STATE OF CALIFORNIA Dave Jones, *Insurance Commissioner*

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VIA ELECTRONIC SUBMISSION

Task Force on Climate-Related Financial Disclosures

RE: Phase I Consultation Comment Letter

Dear Task Force members:

I am privileged to serve as the Insurance Commissioner of the State of California. I lead the California Department of Insurance (the "Department") and regulate the California insurance market. More than 1300 insurance companies are licensed by the Department to sell insurance in the State of California, which has the eighth largest economy in the world.

Insurers collect US$ 259 billion a year in premiums in California, making our insurance market the largest insurance market in the United States and the sixth largest in the world. Under my leadership, the Department protects consumers, helps maintain an economically healthy insurance marketplace, and regulates the financial condition and solvency of insurers.

As a financial regulator, I support efforts to enhance disclosure of climate-related risks to assets that are held by investors, including insurance companies. Climate risk disclosures should be designed to better inform investors, consumers, markets, and regulators through improved transparency, thereby helping to reduce the potential of large, abrupt corrections in asset values which might destabilize financial markets and ultimately harm consumers, investors, and insurance policyholders. I appreciate the opportunity to provide comments to the Financial Stability Board's ("FSB") Task Force on Climate-Related Financial Disclosures ("Task Force" or "TCFD") with regard to the insurance sector and industry.

The insurance industry is a vital element of the U.S. and global economy. Insurance products are necessary for the wellbeing and economic security of consumers, businesses, trade, commerce, and the overall economy. Insurers in the United States have over $7 trillion in assets under management. Insurers' products, pricing, and investment decisions influence business and consumer behavior across all sectors.

Since 2011, I have led the multi-state administration of an annual climate-change risk disclosure survey – the National Association of Insurance Commissioners' ("NAIC")

Climate Risk Disclosure Survey.[1] The survey asks insurers questions regarding whether they have identified climate related risks to their business operations, underwriting and reserving, and what, if any, steps they have taken to address these risks. The survey results are published on the Department's website at http://www.insurance.ca.gov/0250-insurers/0300-insurers/0100-applications/ClimateSurvey/.

More recently, and consistent with my statutory responsibility to make sure that California-licensed insurance companies identify and mitigate potential financial risks to the reserves they hold to pay future claims, I announced in January of this year the Department's Climate Risk Carbon Initiative, which currently includes:

(a) New required financial disclosures by insurers of their investments in fossil fuel (thermal coal, oil, gas, and utilities) enterprises through a survey or "data call", which is applicable to California-licensed insurers with 2015 direct written premiums equal to or greater than US$100 million nationwide ("Data Call"), and

(b) A request that California-licensed insurance companies voluntarily divest from thermal coal enterprises, applicable to all California-licensed insurers ("Thermal Coal Divestment").

I am the first insurance regulator in the United States to require that insurance companies provide detailed and public disclosure of their investments in the carbon economy and the first to call on insurance companies to divest from thermal coal. The Data Call was successfully issued in early May with a deadline of July 1, 2016 to provide the required financial disclosures of fossil fuel investments and to provide an answer as to whether the insurer will divest from thermal coal. Further information on the Climate Risk Carbon Initiative, is at http://www.insurance.ca.gov/0250-insurers/0300-insurers/0100-applications/ci.

In addition to administering the NAIC Climate Risk Disclosure Survey and the new Climate Risk Carbon Initiative, the Department also is using its routine financial examinations, its review of the new Own Risk and Solvency Assessment Act reports by insurers ("ORSA"),[2] and the new Form F filings required under the NAIC Model Holding Company Act, to obtain information about insurers' identification of and responses to climate risk.

I am pleased to share with the Task Force and the Financial Stability Board the Department's work and experience in the area of climate risk and the insurance sector.

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[1] The NAIC is the United States standard-setting and regulatory support organization governed by the chief state insurance regulators of all states.

[2] In 2011, the NAIC adopted the ORSA model act, under which large insurers or groups are required to file annual ORSAs with regulators. In these reports, insurance companies make their own assessment of their current and future risks through an internal risk self-assessment process which allows regulators to form an enhanced view of an insurer's ability to withstand financial stress. Included is an assessment of material risks and the capital needed to support these risks. Climate change is included in many of the risks impacting the insurance companies and groups either directly or indirectly through their assessments of other risks. For further information on ORSA, visit http://www.naic.org/cipr_topics/topic_own_risk_solvency_assessment.htm.

It was a personal privilege to be invited to make a presentation to the Financial Stability Board on the Department's work regarding climate risk and the insurance sector at the FSB's meeting in London in September of 2015, after which the FSB announced the formation of the Task Force.

Because the Consultation seeks to strengthen the Task Force's recommendations to be issued in Phase II by building upon the expertise of Submitters who are asked to provide meaningful and substantive input, the Department's attached responses focus on areas within its expertise. Absence of a response or discussion of certain items does not signify that the Department has objections to their inclusion or consideration.

I congratulate the Task Force for its important and meaningful work and look forward to its Phase II Report. Thank you for considering our comments. We would welcome the opportunity to provide further input and support to the Task Force as it advances its mission.

If the Task Force has any questions about this Comment Letter or the California Department of Insurance Climate Risk Carbon Initiative, including the Thermal Coal Divestment or Fossil Fuel Investment Data Call, please contact me or Mr. Libio Latimer, Director, Office of Climate Risk Initiatives, California Department of Insurance, at 45 Fremont St., San Francisco, CA 94105, USA, or [redacted]. Mr. Latimer can also be reached at [redacted].

Sincerely,

DAVE JONES
Insurance Commissioner

COVERAGE AND AUDIENCES

1. **Which types of non-financial firms should any disclosure recommendations cover? List in order of importance.**

    1. Energy (equipment, services, oil, gas, etc.)
    2. Utilities (electric, gas, renewables, water)[1]
    3. Materials (chemicals, construction, metals & mining, paper & forests, etc.)
    4. Industrials (capital goods, commercial services, transport)
    5. Health Care (equipment, services, oil, gas, etc.)
    6. Telecommunications (diversified, wireless, etc.)
    7. Information technology (semiconductors, software, hardware, etc.)
    8. Consumer Discretionary (auto, durables, retailing, etc.)
    9. Consumer Staples (food, beverage, retailing, etc.)

2. **Which types of financial firms should any disclosure recommendations cover?**

    - Insurance (brokers, multi-line, property, reinsurance, etc.)
    - Pension Funds/Schemes
    - Diversified Financials (asset management, investment banking/broker-dealer, consumer)
    - Credit rating agencies
    - Banks (diversified, thrifts, mortgage, etc.)
    - Real Estate (REITS, management and development)
    - Other:
        - Stock exchanges
        - Hedge funds and private equity
        - Sovereigns

3. **Which users in the financial sector should be considered as the target audience?**

    - Investors (including insurers, asset managers, funds, pensions, etc.)
    - Banks (diversified, commercial, project finance)
    - Broker-Dealers and Investment Banks
    - Credit rating agencies
    - Consultants/Advisory
    - Other:
        - Insurance policyholders, beneficiaries, and consumers
        - Insurance rating agencies
        - Financial regulators

[1] Information on sources used to generate electricity (coal, oil, gas, others) by public utilities is currently not easily available in California and or in other parts of the United States. Calling on these utilities to record and disclose this information will help determine their “carbon footprint.”

CLIMATE-RISK DIMENSION

4. For non-financial preparers of climate risk and opportunity information, what are the top three key concerns that you would like the Task Force to keep in mind in making our recommendations?

- Energy utility companies (private or publicly owned) should account for and disclose the energy sources used to generate their electricity, such as thermal coal, gas, oil, natural gas, purchased, etc., by percentage. If they market purchased electricity, they should account for and disclose the percentage of energy sources used by the seller to generate electricity.

- Disclosing companies should assess and disclose a pertinent quantification of what constitutes material risk to their business for any given climate-related exposure to risk. They should also provide explanations as to how they made such individual determinations (general guidelines or standards used).

- Narrative reporting should be subject to applicable Fundamental Principles for Effective Disclosures: relevant; specific and complete; clear, balanced, and understandable; consistent over time; designed to be comparable among companies within a sector, industry, or portfolio; reliable, verifiable, and objective. Disclosing companies should be aware that narratives may influence the valuation of securities, which, depending on jurisdiction, may subject comments to certain standards.

5. For users of climate risk and opportunity information, what are five specific points of information that you wish to secure?

- Whether the disclosing company performed an analysis of its investment portfolio to measure carbon investment concentration or global carbon footprint. If so, disclosure of type of filter used (commercial, internally developed, or other).

- Whether the disclosing company had fossil fuel investments (thermal coal, gas, oil) during period being reported.

- If so, provide investment identification (such as CUSIP), name/ description, actual cost, fair value, book/adjusted carrying value, acquired date, stated contractual maturity date, fossil fuel type sector (thermal coal, oil and gas, corporate owned utility, municipally owned utility, or other), and percentage and amount of annual revenue enterprise derives per fossil fuel type.

- Whether disclosing company has divested from fossil fuel investments during reported period or intends to divest in future and when.

- If so, provide investment identification (such as CUSIP), name/description, (projected) disposal date, actual cost, realized gain, total gain (loss) on disposal, and if thermal coal, and disclose thermal coal investment type (corporate owned utility, municipally owned utility, or non-utility) of divestments.

6. **Are there any best practice disclosures of climate risks by companies that you would like to bring to our attention? What specific climate elements of this disclosure would you like to highlight? (Please limit to two examples)**

A disclosure that links ranges of scenario outcomes within risk types (Physical, Liability, and Transition) to projected financial performance of the disclosing company, for both orderly transition and "hard landing" timelines, would be a good practice. Linking these disclosure elements would allow users of information to better perform their own assessments.

Following are two disclosure programs in the insurance industry in the United States which provide further information on best practices and climate elements of disclosure:

- In January of 2016, consistent with my statutory responsibility to make sure that California-licensed insurance companies identify and mitigate potential financial risks to the reserves they hold to pay future claims, in addition to a Thermal Coal Investment Request, I announced the Department's Climate Risk Carbon Initiative, which currently includes new required financial disclosures by insurers of their investments in fossil fuel (thermal coal, oil, gas, and utilities) enterprises through survey or "Data Call." The Data Call is applicable to California-licensed insurers with 2015 direct written premiums equal to or greater than US$100 million nationwide. The Data Call was successfully issued in early May with a deadline of July 1, 2016 to provide the required financial disclosures of fossil fuel investments.

- In 2010, the NAIC adopted the Insurer Climate Risk Disclosure Survey. The aim of the survey is to provide regulators, insurers, investors and other stakeholders with substantive information about the risks insurers face from climate change and the steps insurers are taking - or are not taking - to respond to those risks. This survey is comprised of eight questions that assess insurer strategy and preparedness in the areas of investment, mitigation, financial solvency (risk management), emissions/carbon footprint and engaging consumers. The survey results provide trends, vulnerabilities and best practices related to insurers' response to climate change.[2] For Reporting Year 2014, in 2015 six state

[2] For further information on the NAIC Climate Risk Disclosure Survey, visit http://www.naic.org/cipr_topics/topic_climate_risk_disclosure.htm.

departments of insurance, including California, partnered in administering, to approximately 77% of the US insurance sector as measured by premium volume, this annual survey. The California Department of Insurance serves as the central location to access survey information from this multi-state initiative.[3]

7. **"Transition Risk" in terms of climate is an evolving term. How would you define this risk? What specific disclosures would help measure it?**

   The accelerating policy and private market movement away from the burning of carbon poses a potential financial risk to insurance companies investing in the carbon economy. The potential risk of continuing carbon investments is that they will lose value over time or that they lose value quickly. In either case, carbon investments pose a potential financial risk to those who invest in them.

   In order to achieve the COP21 objective of limiting global temperature rise to 2 degrees Celsius, nations, states, and municipalities will need to dramatically restrict the burning of carbon. As a result, investments in coal mines, in oil and gas wells, in companies that extract coal, oil or natural gas, in companies that transport coal, oil and gas, in utilities that rely on coal, oil or gas, among others, could drop dramatically in value, as they become “stranded assets.”

   Widely-accepted methods to separate changes in valuation due to climate risk from changes in valuation due to other factors are still to be developed. However, knowing the extent to which insurance companies are invested in oil, gas, coal, and related companies provides important information about the financial vulnerability the insurance industry has to a decarbonized economy and helps insurers and regulators determine how best to address this risk. The Data Call of the California Department of Insurance Climate Risk Carbon Initiative announced in January 2016 is an example of a financial disclosure to obtain this information. As stated above, the Data Call is a required financial disclosure of insurance companies’ investment in fossil fuel (thermal coal, oil, gas, and utilities) enterprises. The Data Call is applicable to those California licensed insurers with 2015 direct written premiums equal to or greater than US$100 million nationwide.

8. **Which three sectors do you think are most exposed to climate risks? For these sectors, how are physical, transition and liability risks best measured and reported?**

   The insurance sector is exposed to climate-related financial risks with regard to underwriting and investment (subject mainly to transition and potentially liability risks). Physical risks are best measured and reported by quantification of claim losses for a given reporting period. Transition risks can be measured by quantification of losses caused by devaluation of security holdings arising from

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[3] To access further information on the annual NAIC Climate Risk Disclosure Survey, visit http://www.insurance.ca.gov/0250-insurers/0300-insurers/0100-applications/ClimateSurvey/.

climate risk. Methods to separate changes in valuation due to climate risk from changes in valuation due to other factors are still to be developed.

Liability risk with regard to underwriting can be measured by the amount of compensation incurred or paid during a reporting period arising from claims by parties who have suffered loss or damage from the effects of climate change. At present, sources and methods that would allow separation of claims costs which are attributable to climate change from those which may be attributable to other causes are still to be developed. With regard to corporate liability to shareholders for investment losses associated with failure to identify and take steps to mitigate climate risk and liability associated with contributing to the injuries or losses of others due to climate risk, the law is evolving and analysis of tort and shareholder liability in other contexts may provide a useful guide to potential exposure and losses.

The energy and real estate sectors are also significantly exposed to climate risk. Energy companies may be exposed to disruptions of supply, infrastructure damage, and alteration of demand patterns (physical risks). Securities issued by them may also be affected by transition risk. The real estate sector may be affected by physical risks as well as environmental and land use policies adopted in response to climate change and pollution. These may include liability risks. These physical, transition and liability risks bear correlation to the extent energy and real estate firms own, possess, control, and operate assets subject to these risks. Therefore, quantification and reporting of assets subject to these physical, transition and liability risks can provide a way to measure these risks.

9. How should the task force consider the challenge of aggregate versus sector-specific climate-related financial risks and opportunities?

Quantitative disclosures should provide consistent and comparable data and metrics that can be aggregated across portfolios and classes of reporters. Because sectors may differ in their investment characteristics and reporting methodologies, a uniform system should be created that allows for certain reporting and quantification parameters that are common across sectors while maintaining unique or uncommon parameters of given sectors. Aggregation at the sector level will form the basis of economy-wide aggregation. Such structure would allow for ability to adjust scope and “drill up” or “drill down” as disclosure user desires. Given the common need for financial stability analysis purposes, aggregation of comparable risk and opportunity data is of significance importance and should be given meaningful consideration.

10. Is there a role for scenario and sensitivity analysis – for the non-financial and/or financial sectors? Please provide three specific examples.

Yes, scenario and other sensitivity analyses can provide useful and flexible tools for forward-looking assessment of risks. Scenario analysis enables users of information to perform their own assessments. Risk analysis in the financial sector should benefit from scenario and sensitivity analysis by non-financial

sectors. Examples may include (1) Asset investment selection and hedging of risks, (2) Underwriting risk assessment and pricing, and (3) Physical location risk adjustment.

ASSET-CLASS DIMENSION

11. Which are the key asset classes that require initial attention? Are there any gaps that we should focus on? Within this, what are the top two priorities for action?

Require initial attention:

- Equities
- Fixed Income
- Commodities
- Project and Infrastructure Finance
- Real Estate
- Private Equity
- Loans and other banking financing
- Other: secondary investments in aggregated funds

Top two priorities for action:

- Equities
- Fixed Income

INTERMEDIARY/USER SCOPE

12. Considering the breadth of services the capital supply chain provides, please provide up to three examples of leading work (research or other) from sell-side brokers' investment recommendations, listing rules of stock exchanges, portfolio management and stewardship examples by fund managers, fund-manager recommendations by consultants, or others we should consider.

- The 2015 Mercer “Investing in a Time of Climate Change” report describes key motivations for investor action, risk factors, scenarios, asset sensitivity, portfolio implications and investor actions. Key findings are that climate change will have impact regardless of scenario; potential sector impacts are most meaningful, particularly over the next 10 years to 2025; asset class impacts can also be material, and vary by climate scenario; a 2 C scenario need not harm total diversified portfolio returns out to 2050.

- Insurers responding to the California Department of Insurance’s Climate Risk Carbon Initiative Data Call need information on the carbon profiles of various investments. Several investment advisors, such as South Pole

Group, Trucost, FTI Consulting, RobecoSam, MSCI, FTSE and Mercer provide related information and materials.

By mentioning these resources, the Department does not endorse or recommend any particular third-party consultant, research product, or services.

13. **Please identify three examples of existing disclosure practices on climate risk disclosures you consider to be effective by investment banks, stock exchanges, investment managers, investment consultants and asset owners. Please indicate preparer and type of disclosure.**

Climate-risk disclosures applicable to all state-licensed insurance companies for a given reporting period structured to provide an understanding of the exposure to risks is an effective practice that aids assessments by investors, analysts, regulators, and the public. The California Department of Insurance's Climate Risk Carbon Initiative Data Call is a specific example of this practice (see answers to questions 6 and 7).

14. **How can climate risk information be simply summarized for retail investors? What standards or mechanisms exist for assuring end investors that climate risks and opportunities have been considered in the way that their savings and investment and pension products have been managed?**

No comment. This question is beyond the expertise of the Department.

MACRO SCOPE

15. **In conducting macroeconomic analysis, what are the top three key measures of macroeconomic climate risk performance when seeking to measure the extent to which the global economy is transitioning towards net zero emissions?**

Described measures may include:

- Rate at which existing emission intensive assets are being replaced by low emission assets.
- Trends of global movements, such as fossil fuel divestment initiatives, that influence rate of such replacement.
- Quantification of volume of investment capital conditioning investment on actions that influence such replacement.

16. **One way to measure transition risk is by considering disclosures based on sector/market analysis. What scenario planning work is currently available in this area?**

While substantive and thorough scenario planning work specific to the insurance sector is information we continue to seek from insurers, discussion on IPCC scenarios and expected temperature changes in regards to insurance is

available. See The Impact of Climate Change on the UK Insurance Sector, Bank of England Prudential Regulation Authority, Sep. 2015, pages 18 – 20 (discussing IPCC's Fifth Assessment Report, available at http://www.ipcc.ch/). See also IPCC's Climate Change 2014, Synthesis Report, pages 8 - 13, available at https://www.ipcc.ch/pdf/assessment-report/ar5/syr/SYR_AR5_FINAL_full.pdf.

17. **The United Nations Framework Convention on Climate Change (UNFCCC) five yearly "global stocktakes" seek to establish in part whether financial flows are consistent with the less-than-two-degree scenarios. Are there any climate-risk disclosure recommendations that would appropriately feed into such an effort?**

Call for disclosure of whether company's climate-related risk program fits into any private or governmental scheme that has less-than-two-degree objectives. As governments communicate how they plan to transition their economies toward net zero emissions through national plans, companies will be increasingly more able to manage their financial flows to be consistent with these larger plan objectives.

LOOKING AHEAD

18. **How should the Task Force define "success"?**

Establishment of decision-useful, effective, efficient, and widely-accepted disclosure regime resulting from Task Force recommendations for financial disclosures of climate-related risks that are responsive to the needs of insurers, policyholders, investors, rating agencies, lenders, and other users of disclosures. The disclosure regime should be structured in a way that allows for aggregation on-demand and has the ability to sustain future changes. The net result of the described disclosure regime would be improved market pricing and transparency that reduce the potential for large, abrupt corrections in asset values that can destabilize financial markets.

19. **What are the key barriers that you believe the Task Force needs to overcome?**

Key barriers that we believe the Task Force needs to overcome are:

- Alignment of incentives so that companies voluntarily disclose information that may potentially place the company at a competitive disadvantage in the market is a barrier. For example, risk disclosure based on miscalculations that, in turn, result in undue depreciation or mispricing of company securities have potential to result in cost and liabilities. This possibility might discourage disclosure or provide incentive for minimalistic disclosures that are less than candid. Ensuring that disclosures are complete and accurate is necessary to accomplish the purposes of the Task Force. Disclosures that are mandatory and made publicly available in proper form have the capacity to address some of these issues, and

therefore we support and recommend that disclosures be mandatory and made public.

- Climate-related data of private securities investments is important in order to have an accurate view of exposure to potential climate-related risks; however, obtaining this data is difficult in the United States, and likely in other countries, due to their non-public nature. The Task Force should explore ways to obtain disclosure of this important sector.

- Scarcity of company managers who have adequate skill and sophistication to manage company transition to less carbon dependency. Companies need such skilled and sophisticated leadership to plan for and manage transition to a low-carbon economy in a proactive manner and also to make disclosures that accurately inform investor expectations and decisions.

- Persistent legal, socio-political resistance to the concept of climate change and its human causes, and consequential physical, transition, and liability risks. While progress has been accomplished in this area, certain segments exist that still view these issues with scepticism.

- Ability to link actions at company, sector, or national economy level to change in global temperature (2 C). Widely accepted evidence of correlation of these would enormously strengthen Task Force's efforts and those of the climate related financial risk disclosure community.

20. Is the Task Force focused on the appropriate set of topics for its Phase II work plan?

As articulated in the FSB remit on the TCFD, Phase II will set out specific recommendations and guidelines for voluntary disclosure by identifying leading practices to improve consistency, accessibility, clarity, and usefulness of climate-related financial reporting. Additionally, Phase I Report's Terms of Reference for Phase II mentions good governance, assessment of impacts of climate change on reporting companies' businesses, and continued stakeholder outreach as elements in Phase II. Assuming these are the topics, they seem appropriate since they contemplate building on existing work, allowing stakeholder participation, focusing on reporting companies' businesses, elevating the issue to board of director level, and delivering a work product that includes practical recommendations. Topics that are absent, and which may be in a possible Phase III, are promotion of TCDF recommendations in order to accomplish wide adoption, and periodic measurements of such adoption. Sustained focus on the insurance industry is also proper consistent with the central focus this industry has in the Task Force's mission.

21. What additional topics should it consider?

As stated above, it should consider promotion of adoption of Task Force recommendations and measurement and assessment of subsequent progress in

adoption of recommendations, and most significantly, the quality and quantification of disclosures.

22. **The Task Force plans to reach out to a broad sample of key stakeholders in the preparer, user and standard setting communities. Are there particular types of entities or organizations that you believe the Task Force should reach out to?**

    Yes, since the Task Force has found in its Phase I report that the existing landscape of climate-related disclosure remains fragmented, which is not a desirable state, there should be some effort to reach out to government officials and financial regulators, in an effort to agree on common principles of disclosure that may provide a common framework for data aggregation and could potentially obviate duplication of disclosures.