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Climate Risk Reporting in SEC Filings of Publicly-traded Property & Casualty Insurers

Friends of the Earth (FoE) reviewed the 2004 annual SEC filings of 106 publicly-traded property and casualty insurers to determine the extent of these companies' reporting on climate change¹-related risks. FoE found that while many insurers generically describe risks due to severe weather events or catastrophes, only five companies (about 5 percent) referenced climate change issues in their SEC reporting.

Introduction

Although climate change-specific accounting requirements do not yet exist in the United States, securities disclosure rules require companies to disclose all material risks facing their firms. Indeed, some insurers are already discussing global warming in their SEC filings, indicating that climate change is in fact a material issue for the insurance industry.

In the absence of specific climate disclosure rules, these reporting companies are following general disclosure rules that prompt companies to report all material information. For example, Rule S-K, Item 303 of the Securities Act of 1933 requires publicly traded companies to disclose instances "where a trend, demand, commitment, event or uncertainty is both presently known to management and reasonably likely to have material effects on the registrant's financial condition or results of operation." The Financial Accounting Standards Board has instructed companies to disclose information if its omission or correction would probably change or influence "the judgment of a reasonable person relying upon the report."¹ Similarly, the Supreme Court has ruled that disclosure is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information available," or if "there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."² Finally, the Sarbanes-Oxley Act requires companies to "fairly present," in all material aspects, their financial conditions and results of operations, and not just follow the letter of the law.

This short briefing paper assumes that climate change can indeed be a material issue for many firms and sectors, including the insurance industry. It accompanies a larger report released by FoE in September 2005 which reviewed climate change-related disclosure in the 2004 annual Securities and Exchange Commission (SEC) filings of 112 automobile, petrochemical, integrated oil & gas, property & casualty insurance, and electric utilities companies. This insurance-

¹ FASB, Statement of Financial Accounting Concepts No. 2, Qualitative Characteristics of Accounting Information, 1980.

² TSC Industries Inc. v. Northway, Inc. 426 U.S. 438, 448 (1976)

specific briefing paper was prepared because the insurance industry provided the lowest levels of climate reporting among the five sectors surveyed. It examines the SEC filings of 106 publicly-traded property and casualty insurers to determine the extent of these companies' reporting on climate change-related risks.

The impact of climate change on the insurance sector

The increase of severe storms and weather events associated with climate change could particularly impact small or undiversified property insurers and reinsurers.³ Today, weather-related disasters occur at over five times the rate as they did 40 years ago.⁴ Munich Re's 2003 annual report notes that "what we call a hundred-year event today, will become a ten-year or 20-year event as a result of climate change." The increase in serious weather events has resulted in over 13 times more insured losses; this cost U.S. insurers \$9.2 billion per year in the 1990s. For U.S. insurers, inflation-adjusted catastrophe losses grew seven fold over the past 30 years, while the ratio of premiums to catastrophe losses fell by six fold.⁵ Globally, economic losses due to natural disasters appear to be doubling every 10 years, and by the next decade they will reach US\$150 billion per year.⁶

A 2005 climate change report issued by Germany-based insurer Allianz and environmental group WWF points out that climate change is causing an increase in severe weather events, and also warns of water shortages.⁷

Severe damage is already evident. Storms in 1999 cost 13 billion euros, floods in 2002 13 billion euros, and a heat wave in 2003 10 billion euros. A total of 14 climate-related incidents since 1987 have cost over 75 billion euros, while the annual cost of climate disasters in the EU region has doubled to 8 billion euros in 20 years. By 2070 rivers in southern Europe will be carrying half the water they do now while those in the north will be carrying half as much again. Even in regions that become drier, rainfall will be more concentrated. The risks of flooding will rise. An analysis of catastrophe damages suggests that a 1 percent increase in precipitation is associated with losses of up to 2.8 percent. Already the number of major floods in Europe has risen from one per year between 1900 and 1974 to 15 a year between 1993 and 2001.

Allianz and WWF, Climate Change and the Financial Sector, 2005

³ *Climate Change: A Risk Management Challenge for Institutional Investors*, University Superannuation Scheme (prepared by Mark Mansley and Andrew Dlugolecki), 2001.

⁴ Mills, Evan, Eugene Lecomte and Andrew Para. "U.S. Insurance Industry Perspectives on Global Climate Change," Lawrence Berkeley National Laboratory, February 2001.

⁵ Ibid.

⁶ *Climate Change and the Financial Services Industry*, United Nations Environment Programme (prepared by Innovest Strategic Value Advisors), 2002.

⁷ *Climate Change and the Financial Sector: An Agenda for Action*, "Allianz Group and WWF, June 2005. At http://www.allianz.com/Az_Cnt/az/_any/cma/contents/839000/saObj_839080_Allianz_Climate_Change_Press_Release_final_English.pdf

Disclosure Rates and Quality

Despite these trends and projections, disclosure of climate change related risks among publicly traded insurance companies in the U.S. is very poor. *Climate reporting remains very low among insurers, with only five out of 106 property & casualty insurers surveyed reporting (4.7 percent).*

Allianz, Aspen Insurance, Chubb, Cincinnati Financial Corporation, and Millea were the five companies providing climate reporting in their 2004 annual SEC filings.⁸ (It should be noted that in 2003, Allstate offered climate disclosure, but ceased to do so in 2004).

However, the quality of disclosure between these five insurers differed greatly. Chubb and Cincinnati Financial Corporation simply stated that they continue to analyze “credible scientific evidence” on climate change. This statement indicates that the companies are cognizant of climate change, but it stops short of identifying global warming as a business risk. In contrast, Allianz, Aspen Insurance, and Millea acknowledge impact of climate change on natural disaster claims.

Allianz, Aspen Insurance and Millea: Connecting the Dots on Climate

Allianz expressed a view that climate change could indeed be leading to more severe weather events, and that it represented a challenge to the insurance industry:

Natural disasters such as earthquakes, storms and floods represent a special challenge for risk management. The tsunamis in South Asia have shown how devastating the effects of such events can be across national borders. This disaster, and potential dangers from global climate changes, emphasize the significance of risk quantification and management for natural disasters. The relatively low net claims against the Allianz Group from the series of hurricanes in 2004 show that active portfolio management can reduce the effects on results by means of a selective and disciplined underwriting policy.

Allianz 2004 SEC Form 20-F

The company then continues to describe modeling techniques based on simulations or scenarios to estimate the magnitude for potential damage from natural disasters. It should be noted that in addition to the climate report that Allianz released in June 2005, the company also made a commitment to increase investments in renewable energies by 300 to 500 million euros over the next five years.⁹

US-based Aspen Insurance included climate reporting in the Key Risks portion of its SEC Form 10-K. The company particularly has exposure in California and Florida, where

⁸ Many insurers generally mentioned that an unanticipated number of natural disasters could create material adverse impacts on the firm. However, only those companies that specifically mentioned “climate change,” “global warming” or the “greenhouse” effect were considered climate reporters.

⁹ *Climate Change and the Financial Sector: An Agenda for Action*, Allianz Group and WWF, June 2005. At http://www.allianz.com/Az_Cnt/az/_any/cma/contents/839000/saObj_839080_Allianz_Climate_Change_Press_Release_final_English.pdf

earthquakes and windstorms can reach catastrophic proportions. Aspen continues by explaining the volatility of such events, and points out how climate change can exacerbate this risk:

We expect that increases in the values and concentrations of insured property will increase the severity of such occurrences per year in the future and that climate change may increase the frequency of severe weather events. Although we will attempt to manage our exposure to these events, a single catastrophic event could affect multiple geographic zones or the frequency or severity of catastrophic events could exceed our estimates, either of which could have a material adverse effect on our financial condition or results of operations.

Aspen Insurance Holdings, 2004 SEC Form 10-K

Finally, Japan-based Millea Holdings similarly described climate-related risks in the Key Risks section of its SEC filing.

Over the past several years, changing weather patterns and climatic conditions, such as global warming, have added to the unpredictability and frequency of natural disasters in certain parts of the world and created additional uncertainty as to future trends and exposures. These natural disasters can have a serious impact on property and casualty insurers, depending on the frequency, nature and scope of the disaster, the amount of insurance coverage that the insurer has written in respect to the disaster, the amount of claims for losses, the timing of claims, and the extent to which the insurer's liability is covered by reinsurance.

Millea 2004 SEC Form 20-F

Notably, Millea was the only company to actually suggest that their financial results for the past fiscal year was actually affected by climate change-related events. The company states that "Japan has been hit by more severe typhoons in the first six months of this current fiscal year than in the same period in the previous years and therefore our financial position and results of operations for the year ending March 31, 2005 could be significantly affected." Millea reports that it mitigates the effect of these disasters through adjusting premium rates and retaining reinsurance.

Climate Reporting Among Top Insurers in the Gulf States

Many of the largest homeowners' and commercial property owners' insurers in Alabama, Louisiana and Mississippi are privately held or not traded in the US. (See Appendix II for list of top homeowners' and commercial property insurers in these states.) However, the following are publicly traded and were included this review: Ace Ltd, Alfa Insurance, Alleghany Corporation, Allmerica Financial Corporation, Allstate, American International Group, Cincinnati Financial Corporation, CNA Insurance Group, Fidelity National Financial (American National Financial), Metropolitan Group (MetLife), St. Paul Travelers, United Fire & Casualty Group, and WR Berkley Corporation.

Of these 13 insurers, only one company, Cincinnati Financial Corporation, referred to climate change in its 2004 annual SEC filing. This company only mentioned that it studies climate change, but not state that it can have an effect on the firm.

Potential reasons for low climate reporting among US insurers

The vast majority of property & casualty insurers that were surveyed provided no climate-related reporting. Some companies, such as AMBAC and MGIC may have less exposure to severe weather events because of their relatively low concentration in property insurance for structures, but the general US insurance sector is probably underestimating the impacts of global warming.

A study by the Lawrence Berkeley National Laboratories attempted to identify the reason why U.S. insurers are relatively disengaged in climate risk management. One major cause is that the U.S. government has historically had a role in providing disaster prevention and recovery aid (\$119 billion from 1977-1993). Other potential reasons are that the topic of climate change creates controversy and anxiety among U.S. insurers, the job of quantifying vulnerability to climate change is difficult, and that insurers are able to manage and hedge risks with various financial instruments.¹⁰

While US insurance companies have been slow to disclose the potential ramifications of climate change on the industry, European insurance companies have taken the lead in analyzing risks due to climate change. For example, Munich Re (not traded in the US), in its annual reports cites environmental and climate expertise as one of its “core competencies.” The company illustrates its level of climate analysis when discussing Asia as one of its potential growth markets: in analyzing its prospects in that region the company mentions the spread of infectious diseases as a key issue, and notes that this phenomenon can be exacerbated by climate change. In another example of sector leadership, Swiss Re helped sponsor a joint project between Harvard Medical School and the United Nations Development Program on the impact of climate change on public health.

Conclusion

The findings of this survey suggest that the insurance sector is failing to adequately disclose climate change-related risks to their shareholders. The fact that five insurers provided climate change reporting demonstrates that some companies have recognized the risks associated with global warming, and have deemed them as materially important and worthy of shareholder disclosure. The lack of disclosure from other insurers stems from a) a potentially well-deliberated analysis that climate change is immaterial for the firm, b) the insurers’ failure to recognize the effect of global warming on their business, or c) deliberate attempts to paint overly optimistic and misleading pictures of how their companies are positioned in light of future trends and uncertainties.

¹⁰ Ibid.

Even if companies expect that global warming will not pose a material adverse risk to them, the best practice disclosure suggests that a global warming discussion with investors is warranted. For example, FoE found that several (non-insurance) companies – including BP, PG&E, Scottish Power and Suncor – all maintain that they will be unaffected by climate change, yet they still analyze and discuss global warming in their SEC filings.

Friends of the Earth believes that insurance companies should provide climate change disclosure as a matter of the shareholders' right to know. However, even with unequal levels of climate reporting among various insurers, savvy investors still may be able to distinguish the strategically-managed and well-governed firm by the company's provision or lack of climate-related disclosure.

Appendix I

Property and Casualty Insurers Reviewed (106)

For US companies, the 2004 SEC Form 10-K was used; the SEC Form 20-F or 40-F was used for foreign or Canadian companies.

ACE Ltd.	Hartford Financial Services
Affirmative Insurance Holdings	HCC Insurance Holdings Inc.
Alfa Corp.	Horace Mann Educators Corp.
Alleghany Group	Infinity Property and Casualty
Allianz AG	Kingsway Financial Services In
Allmerica Financial Corp.	Loews Corp.
Allstate Corp.	Markel Corp.
Ambac Financial	Max Re Capital Ltd.
American Financial Group Inc.	MBIA
American International Group	Meadowbrook Insurance Group
American Physicians Capital	Mercer Insurance Group Inc.
American Safety Insurance Hold	Merchants Group Inc.
Arch Capital Group Ltd.	Mercury General Corp.
Argonaut Group Inc.	Metropolitan Group (MetLife)
Aspen Insurance Holdings Ltd.	MGIC Investment Corp
AssuranceAmerica Corp.	Midland Co.
Axis Capital Holdings Ltd.	Millea Holdings Inc.
Baldwin & Lyons Inc.	Montpelier Re Holdings Ltd.
Berkshire Hathaway Inc.	National Atlantic Holdings
Bristol West Holdings Inc.	National Interstate Corp.
Chubb Corp.	National Security Group Inc.
Cincinnati Financial Corp.	Navigators Group Inc.
CNA Financial Corp.	Nymagic Inc.
CNA Surety Corp.	Odyssey Re Holdings Corp.
Commerce Group Inc.	Ohio Casualty Corp.
Converium Holding AG	Old Republic
DCAP Group Inc.	PartnerRe Ltd.
Direct General Corp.	Paula Financial
Donegal Group Inc.	Philadelphia Consolidated Hold
EMC Insurance Group Inc.	Phoenix Companies Inc.
Endurance Specialty Holdings	PICO Holdings Inc.
Erie Indemnity Co.	Platinum Underwriters Holdings
Everest Re Group	PMA Capital Corp.
Fairfax Financial Holdings Ltd	PMI Group
Fidelity National Financial	ProAssurance Corp.
First National Power Corp.	ProCentury Corp.
Fremont Michigan Insuracorp	Professionals Direct, Inc.
Gainsco Inc.	Progressive Corp.
Hallmark Financial Services	PXRE Group Ltd.
Harleysville Group Inc.	Quanta Capital Holdings Ltd.

Radian Group
RenaissanceRe Holdings Ltd.
RLI Corp.
Royal & Sun Alliance Insurance
RTW Inc.
Safeco Corp.
Safety Insurance Group Inc.
SCOR
SCPIE Holdings Inc.
SeaBright Insurance Holdings
Selective Insurance Group Inc.
Specialty Underwriters' Alliance
St. Paul Travelers Companies
State Auto Financial Corp.
Tower Group Inc.
Transatlantic Holdings Inc.
UICI
Unico American Corp.
United America Indemnity, Ltd
United Fire & Casualty Co.
Unitrin Inc.
Universal Insurance Holdings
White Mountains Insurance Group
WR Berkley Corp.
XL Capital Ltd.
Zenith National Insurance Corp
21st Century Holding Co.
21st Century Insurance Group

Appendix II
Top Homeowners' and Commercial Property Insurers by Market Share
in Alabama, Louisiana and Mississippi

From Property Casualty Insurers Association of America press release August 29, 2005.

Top Ten Homeowners Insurers by Market Share
Name/Percent Market Share

Alabama

State Farm Group 30.0%
Alfa Insurance Group 20.8%
Allstate Insurance Co Group 11.0%
Zurich Insurance Group 5.7%
St Paul Travelers Companies 3.8%
Nationwide Corporation 3.6%
United Services Automobile Association Group 3.3%
Auto Owners Group 3.1%
Country Insurance & Financial Services Group 2.1%
Cincinnati Financial Corporation 2.0%

Louisiana**

State Farm Group 34.7%
Allstate Insurance Co Group 20.8%
Louisiana Farm Bureau Mutual 6.0%
Zurich Insurance Group 4.2%
St Paul Travelers Companies 3.9%
Liberty Mutual Insurance Group 3.9%
United Services Automobile Association Group 3.4%
American International Group 2.4%
American National Financial Group 2.3%
Allmerica Financial Corporation 2.0%

Mississippi

State Farm Group 30.4%
Mississippi Farm Bureau Mutual 19.7%
Allstate Insurance Co Group 9.9%
Nationwide Corporation 7.0%
Zurich Insurance Group 5.7%
Metropolitan Group 4.3%
Shelter Insurance Companies 2.8%
United Services Automobile Association Group 2.7%
Alfa Insurance Group 2.5%
St Paul Travelers Group 1.9%

Top Ten Commercial Property Insurers by Market Share
(includes fire, allied lines and commercial multiple peril non-liability)
Name/Percent Market Share

Alabama

St Paul Travelers Companies 8.1%
Zurich Insurance Co Group 7.6%
Alfa Insurance Group 5.5%
Auto Owners Group 5.0%
State Farm Group 4.2%
FM Global Group 4.1%
Cincinnati Financial Corporation 3.6%
Alleghany Group 3.0%
Nationwide Corporation 2.8%
QBE Insurance Group Ltd. 2.7%

Louisiana

St Paul Travelers Companies 10.5%
Zurich Insurance Co Group 6.8%
State Farm Group 5.7%
American International Group 4.4%
Ace Ltd. 3.9%
United Fire & Casualty Group 3.8%
CNA Insurance Group 3.8%
Liberty Mutual Insurance Group 3.7%
FM Global Group 3.7%
Allmerica Financial Corporation 3.6%

Mississippi

St Paul Travelers Companies 10.2%
Zurich Insurance Co Group 9.2%
Mississippi Farm Bureau Mutual 7.8%
American International Group 7.1%
State Farm Group 3.9%
Nationwide Corporation 3.4%
Alleghany Group 3.3%
FM Global Group 3.1%
WR Berkley Corporation 2.5%
American Modern Insurance Group 2.3%

* This list does include the Louisiana Citizens Property Insurance Corporation (CPIC)

Appendix III Select Excerpts from 2004 SEC Annual Reports

Allianz Aktiengesellschaft – Select disclosure from 2004 SEC Form 20-F

Risk Controlling – Insurance Business - Premium Risks.

Premium risks are controlled primarily with the assistance of actuarial models used to calculate premiums and monitor claim patterns. In addition, we issue guidelines for underwriting insurance contracts and assuming insurance risks. Natural disasters such as earthquakes, storms and floods represent a special challenge for risk management. The tsunamis in South Asia have shown how devastating the effects of such events can have across national borders. This disaster, and potential dangers from global climate changes, emphasize the significance of risk quantification and management for natural disasters. The relatively low net claims against the Allianz Group from the series of hurricanes in 2004 show that active portfolio management can reduce the effects on results by means of a selective and disciplined underwriting policy. The increasing claim volume worldwide is caused by an increasing concentration of insured values, especially in endangered areas. In order to manage such risks and better estimate the potential effects of natural disasters, we use special modeling techniques in which we combine data about our portfolio (e.g. the geographic distribution of insurance amounts), with simulated natural disaster scenarios in order to estimate the magnitude for potential damage. Where such models do not exist (e.g. flood risk in Germany), we utilize a scenario-based methodology.

Aspen Insurance Holdings Ltd – select disclosure from 2004 SEC Form 10-K

Risks Related to our Company

Our financial condition and results of operations could be adversely affected by the occurrence of catastrophic events such as natural disasters.

As a part of our insurance and reinsurance operations, we have assumed substantial exposure to losses resulting from natural disasters and other catastrophic events. Catastrophes can be caused by various events, including hurricanes, earthquakes, hailstorms, explosions, severe winter weather, floods, tornadoes, and fires. The incidence and severity of such catastrophes are inherently unpredictable and our losses from catastrophes could be substantial. The occurrence of large claims from catastrophic events may result in substantial volatility in our financial condition or results of operations for any fiscal quarter or year and could have a material adverse effect on our financial condition or results of operations and our ability to write new business. In particular, we write a considerable amount of business that is exposed to Florida windstorms and California earthquakes. This volatility is compounded by accounting regulations that do not permit reinsurers to reserve for such catastrophic events until they occur. We expect that increases in the values and concentrations of insured property will increase the severity of such occurrences per year in the future and that climate change may increase the frequency of severe weather events. Although we will attempt to manage our exposure to these events, a single catastrophic event could affect multiple geographic zones or the frequency or severity of catastrophic events could exceed our

estimates, either of which could have a material adverse effect on our financial condition or results of operations. Events that are driven by Florida windstorms and earthquakes in California in particular could have a material adverse effect on our financial condition and results of operations.

Chubb Corp. - Select disclosure from 2004 SEC Form 10-K

Review of Underwriting Results by Business Unit - Catastrophe Risk Management

Our property and casualty subsidiaries have exposure to losses caused by hurricanes, earthquakes, winter storms, windstorms and other natural catastrophic events. The frequency and severity of natural catastrophes are unpredictable.

The extent of losses from a catastrophe is a function of both the total amount of insured exposure in an area affected by the event and the severity of the event. We continually assess our concentration of underwriting exposures in catastrophe exposed areas globally and develop strategies to manage this exposure through individual risk selection, subject to regulatory constraints, and through the purchase of catastrophe reinsurance. In recent years, we have invested in modeling technologies and concentration management tools that allow us to better monitor and control our accumulations of potential losses from catastrophe exposures. We maintain records showing concentrations of risk in catastrophe exposed areas such as California (earthquake and brush fires) and the gulf and east coasts of the United States (hurricanes). We also continue to explore and analyze credible scientific evidence, including the impact of global climate change, that may affect our potential exposure under insurance policies.

Cincinnati Financial Corp - Select disclosure from 2004 SEC Form 10-K

Outside Actuarial Review - HIGHLY UNCERTAIN EXPOSURES

The company uses the Risk Management Solutions and Applied Insurance Research models to evaluate exposures to a once-in-250-year event in determining appropriate reinsurance coverage programs. Reinsurance mitigates the risk of these highly uncertain exposures and limits the maximum net loss that can arise from large risks or risks concentrated in areas of exposure. In conjunction with these activities, the company also continues to explore and analyze credible scientific evidence, including the impact of global climate change, which may affect its exposure under insurance policies. Management's decisions regarding the appropriate level of property casualty risk retention are affected by various factors, including changes in the company's underwriting practices, capacity to retain risks and reinsurance market conditions. See Item 1, Reinsurance, Page 6, for a discussion of the company's 2005 reinsurance treaties.

Millea Holdings - Select disclosure from 2004 SEC Form 20-F

RISK FACTORS

Japan is prone to natural disasters that can result in substantial claims under non-life insurance policies.

Japan is subject to earthquakes, typhoons, windstorms, volcanic eruptions and other types of natural disasters, the frequency and severity of which are inherently unpredictable. Over the past several years, changing weather patterns and climatic conditions, such as global warming, have added to the unpredictability and frequency of natural disasters in certain parts of the world and created additional uncertainty as to future trends and exposures. These natural disasters can have a serious impact on property and casualty insurers, depending on the frequency, nature and scope of the disaster, the amount of insurance coverage that the insurer has written in respect of the disaster, the amount of claims for losses, the timing of claims, and the extent to which the insurer's liability is covered by reinsurance. In order to mitigate the effect of disasters, we set our premium rates at levels which we believe are adequate to accommodate the effect of disasters, and cede certain of the relevant risks to reinsurers under reinsurance policies. However, the occurrence of a natural disaster the severity of which we did not predict, or for which we were not adequately reinsured, could significantly affect our financial position and results of operations. In addition, Japan has been hit by more severe typhoons in the first six months of this current fiscal year than in the same period in the previous years and therefore our financial position and results of operations for the year ending March 31, 2005 could be significantly affected.
