SERVICE SHEET

Climate Risk Management

Assisting Insurers with NYDFS's Guidance on Managing Financial Risks from Climate Change

The ever-increasing frequency and severity of extreme weather-related events such as wildfires and hurricanes have resulted in greater regulatory focus on climate-related risks for many sectors, including the insurance industry.[1]

The New York State Department of Financial Services (NYDFS) issued guidance for domestic insurers to take a proportionate approach to managing climate risks.[2] The guidance requires insurers to integrate climate risk factors into Board governance and organizational frameworks and other related tasks, such as risk quantification.[3]

Best Practices for Insurers to Consider

Although climate change and its effects on insurers is extremely complex, there are several best practices insurers can begin to implement now so they are better equipped to address climate-change guidance:

— **Formulate climate-risk governance:** It is critical for top management to set the "tone on top" for climate risk governance. The board should understand relevant climate risks and designate a member or committee(s) of the board to be responsible for overseeing climate risks.

— **Tailor business and credit strategy:** Climate considerations should be deeply embedded in risk frameworks and capital allocation processes. Many institutions have decided not to serve certain companies or sectors or have imposed emissions thresholds for underwriting in some sectors.[4] Boards should regularly track impacts, as well as identify potential threats to strategic plans and business models.

— **Align risk processes:** To align climate risk exposure with risk appetite and business strategy, managers should introduce climate risk considerations into all management processes (capital allocations, underwriting approvals, portfolio monitoring, reporting, etc.). Some may have begun to develop methodologies for assessing climate risk at the level of counterparties and value chain.[5]

— **Ensure you are fully informed on stress testing:** Scenario analyses and stress tests are high on business and regulatory agendas and are critical in aiding firms assess materiality impacts and resilience. By identifying important climate hazards and primary risk drivers by industry, an analysis can then be used to generate physical and transition-risk scenarios. These in turn can help estimate the extent of the damage caused by events, *e.g.*, droughts, heat waves, etc. As regulators are prioritizing stress testing for coming periods, developing the necessary climate-modelling expertise and climate hazard and asset-level data is vital.[6]

1 "FDIC Issues Request for Comment on Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions," FDIC web site, March 30, 2022. Last accessed on Aug. 16, 2022: https://www.fdic.gov/news/press-releases/2022/pr22027.html?source=govdelivery&utm_medium=email&utm_source=govdelivery

2 "Guidance for New York Domestic Insurers on Managing the Financial Risks from Climate Change," New York Department of Financial Services web site, Nov. 15, 2021. Last accessed on Aug. 16, 2022: https://www.dfs.ny.gov/system/files/documents/2021/11/dfs-insurance-climate-guidance-2021_1.pdf

3 Ibid. See Section 3.5

4 "Acting Superintendent Adrienne A. Harris Announces DFS Issues Final Guidance to New York Domestic Insurers on Managing the Financial Risks from Climate Change," Department of Financial Services web site, Nov. 15, 2021. Last accessed Aug. 16, 2022: https://www.dfs.ny.gov/reports_and_publications/press_releases/pr202111151

5 Ibid.

6 Ibid.

HOW FTI CAN ASSIST WITH NYDFS COMPLIANCE

FTI Consulting can assist with the concrete steps that insurers need to take in the following areas to comply with NYDFS's guidance:

Corporate governance

- Develop and implement a sound process for understanding and assessing the potential impacts of climate-related risk drivers on their businesses and operating environments
- Identify material climate-related financial risks that could materialize over various time horizons and incorporate these risks into overall business strategies and risk management frameworks
- Aid the Board and senior management in clearly assigning responsibilities to members and/or committees to exercise effective oversight of climate-related financial risks
- Identify responsibilities for climate-related risk management throughout the organizational structure including identification of internal stakeholders, and assigning oversight roles leveraging existing ERM functions
- Assist in the development of appropriate policies, procedures, controls, and documentation for organization-wide implementation, including identifying processes, methodologies, and tools needed to manage climate risk effectively
  - Inserting climate factors into underwriting, risk, and credit frameworks
  - Including scenario analyses and stress tests as essential capabilities and hardwiring outcomes into reporting and disclosure frameworks

Internal control frameworks

- Help incorporate material climate-related financial risks into existing internal control frameworks across the three lines of defense to ensure sound, comprehensive and effective identification, measurement, and mitigation
- Support embedding climate risk factors into decision-making across front- and back-office activities, including nonfinancial risks (operational, legal, compliance, and reputational)
- Investigate the impact of climate data on activities such as pricing, credit risk, and client relationship management
- Measure climate risk exposures at several levels, including portfolio, sub portfolio, and even transaction

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WENDY SHAPSS
Senior Managing Director
+1 212 841 9374
wendy.shapss@fticonsulting.com

JIM WRYNN
Senior Managing Director
+1 212 841 9365
jim.wrynn@fticonsulting.com

BOB STEPHENS
Managing Director
+1 212 499 3695
bob.stephens@fticonsulting.com

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