


D&O Heats Up



LOOKING AHEAD: Attorney Rachel S. Kronowitz, a partner with the law firm of Gilbert Randolph, sees the potential for climate change to spark future insurance claims.

Directors & Officers writers are paying close attention to the issue of climate change—not just how it could affect Earth, but how it could impact regulations and ultimately lead to future litigation and claims.

by Meg Green

Ice caps are melting and oceans are warming, but regulatory and political climate changes could have the greatest impact on insurers, especially Directors & Officers underwriters.

The insurance industry “may have more material exposures to climate change than any other sector,” said Rachel S. Kronowitz, a partner in

Climate Change:
Insurers Respond
The First Article in a Series

the Washington, D.C. law firm of Gilbert Randolph. In addition to the potential increase in property dam-

age claims from more severe weather, she believes insurers could face liability claims if their policyholders are found liable for contributing to climate change or pollution.

Insurers may face disclosure-related claims stemming from D&O policies, Kronowitz added. Also, as buyers of D&O coverage themselves, insurers’ own climate-related disclosures

The Ps and Qs of D&O

Directors & Officers coverage is often described as having three components:

Side A: Coverage available to protect the directors and officers of a company, when the company cannot legally or financially indemnify them.

Side B: Coverage for the corporation, to reimburse it for the amount it is obligated to indemnify its directors and officers.

Side C: Coverage for the entity itself, for its liability based on the actions of its employees, including directors and officers.

are likely to be scrutinized—both in the coverage they write and in the investments they make.

As major institutional investors, insurers should be tracking the climate-change-related risks of the companies they have invested in, and may also have to disclose those risks, Kronowitz said.

“The insurance industry itself may feel real direct exposure if they don’t fully disclose issues related to climate change,” Kronowitz said.

Public and private companies, including insurance companies, purchase D&O insurance to protect their leadership from lawsuits. As climate change becomes a hotter issue for regulators and lawmakers, directors and officers may find themselves facing new questions and new risks, which translates into more pressure on D&O underwriters.

“It’s going to have a substantial impact, unless companies start getting their acts together pronto,” said Rick Bortnick, an attorney with Cozen O’Connor. “The regulatory climate is changing, the political climate is changing. Shareholders from various companies have proposed resolutions about global warming, which have forced boards to take action. There’s a growing crescendo of the social, the political, the economic, the regulatory, the legislative and the judicial forces all pulling together to require companies to disclose and fix, or at least deal with, climate issues.”

Two Fronts

Directors & officers insurers are closely watching two fronts: shareholder actions and regulatory actions,

said Carol Zacharias, senior vice president of ACE USA Professional Risk.

“Underwriters are beginning to ask more and more questions. They want to know about the process, about investigation, about disclosure and about alternatives,” Zacharias said. “Right now they are asking, ‘How do we underwrite this? What questions should we be asking? What answers should we expect to get?’”

On the regulatory front, Congress is considering at least 80 bills regarding climate change—from proposals that would step up companies’ disclosure requirements to bills that involve limiting or reducing greenhouse gas emissions.

Many states and cities also have pursued caps on greenhouse gas emissions, which could make additional compliance risks for D&O writers, said Zacharias.

“We’re seeing a push on the regulatory front to try to encourage companies to manage climate

Key Points

- Insurers worry that the increasing number of shareholder resolutions related to climate change might be a harbinger of future lawsuits.
- The percentage of companies identifying climate-change related risks in their SEC reports is increasing.
- Overall, the insurance industry lags behind other industries in its reporting of climate risks.

change, and we’re seeing shareholders encourage management to disclose their plans,” Zacharias said.

There’s been a dramatic increase in shareholder resolutions relating to climate change and disclosure. Such resolutions were fairly rare—fewer than 10 in 2000 and 2001—but have grown to more than 40 in 2007, according to Evan Mills, staff scientist at Lawrence Berkeley National Laboratories.

And while insurers who underwrite D&O coverage should be paying particular attention to such resolutions—since they may be a harbinger of future lawsuits against

What Insurers Are Saying About Climate Change

“Failure to take climate change into account will put companies at risk of future legal actions from their own shareholders, their investors and clients.”

LLOYD’S

—Lloyd’s 2006 report, *Climate Change: Adapt or Bust*

“Our financial exposure from climate change is most notably associated with losses in connection with the occurrence of hurricanes striking Florida. We mitigate this risk of financial exposure from climate change by restrictive underwriting criteria, sensitivity to geographic concentrations and reinsurance.”

21st Century

—21st Century Holding Co. in its annual report filed with the SEC for 2006

“Climate change is one of the greatest challenges of our time. What we do today is crucial for future generations. Therefore, swift international action is urgently needed.”

—Munich Re board member Torsten Jeworrek in a statement June 7, 2007



“For Swiss Re, climate change is a core issue and an important element in the company’s long-term risk management strategy. Climate change has the potential to significantly shift global weather patterns, and since these shifts may affect the number and severity of natural catastrophes, the entire insurance industry is likely to be affected. According to a United Nations Environment Programme Finance Initiative report, climate-change-driven natural disasters may lead to economic losses of \$150 billion per year within the next decade.”

Swiss Re

—Swiss Re’s 2004 report, *Tackling Climate Change*

Property/Casualty

What's Ahead in 2007?

The industry gets down to business with climate-change conferences.

Aug. 9-12: James M. Davis, a managing partner with Anderson Kill and Olick in Chicago, will moderate "Global Warming Litigation After *Massachusetts v. EPA*" at the American Bar Association annual meeting in San Francisco.

Aug. 12-14: The Insurance Regulatory Examiners Society hosts its annual Career Development Seminar at the Pittsburgh Hilton. A joint session covers "whether storms and catastrophes are warning signals of destructive climate change and long-term global warming." www.go-ires.org/events/future.cfm

Sept. 9-12: The International Union of Marine Insurance hosts its annual conference in Copenhagen with the Danish Insurance Association. The conference features a session titled "Global Warming—How is Marine Exposed?" www.iumi2007.dk

Sept. 11-13: The annual conference of the Institute of Risk Management at the University of Hertfordshire in Hatfield, U.K., includes a seminar titled, "Is Climate Change a Four-Letter Word?" The first 75 delegates to book online receive a copy of Al Gore's book, *An Inconvenient Truth*. www.theirm.org/riskforum/index.html

Sept. 30-Oct. 3: The Federation of European Risk Management Associations' Risk Management Forum 2007 in Geneva includes a talk on "Climate Change and its Economic and Social Impacts." www.mega.com/index.asp/en/c/event/p/conference/a/event-conference0046.

Oct. 24-25: The United Nations Environmental Program's Finance Initiative Global Roundtable meets in Melbourne, Australia with panel sessions on "Climate Change: Financing De-Carbonization and a Clean-Tech Future," and "Financial Services, Post-2012 and the Carbon Economy."

Oct. 28-31: The Property Casualty Insurers Association of America hosts its annual meeting in Boston, featuring a session on "Climate Change: Operational Challenges and Political Fallout." Karen Clark, vice chair of cat modeler AIR Worldwide Corp., Boston, will discuss the impact of climate change on public policy solutions for catastrophe insurance.

Nov. 6, 2007: The 9th Singapore International Reinsurance Conference features a panel discussion on "Revisiting the Impact of Global Warming—Is It Time for Insurers and Reinsurers to Wake Up to the Truth?" www.sirc.com.

—Compiled by Bonnie Brewer Cavanaugh

What Are Greenhouse Gases?

Many chemical compounds found in the Earth's atmosphere act as "greenhouse gases." These gases allow sunlight to enter the atmosphere freely. When sunlight strikes the Earth's surface, some of it is reflected back toward space as infrared radiation (heat). Greenhouse gases absorb this infrared radiation and trap the heat in the atmosphere, thus causing the planet to become warmer over time, scientists believe.

Many gases exhibit these "greenhouse" properties. Some of them occur in nature, such as water vapor, carbon dioxide, methane, and nitrous oxide. Others, such as chlorofluorocarbons, are exclusively human-made.

Source: U.S. Energy Information Administration



a company's leaders—insurers may also face similar scrutiny.

In fact, shareholder resolutions about climate change have already touched a handful of insurance companies. Calvert, a family of mutual funds, withdrew climate change shareholder resolutions filed with two insurers after the companies—the Hartford Financial Services Group Inc. and Prudential Financial Inc.—agreed to improve their public reporting and disclosure regarding potential climate-change financial risks they face. The insurers also agreed to develop strategies for mitigating those risks. Ace Ltd. and Chubb have faced similar shareholder resolutions. The resolution concerning Chubb was withdrawn after it agreed to a climate-related shareholders' meeting.

Tripwires and Triggers

Mills, who has written extensively on insurance and global warming, said there will be a variety of triggers for D&O claims.

"These will tend to stem from instances where plaintiffs perceive that corporate leaders do not adequately protect shareholder value in advance of climate change," Mills said in an e-mail interview. "Triggers could include failures to predict or disclose liabilities; loss of revenues or

market share; stock price drops; bad faith; trespass; misrepresentation; reputational damage; or even business opportunities missed in the clean-tech wave. Shareholders of weather-sensitive companies (e.g. agriculture) could be affected just as much as those of polluting companies."

Also, public service D&O insurance, or the insurance carried by local government officials, is likely to be impacted, Mills said. He

Insurers Fall Behind

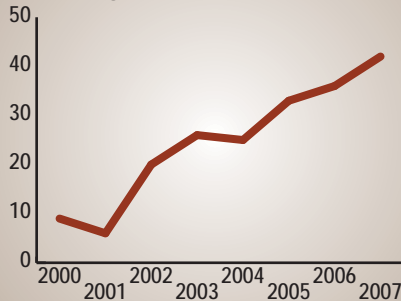
In a survey of Securities and Exchange Commission filings for 2005, the environmental group Friends of the Earth found that insurers are less likely than other industries to disclose potential climate-change-related risks:

- 100% of the 26 electric utilities surveyed disclosed climate change risks, up from 50% in 2000
- 78% of oil and gas companies disclosed climate risks, up dramatically from 44% in 2000
- 28% of petrochemical companies disclosed climate risks, up from 7% in 2000
- 26% of auto manufacturers disclosed climate risks, up slightly from 22% in 2000
- 15% of insurers disclosed climate risks, compared to 7% in 2000 filings

Source: Friends of the Earth

Shareholder Interest Rising

The number of shareholder resolutions related to climate change has been steadily increasing since 2001.



Sources: Institutional Shareholder Services; Ceres; Christina Ross, Evan Mills and Sean B. Hecht, *Limiting Liability in the Greenhouse: Insurance Risk-Management Strategies in the Context of Global Climate Change* (2007).

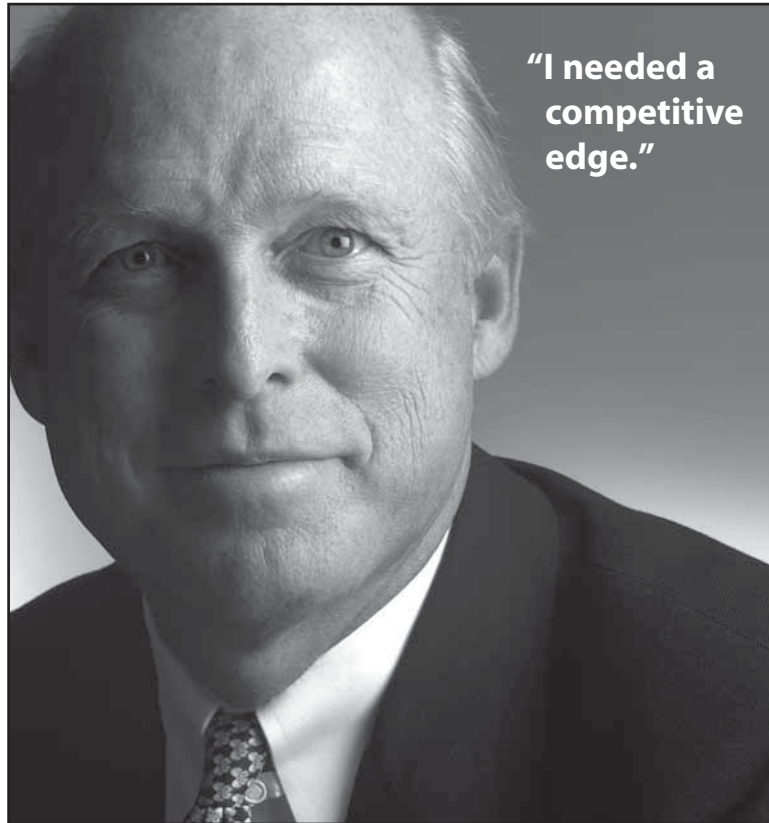
recalled recently addressing an audience of more than 150 people from Connecticut's public sector who were concerned about the various ways in which they could be impacted by climate change.

"It is just as incumbent upon them as it is upon private-sector executives to be proactive in planning for, and minimizing the costs of, climate change," Mills said.

Another sign that climate change is surfacing as a major liability issue: the increasing number of law firms creating a dedicated climate-change practice, and the number of symposiums being held related to liability and climate change (see "What's Ahead in 2007," page 26).

"People are just talking" about potential D&O claims from climate change, said David Wilde, a D&O specialist with Benfield Corporate Risk. "That's a good thing, because it's better to talk about things in advance than wait until they become the crisis."

"It's a lot of speculation right now, which is what underwriters should do," said Steve Shappell, managing director of Aon Financial Services' legal and claims practice. "People have got to be thinking about what is the exposure, so you are covered and so you are collecting premium for the risks. The speculation is that the world is going to



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start drilling down on these global warming/climate change issues. And as they do, countries will enact legislation globally and locally, and there will be greater exposure for companies to comply with those regulations.”

Disclosure Risks

Companies already are facing disclosure risks, and those risks are like-

ly to grow as disclosure requirements become more demanding.

Under current U.S. Securities and Exchange Commission regulations, companies are required to disclose known trends and uncertainties that can impact their business—including environmental and climate change issues. Now Congress is considering strengthening that language to make companies even

more forthcoming.

A study by Friends of the Earth shows that companies are disclosing climate-change-related risks to their investors at nearly twice the rate in 2005 that they did in 2000. However, the survey, which examined the SEC filings for more than 100 companies from the automobile, petrochemical, oil and gas, electric utilities and property/casualty insurance sectors,

Impact of Climate

Climate change and its possible associated risks are high priorities for property/casualty insurers and reinsurers, given the variety of related potential exposures the industry anticipates.

Ivo Menzinger, head of sustainability and climate change management with Swiss Re Group, said the issue of climate change should be viewed from two angles: its possible impact on “extreme events” and the liability risks it may pose.

Regarding the first, he pointed out that it can be difficult to separate the impact of climate change from weather cycles that occur naturally.

“We’re now in the middle of a peak cycle for hurricane intensity, so it is difficult to judge how much is due to natural cycles and how much to human activity,” he said.

Looking at liability risks, Menzinger said there are about 15 lawsuits under way in the United States that are linked to climate change. “There is absolutely evidence that there is a risk to insurers due to climate change,” he said.

Menzinger added that there is a growing consensus among insurers and reinsurers over how to deal with the climate change threat. He believes that some of the consequences of climate change will come to pass, even if greenhouse gas emissions could be reduced to zero today.

“The course of action has to run along two lines,” he said. “One is mitigation, such as reducing emissions and transitioning to a low-carbon economy.”

The other involves making buildings more resistant to strong storms, using smart zoning to avoid high-risk areas for development, and improving defenses along the coastlines.

Menzinger sees a close partnership between insurers, reinsurers and their clients regarding climate change threats.

“We have always been in this together, and the insurance industry has always been an important adviser on risk issues,” he said. “So the industry can actually prove its value once again in helping companies adapt to climate change, and on the other hand to assume their risks.”



Ivo Menzinger

Increased risks related to climate change are likely to be seen in many places around the globe, said Menzinger. Obvious problem areas will be low-lying land and coastal zones, along with polar and mountain areas susceptible to glacier and snow melt, he pointed out.

“In terms of economic consequences, it will be the poorest regions of the world, that are not as resilient as industrialized countries, that will suffer most,” he said.

Property, engineering, marine and agricultural insurance lines will be most affected. General liability, product liability and Directors & Officers lines will be prone to litigation risks, he said.

On the Case

Swiss Re has been working on the climate change threat for more than 20 years, said Menzinger. The reinsurer has incorporated climate change risks into its overall risk strategy.

Menzinger described a “four-prong approach” Swiss Re takes to climate change:

- Collaborating with universities and research institutions, and using new knowledge to change pricing and risk models;
- Developing products and services that adapt to climate change, such as insurance-linked securities, and encouraging carbon-trading exchanges and clean-energy funds;
- Acting in an advocacy role to share knowledge with governments and policy-makers;
- Keeping their own house in order. Swiss Re committed to a carbon-neutral program in 2003.

Menzinger believes his industry has unique leverage to influence the climate change debate because of its accumulated knowledge and data about natural catastrophe risks.

“Absolutely, I believe we are credible,” he said. “We have a stake in it. We have the data as to the losses. We are not going to lobby for particular solutions, but we are going to advocate the reduction of emissions.”

By adjusting prices and updating models in response to conditions in the real world, major insurers and reinsurers such as Swiss Re serve as indicators of the changing nature of natural catastrophe threats.

—David Pilla

found overall reporting rates still hover at about 49%. Additionally, the quality of disclosure continues to be uneven among reporting companies.

Another Friends of the Earth white paper that focused on 106 public property/casualty insurers' SEC filings found only nine companies—21st Century Holdings, Allianz, Arch Capital Group, Aspen Insurance, Chubb, Cincinnati Financial Corp., Millea, Everest Reinsurance and Selective Insurance Group—included climate-change reporting.

"An argument can be made that insurance companies are not directly addressing their potential exposures to climate change," said Peter M. Gilson, principal shareholder at the law firm Greenberg Traurig. "The possible effects include everything from hurricanes to floods due to rising seas, to severe weather and thunderstorms. There's lots of potential exposures—although I wouldn't say it's in the top 10 of potential threats to D&O right now."

Wilde of Benfield noted that the pressure to provide shareholders with information also increases the future threat that the information disclosed wasn't accurate. "The more you say, the more chance there is that someone will accuse you of not being accurate," Wilde said.

And because climate-related disclosures have yet to be tested in court, they may not be protected under the same safe harbor provisions that allow management to conduct good-faith discussions about a company's financial forecast.

Pollution Exclusion

In its simplest terms, climate change might be seen as caused by a form of pollution, said Wilde.

That view is based on the April 2007 U.S. Supreme Court decision in *Massachusetts v. Environmental Protection Agency*, considered a seminal event in the debate over how climate change might impact insurers. In its 5-4 decision, the court found that the EPA had vio-

lated the Clean Air Act by declining to regulate new emissions standards for carbon dioxide. Further, the court ruled that greenhouse gases are pollutants under the act.

"A lot of D&O policies have pollution exclusions, but there's many ways that they might or might not apply," said Aon Financial's Shappell. "A lot of people don't agree

with the Supreme Court. They don't want to put a pollutant label on greenhouse gases. It's different from the traditional pollutions we deal with."

He said all three types of D&O coverage (see "The Ps and Qs of D&O" on page 25) typically have a pollution exclusion. "But often there's a carve-back that says the exclusion



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won't apply to the Side A claim," Shappell said.

Many companies buy additional Side A coverage to protect their directors and officers, which generally does not have pollution exclusions, said Wilde. "The lack of the pollution exclusion has been a key selling point of these policies," he said. Wilde added that he expected the demand for Side A coverage to increase as disclosure pressures continue to heat up.

Legal Actions Underway

While it may be difficult to prove how much a single company or industry can be held responsible for climate change, a couple of lawsuits have attempted to do just that.

In *Comer v. Nationwide Mutual Insurance Co.*, a group of Mississippi homeowners sued Nationwide and a number of other insurers for allegedly failing to pay claims relating to Hurricane Katrina. The plaintiffs later amended their original complaint in order to sue oil and energy compa-

nies for allegedly engaging "in activities that have produced the greatest single source of byproducts leading to the development and increase in global warming," according to the suit. The class-action suit was filed in federal district court for the Southern District of Mississippi.

"It may be a stretch, but people are looking for other places to cover their losses," Kronowitz said about the case.

Another class-action lawsuit, *Barasich v. Columbia Gulf Transmission Co.*, was filed against a number of oil and energy companies. The suit sought to link the businesses' activities to global warming (see Legal Insight on page 96).

In what could be a sign of the times, the SEC took an enforcement action against Ashland Inc., a Kentucky-based oil company, in November for allegedly materially understating the reserves needed to do environmental remediation, which allegedly inflated the company's operating profits.

"It's not directly climate-change linked, but an indicator of SEC's scrutiny of environmental liability reporting,

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and an indicator of the SEC's willingness to hold companies responsible for environmental risk," Kronowitz said.

Change in Terms, Prices

The first stage of any potential policy change takes place when underwriters begin to ask a lot of questions, Wilde said. "Do we get to the point where underwriters start discussing exclusions? I think that's a long way off right now," he said.

It hasn't happened...yet.

"These are issues that are not quite ripe...but there is real concern that there might be real liability," Kronowitz said. 

Munich Re Sets Sights on Becoming Carbon-Neutral

Munich Re said its reinsurance operations are aiming to be climate-neutral when it comes to global reinsurance activities by 2012.

The company said its head office in Munich, where more than half of its international reinsurance work force of almost 7,000 people is based, will have a neutral position with regard to carbon dioxide by 2009.



Swiss Re announced in 2003 a 10-year plan to become greenhouse-gas neutral, while Royal & SunAlliance said it became carbon neutral in the United Kingdom in 2006.

Munich Re declined to comment on how much the project will cost. However, Michael Able, press officer at the company, said according to Munich Re's latest sustainability report, its reinsurance group produced somewhere in the region of 70,000 tons of carbon dioxide a year, and that the cost of taking care of each ton was roughly €10.

Torsten Jeworrek, board member at Munich Re, said the company is putting its money where its mouth is. "Adopting a climate-neutral position underlines that we not only play a leading role in the scientific analysis of climate change but are also doing something about it," he said.

With awareness of climate change growing, more and more insurance companies are developing insurance and

risk-management products for the low-carbon economy. Earlier this year, St. Paul Travelers Cos. introduced a new program to offer a 10% discount to drivers of hybrid-electric vehicles. In May, American International Group Inc. said it was developing a number of products, including coverages for the carbon trading market. Fireman's Fund Insurance Co., a subsidiary of German insurer Allianz S.E., has introduced a series of coverages for buildings that are green-certified, as well as for those with owners who would like to capture green benefits.

Munich Re will aim for carbon neutrality by reducing emissions per employee, using "green" power sources and investing in renewable energies, as well as tree planting schemes that are designed to lock carbon dioxide into new forests, it said in a statement.

Although the investment projects will call for a greater one-off investment than the purchase of emission certificates, they will bring the added benefit of earning interest at the market rate, the company said.

Remaining emissions will be accounted for by participating in climate-protection projects in emerging countries that comply with the Kyoto Protocol. The company will not be purchasing carbon credits.

—Marc Jones