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Memorandum

Texas Law Could Further Complicate the ESG Landscape for Insurance Companies

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On May 24, the Texas legislature passed a bill that, once signed by the Governor, will make Texas the first state to target insurers' ability to incorporate ESG factors into pricing. The enrolled bill, which will become effective September 1, 2023, is meant to regulate the use of ESG models, scores, factors or standards in insurance pricing. But unlike the original draft of the bill, the enrolled bill includes several important exceptions.

First, an insurance company is not in violation if its actions are based on "ordinary insurance business purposes," which includes sound actuarial principles or considerations of financial solvency that are reasonably related to loss experience for the risks at issue. Second, the law states that it shall not be construed or applied to require "a material change in the insurer's current business plans," nor does it prohibit insurers from using the types of information that may also be used to develop ESG models, scores, factors or standards, if that information is "relevant and related to the risks being insured." The ultimate impact of the law is not immediately clear, as the ways in which ESG-related information is being leveraged into pricing models by insurance companies today is largely in respect of actuarial principles and documented risk of loss. And with a number of undefined terms in the legislation (including "environmental, social or governance model, score factor or standard") and the novelty of the restriction being implemented, whether and to what extent practices will need to change may depend on how the Texas Department of Insurance interprets the statute.

Gov. Greg Abbott had forecasted the intention to target insurers' ESG commitments in a letter he sent to President Biden on March 16 of this year. After touting the state's 2022 anti-boycott law, which resulted in the blacklisting of 10 financial institutions prohibited from doing business in the state due to their alleged "boycotting" of fossil fuel companies, Gov. Abbott indicated that the state's anti-ESG focus would shift to insurance activity. In order to protect the energy sector, he wrote, the state would enact legislation to ensure that insurance companies do not hinder energy companies in order to "placate ESG advocates."

While a number of states have recently enacted legislation designed to block the consideration of ESG factors in state investment decisions, Texas is the first to pass legislation directed at insurance companies. In the end, lawmakers did so with just minutes to spare before the close of the legislative session. Two other bills targeting the use of ESG factors in investment decisions expired with the session.

The law arrives at a complicated moment for the insurance industry's ESG and sustainability-related efforts. To date, ESG considerations have been increasing in significance for the industry with key issues falling into three main categories:

- Institutional issues, including public commitments, business decisions and investments that in turn impact behavior and performance;
- Operational issues including internal management concerns; and
- Shareholder issues such as activism and requests for reporting.

Growing pressure from new and amplified legal requirements,[1] industry-specific regulatory attention,[2] increasing claims activity around ESG and sustainability issues resulting in losses to carriers,[3] non-regulatory initiatives[4] and strategic opportunity factors[5] have, among other developments, led a number of large insurance companies to adopt a broad range of ESG and sustainability measures to evaluate long-term strategic business issues relating to environmental and social factors. As global ESG regulatory obligations grow, stakeholder expectations, including from investors and standards-setters, continue to evolve as well. This means greater attention on how long-term insurance companies' strategy and investment incorporates sustainability-related risks and opportunities.

However, developments are by no means progressing in a straight line. The Net Zero Insurance Alliance (NZIA), a group of insurers and reinsurers publicly committed to transitioning their underwriting portfolios to net-zero greenhouse gas (GHG) emissions by 2050, has recently lost a number of high-profile members (including five of its eight founding companies).[6] Notably, most of the departing companies have said they remain committed to their environmental goals and sustainability efforts.[7]

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[1] Many insurers are broadly subject to the EU sustainable finance package, which is also relevant to insurance intermediaries providing advice. In the EU, U.K. and other jurisdictions, regulatory attention to insurers' approaches to managing financial risks from climate change has also been increasing.

[2] The U.S. National Association of Insurance Commissioners (NAIC), whose members are state insurance regulators, continues to publish progress updates in respect of initiatives relating to race and insurance and climate and resiliency. *See* NAIC special executive committee pages on Race and Insurance and Climate and Resiliency, available here and here.

[3] In particular, climate change-related litigation, greenwashing claims, and product liability and construction claims have increased.

[4] The International Association of Insurance Supervisors (IAIS), whose members are insurance supervisors and regulators from over 200 jurisdictions, continues to prioritize climate risk and DEI efforts. The UN-convened Sustainable Insurance Forum, a leadership group of insurance supervisors and regulators in 35 jurisdictions (including the NAIC and six U.S. states), also continues to work to integrate sustainability factors into the regulation and supervision of insurance companies.

[5] In particular, this includes opportunities to capitalize on investment in climate transition technologies, innovative alternatives to traditional risk transfer solutions, and climate adaptation and resilience advisory services.

[6] Departures from the NZIA include Lloyd's of London, Axa, Allianz, Beazley, SCOR, Sompo Holdings, Munich Re, Swiss Re, Zurich Insurance, Hannover Re and QBE Insurance Group.

[7] In March 2023, Chubb announced ambitious new underwriting standards for oil and gas extraction, requiring clients to reduce methane emissions and submit evidence-based plans to manage emissions. Under the standards, the company also will not provide insurance for oil and gas projects in government-protected conservation areas in the World Database of Protected Areas that do not allow for sustainable use.

The decision to withdraw from the alliance coincided with a May 15 letter signed by 23 state attorneys general to the members of NZIA, expressing concern about whether the requirements of the alliance violate federal and state antitrust laws by unfairly or unreasonably harming competition. The attorneys general pointed to a NZIA requirement that members (i) adopt at least one of NZIA's defined climate targets, and (ii) set engagement targets to require asset managers to use leverage over companies to change behavior. They also requested documents and information describing all communications related to NZIA commitments and how they would be met, any limitations placed on reinsurance for the U.S., how membership has influenced decisions to work to reduce emissions associated with a portfolio, and any steps taken to do so (including refusing to insure individuals or activities because of their GHG emissions).

As is common when it comes to ESG matters in the U.S., though, opposing sides are imposing pressure simultaneously on insurance companies. New legislation enacted in Colorado this year will require large insurers in the state to complete the National Association of Insurance Commissioners' annual Insurer Climate Risk Disclosure Survey, which requires information on climate-related governance, strategy, risk management, investments, and metrics aligned with the Task Force on Climate-Related Financial Disclosure (TCFD). A proposed bill in Connecticut would establish a surcharge on insurers' premiums from the fossil fuel industry; the proposal calls for an annual 5% tax on any premiums an insurer licensed in Connecticut receives from fossil fuel companies.

During this year's annual meeting season, shareholders submitted ESG-related proposals at several insurance companies seeking more robust reporting and stronger climate-related commitments. A proposal submitted by As You Sow seeking a report disclosing 1.5°C aligned medium and long-term GHG targets for the company's underwriting, insuring and investment activities was voted upon at Chubb, Travelers and Berkshire Hathaway–though shareholder support levels at each company were below 30%.[8] In addition, a proposal by Green Century that would have sought to require the company to stop providing coverage to new oil and gas projects went to a vote at Travelers and The Hartford. That proposal secured even lower levels of support from shareholders during a proxy season when many climate-related proposals saw declining numbers.[9]

[8] According to As You Sow's tracker, the resolution secured 29% support at Chubb (compared to 72% support of the same proposal in 2022), 15% support at Travelers and 23% support at Berkshire Hathaway.

[9] Just 9% of shareholders at Travelers and at The Hartford supported the resolution (compared to 13% support at The Hartford of the same proposal in 2022). Chubb also received the proposal, but excluded it from the company's proxy statement after seeking and receiving no-action letter comfort from the SEC.

Key Takeaways

The political climate in the U.S. around ESG will continue to evolve (and likely become even more fraught in the near term), but in the meantime, U.S.-based insurance companies are well-served to:

- Consider the ways in which ESG models, factors and standards are incorporated into pricing, and ensure that decisions regarding those models and the underlying reasoning are well-documented.
- Understand the specific ESG-related concerns most relevant to the company's shareholders and other stakeholders, recognizing that these priorities may vary across companies within the industry.
- Remember that ESG-related activity and coordinated initiatives are subject to the same antitrust laws that apply in other circumstances, and give careful consideration to any antitrust risks before engaging in ESG-focused industry collaborations. For collaborations or commitments that are already in place, be prepared for future scrutiny around that decision-making process.

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