG, similar to the way that management is mobilizing. An example of this shift is companies hiring a climate scientist or expert to serve on a committee of the board. Despite the overall increase in proxy disclosure, there continues to be significant variation in the committee that oversees ESG.

By taking time to charge a committee of the board with the responsibility of ESG early and making it responsible for promoting consensus, minimizing issues, and collaborating quickly without compromising completeness, leaders can reduce the time spent identifying gaps and determining a path forward.

Figure 2. ESG on the board: Insurance companies



ESG oversight on the board and board committees in 2020–2021 for insurance companies in the S&P 500

2. Include people with the appropriate skill set

Perform stakeholder engagement, including education on climate-related risks, data collection, and target setting.

As part of this journey, identifying the key internal and external stakeholders is imperative to meeting objectives. As defined by the Global Reporting Initiative (GRI), stakeholders are individuals or groups that have interests that are affected or could be affected by the organization's activities.[5] Stakeholder engagement is used as a method to obtain stakeholders' opinions and prioritize areas that could assist companies in establishing sustainability strategies. The purpose of stakeholder engagement can be, for example, to identify actual and potential impacts or to determine prevention and mitigation responses to potential negative impacts.[6]

Stakeholder groups for representation in the assessment process are identified using the following GRI stakeholder selection criteria:

- **Responsibility:** Legal, financial, or operational contracts, policies, and regulations
- **Influence:** Ability to impact or maintain some decision-making power
- **Proximity:** Located physically nearby or depend on for daily operations
- **Dependency:** Rely on the business financially, operationally, etc.
- **Representation:** Represent key institutions or constituencies

Common categories of internal stakeholders for insurers may include but are not limited to:

Stakeholder	Impact to role
Client leadership	• Increased emphasis from governance bodies and external stakeholders relating to climate-related risks • Strengthening of business strategy and governance by aligning with ESG investor expectations
Actuarial function	• Incremental analysis on climate-related risk
Human resources	• Additional analysis of the current workforce from a human capital and diversity, equity, and inclusion (DEI) lens • Retaining talent by heightening ESG reputation
Accounting and financial planning and analysis (FP&A)	• Incremental effort to financial reporting and financial projections in connection to climate-related metrics and disclosures • Increased efficiencies and cost saving related to ESG practices
Risk management	• Assessment of climate risk across the organization, and development of associated policies and processes
Underwriting	• Increased consideration of climate-related risks affecting underwriting scoring, coverage, and pricing • Opportunity for identifying untapped markets for products related to ESG

External stakeholders could include investors, credit raters/ESG raters, regulators (e.g., SEC, New York Department of Financial Services), standards/frameworks, industry associations, employees, or customers.

In addition to identifying the appropriate stakeholders, stakeholder engagement starts with education of the relevant topics. Within the current marketplace, there has been an influx of insurers wanting to educate both internal and external stakeholder groups through trainings, publications, webcasts, etc. in order to set strategies and prioritize material topics to relevant ESG standards.

3. Build reporting agility

Enhance data quality, timeliness, automation, and relevance by standardizing governance and controls to prepare for assurance-ready disclosure.

Finance teams will play a pivotal role in ensuring that existing financial reporting systems and processes are adapted to manage reporting requirements introduced by the SEC proposed ruling on climate change. Insurers may wish to consider the following:

- Define a reporting strategy
- Increase the use of reporting tools and accelerators that can help insurers proactively manage the increased volume of disclosures and analysis that may be required to report results under the proposed ruling
- Establish, document, and communicate internal and external climate-related data timelines, aligned with financial reporting
- Review current state of processes and controls around existing climate disclosure
- Understand existing quantitative and qualitative data governance structures, to identify gaps and meet near- and long-term reporting requirements

For insurers that have yet to begin their ESG journey, careful evaluation of financial reporting impacts can lay the groundwork for an effective implementation of the proposed ruling. There is increasing interest by the users of the financial statements around climate risks relating to underwriting and investment activities.

The TCFD has climate-related financial recommended disclosures specific to insurance companies for its four core elements of Governance, Strategy, Risk Management, and Metrics and Targets.[7] Insurers should consider these metrics when drafting disclosures or public announcements to determine if they are measurable and consistent with the standard.

The supplemental guidance from the TCFD for insurance companies states insurance companies should describe the processes for identifying and assessing climate-related risks on insurance portfolios by geography, business division, or product segments, including the following risks:

- Physical risks from changing frequencies and intensities of weather-related perils
- Transition risks resulting from a reduction in insurable interest due to a decline in value, changing energy costs, or implementation of carbon regulation
- Liability risks that could intensify due to a possible increase in litigation[8]

4. Establish controls over climate-related data

Assess the strength of processes and controls over climate-related data, leveraging existing financial reporting controls.

Across the industry, insurance companies have varying levels of control maturity regarding ESG metrics. Companies should assess the readiness of the current control environment today to understand any gaps related to reporting under the SEC's proposed ruling on climate change. Companies should perform the following:

- Identify potential risks that could impact climate-related reporting objectives
- Identify opportunities related to ESG that can strengthen overall company strategy
  - For example, better align investment portfolio with ESG-related goals
- Determine relevant data sources, systems, and process owners
  - For example, involve underwriting and claims departments early to ensure tracking of climate-related inputs in premium and claims processes
- Document end-to-end climate processes through narratives and flowcharts
- Identify and document data and IT system limitations, assumptions, and estimates
  - For example, identify claims and premium data that include climate-related inputs like catastrophe codes or cause of claim in claims intake process
- Evaluate maturity of existing controls to enhance data accuracy and completeness
  - For example, evaluating existing investment controls and related strategies as they relate to climate risks to ensure appropriate data is readily available for ESG reporting
- Define internal process controls and general IT controls (GITCs) to mitigate identified climate-related risks
  - For example, determine if underlying climate tracking systems will be in scope for GITCs if the insurer is relying on the data for financial reporting
- Regularly assess design, implementation, and operating effectiveness of controls
- Integrate controls over climate disclosure into enterprise risk management processes and internal audit plans
- Engage with external assurance provider

With the broader focus on climate risks and the related proposed ruling, there will be many departments of an insurance organization required to change in order to gather information for the climate disclosure as noted above.

5. Think strategically

Understand disclosure requirements for climate targets, preparing for transparency on progress and transition plans.

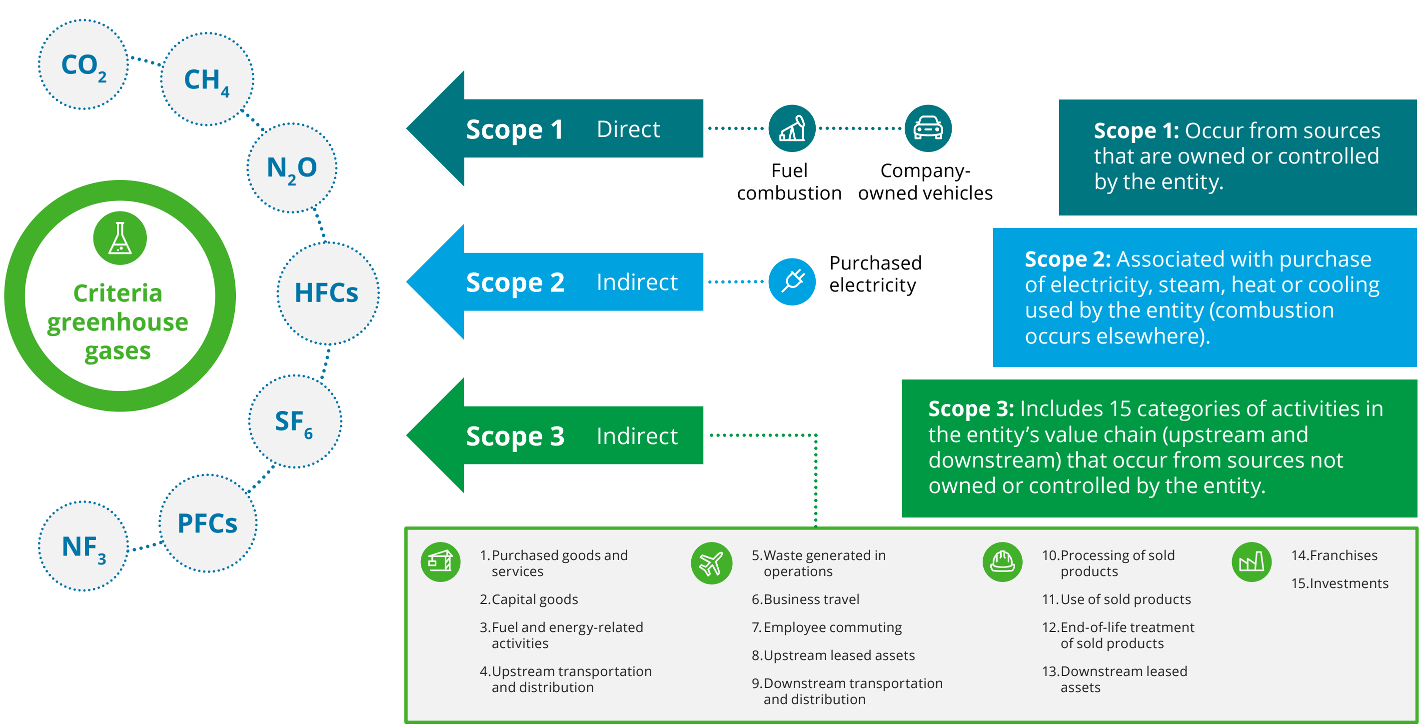
According to the TCFD climate-related recommended disclosures, insurers should contemplate the following information as it relates to strategy:

- Considerations of relevant short-, medium-, and long-term horizons as they relate to climate-related goals
- Specific climate-related issues potentially arising in each time horizon that could have a material impact to the users of the financial statements
- The process used to determine which risks and opportunities could have a material financial impact
- The impact on the insurer's businesses, strategy, and financial planning in the following areas:
  - Products and services
  - Supply chain and/or value chain
  - Adaptation and mitigation activities
  - Investment in research and development
  - Operations (including types of operations and location of facilities)
  - Acquisitions or divestments
  - Access to capital[9]

Insurers that have made GHG emissions reduction commitments, operate in jurisdictions that have made such commitments, or have agreed to meet investor expectations regarding GHG emissions reductions should strategize their plans for transitioning to a low-carbon economy. This could include GHG emissions targets and specific activities intended to reduce GHG emissions in their operations and value chain or to otherwise support the transition.[10]

The SEC proposed rule calls for disclosure of GHG emissions, Scopes 1 and 2 (and Scope 3 phased in if material or if registrant has Scope 3 target), as well as certain financial statement disclosures, and qualitative and governance disclosures. The Scope 1 and 2 GHG emissions disclosures would be subject to limited assurance during a phase-in period, followed by reasonable assurance. See an overview of the GHG emission scopes in figure 3.

Figure 3. GHG emission scopes



Based on figure 3, the GHG Protocol's Corporate Value Chain (Scope 3) Accounting and Reporting Standard gives companies flexibility in whether and how to account for Scope 3 emissions. Scope 3 emissions can represent the largest source of emissions for companies and present the most significant opportunities to influence GHG reductions and achieve a variety of GHG-related business objectives.[11] Because of the foreseen large impact to insurance companies, insurers are encouraged to have discussions within the industry to digest the interpretation of the rule as it relates to Scope 3 disclosures for property and casualty (P&C) and life and health businesses.

One resource to help with those discussions is the Partnership for Carbon Accounting Financials (PCAF), a financial industry-led partnership, which issued the first edition of the Global GHG Accounting and Reporting Standard for the Financial Industry in November 2020. It seeks to help financial institutions assess and disclose the GHG emissions from their loans and investments through GHG accounting. It also provides methods to calculate financed emissions for six asset classes (listed equity and corporate bonds, business loans and unlisted equity, project finance, commercial real estate, mortgages, and motor vehicle loans), with a goal to update these methodologies over time and add additional asset classes that may be beneficial to the insurance industry.

Insurers should additionally think through the changes needed to support their internal and external analyses under the SEC proposed ruling. These may include internal analysis packages for senior leadership, quarterly financial supplements, press releases, analyst packages, and other significant exhibits. Insurers seeking to automate their GAAP reporting may consider leveraging some of those same data flows, tools, and solutions to bring long-term efficiencies to their other reporting processes.

6. Identify climate risks and opportunities

Identify physical and transition risks and opportunities (e.g., legal/policy, market, product, physical hazards) to the business.

Companies should identify, manage, and respond to latent and emerging climate-related risks as noted above and integrate climate risk and opportunity capabilities into existing risk and control frameworks.

By integrating climate-related risks and opportunities, insurers can:

- Drive innovative and brand-enhancing strategies, including strategic choices across the value chain
- Enhance strategic communications to stakeholders to navigate changing expectations and credibly demonstrate prioritization and management of climate-related risks and opportunities
- Align insurers' strategies with emerging expectations from customers and investors
- Prioritize and measure opportunities for cost savings, risk mitigation, and reputation enhancement, and implement solutions to reduce resource inputs and wasteful outputs
- Understand and manage risk and liability considerations related to climate-related performance (e.g., inadequate, or inaccurate, disclosure of material financial risks)
- Incorporate climate-related risks into annual reporting and regulatory filings, investor engagement, pricing, forecasting and budgeting, capital allocation, and annual reporting
- Broaden the integration of climate-related performance into the existing management control frameworks to support compliance around climate-related risk
- Inform stakeholders about how the organization is responding to these risks and opportunities through scenario analysis

As mentioned in the sections above, most insurers, specifically P&C companies, already have dedicated resources to manage and disclose the effects of climate-related activities as it relates to catastrophe losses for example. With these dedicated resources, there is an opportunity for insurance companies to shift the focus to climate-related activities. With the SEC proposed ruling, insurers will be integrating ESG more broadly and have the capabilities to enhance existing risk and control frameworks.

7. Be transparent

Prepare for accelerated reporting timeliness, similar to financial reporting, and establish a plan to obtain and/or increase the level of assurance.

Improving the reliability of information may reduce information asymmetry for investors, leading to better functioning markets and aiding in capital formation.

Based on MSCI conducted research on published reports and available data, 20 public insurance companies have published information about ESG and 130 public insurance companies have mentioned ESG-related topics in 10-K filings.

Fifty-seven percent of insurance companies that are voluntarily disclosing ESG information are publishing a sustainability report based on SASB or TCFD standards (figure 4). Of these companies, 50% are P&C companies, 29% are life and health companies, and 21% are insurance brokerages (figure 5).

Insurance companies are at various stages of ESG reporting. Some insurance companies voluntarily have sustainability reports, some have risk assessments, and others are just starting their ESG journey. The SEC proposed rule calls for an enhanced level of effort and will be required for all public companies in the future. Now is the best time to contemplate the considerations of ESG and how it impacts your insurance company.

Figure 4. Type of published report by insurance companies

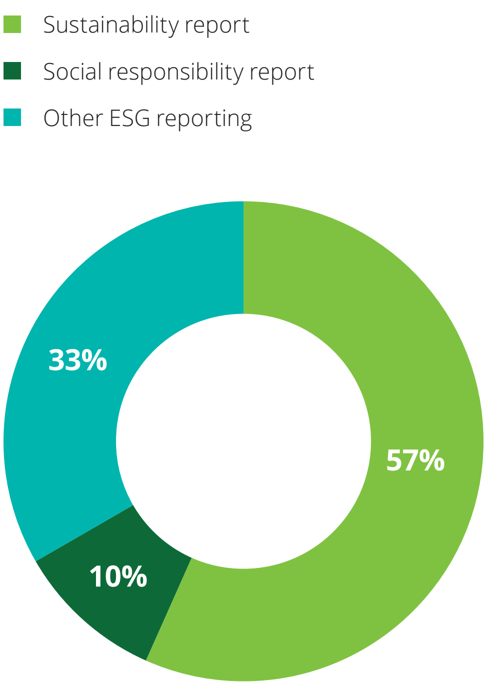
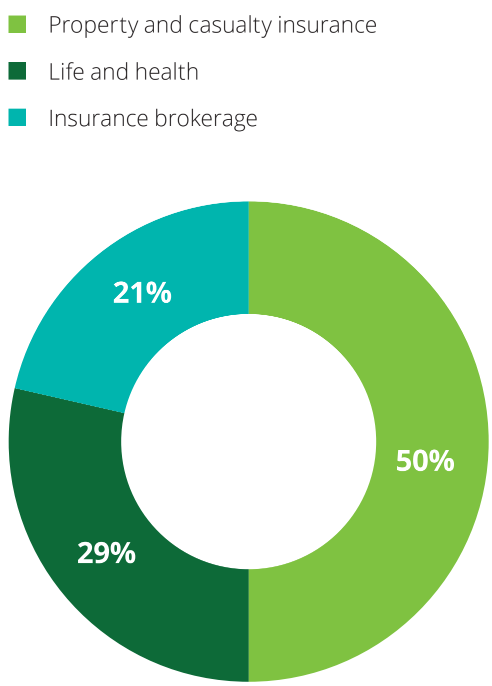


Figure 5. Type of insurance company reporting on ESG



Getting started

The SEC's proposal around climate change will create meaningful changes across insurers' financial reporting process. Carefully assessing these impacts can help insurers better understand the challenges, opportunities, and risks the standard presents. That understanding can then inform strategic investments to alleviate pressure on key areas of the reporting process and assist the insurer in developing an overall ESG strategy that can be a differentiator for the company. For insurers that have not yet begun that assessment—or those looking to accelerate their sustainability reporting—the time is now. Deloitte has extensive experience assisting clients on their ESG journey, from strategy and operational execution to measurement and reporting. Using exclusive partnerships with industry bodies and our own accelerators, we can help you build an executable strategy to aid in meeting the SEC's regulatory reporting requirements.

Contacts

Matt Martinez
Audit & Assurance partner
Deloitte & Touche LLP
+1 312 486 1781
matmartinez@deloitte.com

Donna Szatkowski-Zych
Audit & Assurance partner
Deloitte & Touche LLP
+1 212 436 6139
dszatkowski@deloitte.com

Kedar Kamalapurkar
Consulting managing director
Deloitte Consulting LLP
+1 703 885 6201
kkamalapurkar@deloitte.com

David Sherwood
Deloitte Risk & Financial Advisory managing director
Deloitte & Touche LLP
+1 203 423 4390
dsherwood@deloitte.com

Ashlee Bartlow
Audit & Assurance senior manager
Deloitte & Touche LLP
+1 312 486 1737
ashunt@deloitte.com

Endnotes

1. US Securities and Exchange Commission (SEC), Proposed Rule Release No. 33-11042, The Enhancement and Standardization of Climate-Related Disclosures for Investors.
2. SEC, "SEC proposes rules to enhance and standardize climate-related disclosures for investors," press release, March 21, 2022.
3. SEC Proposed Rule Release No. 33-11042, The Enhancement and Standardization of Climate-Related Disclosures for Investors.
4. Intergovernmental Panel on Climate Change (IPCC), *Climate Change 2013: The Physical Science Basis. Contribution of Working Group I to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change* (Cambridge, UK: Cambridge University Press, 2013).
5. Global Reporting Initiative (GRI), *GRI 2: General Disclosures 2021,* pp. 47–50.
6. Ibid.
7. Task Force on Climate-Related Financial Disclosures (TCFD) website, accessed November 23, 2022.
8. Ibid.
9. Ibid.
10. Ibid.
11. World Resources Institute and World Business Council for Sustainable Development, Corporate Value Chain (Scope 3) Accounting and Reporting Standard, September 2011.

Deloitte.