STATE OF CALIFORNIA Dave Jones, *Insurance Commissioner*

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VIA ELECTRONIC & U.S. MAIL

The Honorable John D. Doak, Oklahoma Insurance Commissioner
The Honorable Stephen W. Robertson, Indiana Insurance Commissioner
The Honorable Mathew M. Rosendale, Montana Commissioner of Securities and Insurance
The Honorable Nancy G. Atkins, Kentucky Insurance Commissioner
The Honorable Jon Godfread, North Dakota Insurance Commissioner

RE: California Department of Insurance Climate Risk Carbon Initiative

Dear Commissioners Doak, Robertson, Rosendale, Atkins, and Godfread:

I write in response to your letter of June 20, 2017.

The overwhelming weight of scientific evidence indicates that climate change is occurring and its cause is largely man made due to increased greenhouse gas emissions over time. Scientists have identified various impacts of climate change, including sea level rise, more frequent, more severe and more unpredictable weather events, and changes in habitat and conditions which in turn lead to changes in the location and in some cases existence of certain plant and animal life.

Climate change and its related impacts pose risks not only for people, businesses, and communities but also for insurers and insurance markets. Insurance regulators and insurers should consider these risks and address them as they would any other risks potentially having an impact on the business of insurance.

While politically popular in your states, denying or ignoring climate change, its impacts and related risks, is contrary to the evidence based approach that lies at the core of our system of state based insurance regulation. The National Association of Insurance Commissioners in 2009 adopted a Climate Risk Disclosure Survey to be administered to insurers for this very reason – that it is important to recognize that there are risks associated with climate change and its impacts which insurers and insurance regulators should consider and address.

California is one of the states which has administered the NAIC Climate Risk Disclosure Survey to insurers since 2009. Based on the results of the NAIC Climate Risk Disclosure Survey, the science of climate change and its impacts, and developing market trends and government policies enacted at the international, national, state and local levels, the California Department of Insurance determined that there are potential climate related risks to financial investments held by insurers. In January of 2016 I directed the Department to initiate the Climate Risk Carbon Initiative to address the risks of climate related impacts to insurer investments in oil, gas, coal and utilities.

The California Department of Insurance Climate Risk Carbon Initiative asks insurance companies licensed to transact business in the state of California to voluntarily divest from investments in thermal coal enterprises (and refrain from making such investments in the future same), and requires California licensed insurance companies that write $100 million or more in national direct premium to disclose their fossil fuel holdings. The key term in the foregoing sentence is that these companies are licensed by the State of California Department of Insurance to transact insurance in the State of California and are therefore subject to regulation by the California Department of Insurance.

As California's Insurance Commissioner, I am a supporter of state-based insurance regulation and the NAIC Accreditation Program and its objectives. The Climate Risk Carbon Initiative is entirely consistent with state based regulation. As insurance regulators, one of our core responsibilities is to make sure that all insurance companies transacting business in our state are financially sound and that they are addressing potential financial risks in the reserves they hold to pay future claims.

As you know, the California Department of Insurance has this duty with regard to all companies selling insurance in the California market, whether they are domiciled here or not. The 1,300 insurance companies that we regulate collect $289 billion a year in premiums in California's insurance market, which is nearly 14% of all U.S. insurance premiums. We have a strong interest in making sure that the millions of policyholders associated with this business are protected. Consistent with the state-based system of insurance regulation here in the United States, both under my watch and under previous Commissioners, the California Department of Insurance has on a number of occasions taken actions against insurance companies in hazardous financial condition that were not California domestics. We are steadfast in our vigilance regarding the financial condition and soundness of investments of all companies operating in California, and take appropriate action when necessary.

We launched the Climate Risk Carbon Initiative because we are aware that governments, at the local, state, national and international levels, are already adopting laws and policies and taking actions which will reduce the use of fossil fuels, and coal in particular. We also have observed that the price per kilowatt hour of renewable energy sources has decreased such that market forces are causing or are likely to cause changes in demand for fossil fuels and that some businesses and consumers are making decisions to reduce their reliance on fossil fuels. Like other insurance regulators in other jurisdictions, we have identified a risk that the value of investments in fossil fuels will decline due to government actions, business and consumer decisions, and market forces.

This risk, referred to by G-20 Financial Stability Board Chairperson and Bank of England Governor Mark Carney and other insurance regulators as "transition risk", is a result of the potential for movement away from the carbon economy in reaction to climate change and overall energy market forces. In fact, as global temperatures continue to rise and climate change continues apace, there is risk that governments will take further steps to restrict the burning of carbon and/or take steps to reduce reliance on same. At that point, investments in coal mines, in oil and gas reserves, 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 in

value (even more than they already have). Before that happens it is important for insurance companies and insurance regulators to understand the scope of these fossil fuel investments by insurance companies and to take steps to address potential climate-related financial risks to those investments.

In fact, we are already seeing negative impacts on fossil fuel investments, particularly coal. In this regard:

- Coal production reached a 30 year low in 2015, and the number of employees in the U.S. coal mining industry fell from 90,000 in 2012 to 50,000 in 2016, according to the Bureau of Labor Statistics.

- The number of U.S. coal mines dropped from 1,831 in 2006 to 1,159 in 2015, according to the Energy Information Administration.

- In March 2016, the U.S. Department of Commerce released data showing that large mining companies collectively lost $227 billion in 2015. This is more than they gained in the previous 8 years combined, completely wiping out profits the industry made since 2007.

- The Dow Jones U.S. Coal Index decreased 92.9% from April 2011 to June 2017.

- Over the past five years, the VanEck Vectors Coal ETF has decreased 49%, compared to a 67% increase in the Dow Jones Industrial Average, and an 84% increase in the S&P 500 during the same period.

- 40+ coal companies have declared bankruptcy since 2012 (SNL).

The massive drop in coal stock value alone should not only give you cause for concern as financial regulators, but also make you re-think your outlook on the future of this sector. However, the impact is not limited to coal, as demonstrated by 69 North American oil and gas producers filing for bankruptcy since 2015 (Oilprice.com), and the California State Teachers Retirement System (CalSTRS) and the California Public Employees' Retirement System (CalPERS), the largest pension funds in terms of assets in the U.S., losing a combined $5.1 billion in their oil, gas, and coal investments in 2014-2015 (Trillium).

The adoption of policies to reduce reliance on fossil fuels is putting even more financial pressure on carbon assets and fossil fuel investments. In fact, as utilities decrease their use of coal and other carbon fuel sources, as states like California limit the ability of the private sector to burn coal and other carbon fuels for power generation, as states impose more stringent air quality requirements which limit the ability to burn coal and other carbon fuels, and as most nations across the world begin to implement the commitments they made to reduce their use of carbon at the United Nations COP21 Climate Summit in Paris, investments in coal and the carbon economy run the risk of becoming "stranded assets" of diminishing value.

In particular, California is decarbonizing its economy and transitioning to clean, pollution free energy resources. Utilities have been required by law to dramatically reduce their reliance on carbon. California's cap-and-trade program also results in raising the cost of carbon and reducing its use.

In addition to government actions, an even more powerful force of change is the price per kilowatt hour of renewable energy sources which has dropped significantly in recent years, making this energy source cheaper than or competitive with fossil fuel energy sources. The price per kilowatt hour of renewables is expected to continue to decline. Market forces are even more powerful than government actions in reducing reliance on fossils fuels. For example, the Kentucky Coal Mining Museum is installing solar panels, a move they expect will save a minimum of $8,000 to $10,000 per year (CNN), while reducing the need for energy generated from coal.

Businesses are also recognizing the risk climate change poses to fossil fuel investments and/or taking steps to address climate change which in turn will impact demand for and the value of fossil fuel investments. Two recent examples are noteworthy in this regard. In May of this year, "[a] majority of Exxon Mobil's shareholders (62.3%), in a reversal, have voted in favor of more open and detailed analyses of the risks posed to its business by policies aimed at stemming climate change (NY Times), and since you wrote your letter, Volvo, "[t]he Swedish automaker is slamming on the brakes on vehicles powered solely by internal combustion engines, announcing that every car it makes from 2019 onward will have an electric motor." (CNN).

A number of insurance companies have already recognized the risks of continued investment in thermal coal. Allianz announced that it would decrease investments in companies using coal and boost funding in those focused on wind power. Similarly, AXA announced that it will remove from its portfolio, and refrain from future investment in, companies that derive more than half of their income from coal mining, including electrical utilities that derive more than half of their energy from thermal coal plants. More recently, Aegon took the decision to strike coal mining off its investment list. Swiss Re has also announced it will no longer invest in coal.

The bankruptcy of more than 40 coal companies and the refusal of three major United States banks to provide loans for new coal infrastructure, the announcement by Deutsche Bank – the largest international coal infrastructure lender – that it will not make new coal infrastructure loans, the decision of major international insurers to stop investing in coal, the decline in price of energy alternatives to coal, and the imposition of clean air regulations, are just some of the indicators that coal is or runs the risk of becoming a "stranded asset."

In light of these risks to the value of coal investments, we asked the insurance companies we regulate to voluntarily divest from coal. We also asked insurers to publicly disclose their investments in coal, oil, gas, and utilities so insurers, regulators, shareholders, and consumers have better insight into these investments to facilitate informed decision making and transparency.

In January of 2016, we specifically asked insurance companies that transact insurance in California to voluntarily refrain from making any new investments, refrain from renewing any

existing investments, and to sell or withdraw from existing investments, in any company that generates thirty-percent or more of its revenue from the mining or use of thermal coal. We also required insurance companies licensed in California that write $100 million or more in national premium, to disclose their carbon based investments, including those in the extraction or use of oil, gas and coal. These insurance companies have fully complied with our requests that they disclose this information, and the results are posted on the California Department of Insurance's website – www.insurance.ca.gov; I encourage you to take a look so that you have a better understanding of the risk to the investments of the insurance companies that operate in your state.

Our Climate Risk Carbon Initiative is a sound regulatory endeavor that is grounded in financial risk analysis, consistent with the state based system of insurance regulation. Your demand that the California Department of Insurance cease the regulation of insurance companies selling insurance to businesses and consumers in California simply because the insurance companies are incorporated in other states is directly contrary to state based regulation which enables each state to regulate insurers selling in its markets.

We are not alone in our concern about the financial risk to insurance company investments associated with climate change and climate risk. The Financial Stability Board of the G20, the Prudential Regulatory Authority of the Bank of England, insurance regulators across the world, institutional and private investors, and many others, have called for disclosure by insurers of climate related risks. The G20 Financial Stability Board is so concerned about these risks that it established the Task Force on Climate-related Financial Disclosures, which recently issued its report calling for disclosures of climate related risks by all sectors of the economy, including insurance companies. Sound regulation of the insurance industry includes consideration of climate related risks. Although it is politically popular in your states to deny or ignore climate change, ignoring the potential financial risks to insurer investments from climate change is irresponsible and even reckless.

We will not stop asking insurance companies to consider climate related risks and in particular we will not stop our Climate Risk Carbon Initiative. Thankfully, the politics of climate change denial in oil, gas and coal states does not dictate insurance regulation in California.

Sincerely,

DAVE JONES
Insurance Commissioner

cc: National Association of Insurance Commissioners