ARTICLE

D&O INSURERS AS CLIMATE GOVERNANCE MONITORS

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ABSTRACT

Society's demands on corporations to address the climate crisis are falling on the shoulders of directors and officers. Directors and officers who either shrug off these challenges, or make missteps, are facing shareholder lawsuits and regulatory investigations. D&O insurers are stepping in, like they always have, to pay for claims. But inside the familiar paradigm, something different is afoot: D&O insurers are beginning to monitor their insureds' climate governance.

This Article argues that climate risk, unlike traditional corporate governance risk, threatens the financial viability of the insurance industry—increasing the incentives for D&O insurers to serve as climate governance monitors. By closely examining the intersection of D&O insurance and climate risk, this Article makes three contributions. First, it relies on qualitative interviews with insurance industry experts to provide a descriptive account of the climate risk facing the insurance industry, and how D&O insurers are starting to monitor their insureds' climate governance in response. Second, it theorizes that this trend is likely to continue, not only for the obvious reason that D&O claims relating to climate risk are increasing, but also because both insurers and insureds benefit from improving their climate governance. Third, it makes a normative argument that invites scholars and policymakers to recognize, and fortify, D&O insurers as climate governance monitors.

Global regulators and institutional investors are searching for ways to bolster boards' climate governance. D&O insurers should have a greater role in monitoring the monitors.

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INTRODUCTION

Society demands accountability for the climate crisis, and its demands have entered the boardroom. The global investment community recognizes that "climate risk is investment risk."[1] But there is more to the story than financial risk. All manner of stakeholders, including NGOs, employees, and consumers, are increasingly asking companies to reduce their environmental harms.[2] These appeals are prompting global regulators and lawmakers to focus on board oversight of climate risk.[3] Today, climate governance is a crucial pillar of corporate governance.[4]

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[1] Larry Fink, *Larry Fink's 2022 Letter to CEOs: The Power of Capitalism*, BLACKROCK, https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter [https://perma.cc/C4TY-99TX] (last visited Aug. 26, 2024); *see* CLIMATE-RELATED MKT. RISK SUBCOMM., U.S. COMMODITY FUTURES TRADING COMM'N, MANAGING CLIMATE RISK IN THE U.S. FINANCIAL SYSTEM, at i (Leonardo Martinez-Diaz & Jesse M. Keenan eds., 2020) (arguing "[c]limate change poses a major risk to the stability of the U.S. financial system and to its ability to sustain the American economy").

[2] *See* Mark Hillsdon, *Society Watch: How Employees Are Taking Their Companies to Task over Climate Change*, REUTERS (Apr. 18, 2022, 10:46 AM), https://www.reuters.com/business/sustainable-business/society-watch-how-employees-are-taking-their-companies-task-over-climate-change-2022-04-18/ [https://perma.cc/8C83-BPR5] (describing employee climate activism at Amazon); IPSOS, CLIMATE CHANGE AND CONSUMER BEHAVIOR, 2 (2019) https://www.ipsos.com/sites/default/files/ct/news/documents/2020-01/global-advisor-climate-change-consumer-behavior.pdf (reporting two thirds of adult consumers across twenty-eight countries made changes to their consumer behavior out of concern about climate change).

[3] *See, e.g.*, The Enhancement and Standardization of Climate-Related Disclosures for Investors, 89 Fed. Reg. 21668, 21671-73 (Mar. 28, 2024) (to be codified at 17 C.F.R. 210, 229, 230, 232, 239, and 249); Amanda Carter, *Corporate Climate Disclosure Has Passed a Tipping Point. Companies Need to Catch Up*, WORLD RES. INST. (May 6, 2024), https://www.wri.org/insights/tipping-point-for-corporate-climate-disclosure [https://perma.cc/DA6B-92AL] ("[D]isclosure mandates have been passed in jurisdictions on nearly every continent . . . ."). In addition to the Consumer Sustainability Reporting Directive, the EU has recently adopted Council Regulation 2020/852, 2020 O.J. (L198/13) (EU) (the "EU Taxonomy"), and Council Regulation 2019/2088, 2019 O.J. (L317/1) (EU) (the "EU Sustainable Finance Disclosure Regulation"). *See* INST. OF INT'L FIN., BUILDING A GLOBAL ESG DISCLOSURE FRAMEWORK: A PATH FORWARD 8 (2020) ("As of June 2020, we estimate that there are nearly 200 policy and regulatory measures pertaining to ESG disclosure in place across jurisdictions . . . .").

[4] *See* Cynthia A. Williams, *Fiduciary Duties and Corporate Climate Responsibility*, 74 VAND. L. REV. 1875, 1878-79 (2021) (arguing fiduciary duties of care and loyalty require directors to oversee climate risk); *see also* Shai Ganu, Hannah Summers & Christopher Au, *The Role of Boards in Climate Governance*, WTW (Jan. 16. 2024), https://www.wtwco.com/en-us/insights/2024/01/the-role-of-boards-in-climate-governance [https://perma.cc/XQ6Y-48UR] ("Climate is a board-level issue. It is widely recognized as being among the most material financial risks facing businesses — and one that will transform business models over the long term.").

In this shifting landscape, directors and officers are exposed to more legal scrutiny than ever before, including shareholder litigation and regulatory investigations.[5] These claims allege that the board's oversight duties extend to climate governance, from reducing carbon emissions to protecting biodiversity.[6] But the directors and officers under scrutiny do not bear the financial burden of defending, settling, or paying for these claims. Instead, the legal costs fall almost entirely on the insurers that issue directors and officers ("D&O") liability insurance.[7] In fact, public companies buy D&O insurance for precisely this reason: to protect their directors and officers, and the corporation itself, from the financial costs arising out of claims.[8]

D&O insurers bear the brunt of the cost of poor corporate governance.[9] In the climate context, both "good" and "bad" climate governance can have compounding effects on both sides of insurers' balance sheets.[10] "Bad" climate governance precipitates climate disasters, which simultaneously draw on numerous lines of insurance coverage and threaten insurers' diversified investments.[11] Meanwhile, "good" climate governance reduces claims and creates portfolio-spanning value for insurers.[12] Thus, scholars have theorized

5 *See* Sam Meredith, *Shell's Board of Directors Sued over Climate Strategy in a First-of-Its-Kind Lawsuit*, CNBC, https://www.cnbc.com/2023/02/09/oil-shell-board-of-directors-sued-by-investors-over-climate-strategy.html (last updated Feb. 9, 2023, 4:44 AM) [https://perma.cc/8FY4-S5QV]; Jonathan D. Brightbill, *Government Enforcers Ramp Up Climate and ESG Claim Investigation*, WINSTON & STRAWN LLP (Sept. 7, 2021), https://www.winston.com/en/blogs-and-podcasts/winston-and-the-legal-environment/government-enforcers-ramp-up-climate-and-esg-claim-investigation [https://perma.cc/9Z6G-5GVJ]; Shane Dilworth, *Fights over ESG Goals May Lead to D&O Claims*, BUS. INS. (May 1, 2024), https://www.businessinsurance.com/article/20240501/NEWS06/912364042/Fights-over-ESG-goals-may-lead-to-D&O-claims [https://perma.cc/537J-HZ8T]; Edward Kirk, *ESG Claims Under D&O Policies Will Increase Significantly in 2023*, CLYDE & CO (Jan. 4, 2023), https://www.clydeco.com/en/insights/2023/01/esg-claims-under-d-o-policies-will-increase [https://perma.cc/7WHC-M9HU].

6 *See infra* Section II.C.

7 *See infra* Section I.B.2.

8 *See* Colin T. Kemp, Alexander D. Hardiman & Jose L. Lua-Valencia, *The Private vs. Public D&O Insurance Form: Important Considerations for Companies Looking to Avoid Growing Pains*, POLICYHOLDER PULSE (May 23, 2019), https://www.policyholderpulse.com/private-public-considerations-pains [https://perma.cc/5GA8-B7AK]; *What Is D&O Insurance? Learn More About Directors & Officers Insurance*, ALLIANZ (June 2022) [hereinafter *What Is D&O Insurance?*], https://commercial.allianz.com/news-and-insights/expert-risk-articles/d-o-insurance-explained.html [https://perma.cc/6FNZ-PLWJ].

9 *See infra* Section I.B.

10 *See infra* Section III.A.

11 *See id.*

12 *See infra* Section III.A.

that insurers may be uniquely incentivized to monitor the board, and perhaps even improve climate governance.[13]

This view is consistent with a renewed hope in the ability of insurance to reduce harm as opposed to transfer risk—referred to as "insurance as regulation."[14] An emerging number of scholars argue that insurance can increase diversity, improve cybersecurity, and decrease police brutality.[15] With respect to climate change in particular, scholars have argued that insurance can provide incentives for private parties to mitigate environmental harms.[16] However, critics argue this approach is in tension with the traditional "moral hazard" problem of insurance, in which the presence of insurance coverage arguably encourages insureds to take *less* care.[17] Insurers attempt to mitigate the effects of moral hazard by using a variety of "carrots and sticks" to monitor their

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[13] *See, e.g.*, Jonathan M. Gilligan, *Carrots and Sticks in Private Climate Governance*, 6 TEX. A&M L. REV. 179, 187 (2018) (noting insurers' concerns regarding stranded assets resulting from climate change are motivating them to compel board action by threatening denial of coverage). *But see* Tom Baker & Sean J. Griffith, *The Missing Monitor in Corporate Governance: The Directors' & Officers' Liability Insurer*, 95 GEO. L.J. 1795, 1798-99, 1807 n.62 (2007) [hereinafter Baker & Griffith, *Missing Monitor*] (developing empirical findings that "D&O insurers [nonetheless] do not offer real loss prevention services or otherwise monitor corporate governance").

[14] Omri Ben-Shahar & Kyle D. Logue, *Outsourcing Regulation: How Insurance Reduces Moral Hazard*, 111 MICH. L. REV. 197, 217-28 (2012) (describing ability of insurance to regulate risk in ways superior to government regulation).

[15] *See* Kenneth S. Abraham & Daniel Schwarcz, *The Limits of Regulation by Insurance*, 98 IND. L.J. 215, 221 (2022); *see also infra* Section I.A.

[16] This scholarship is focused almost exclusively on property insurance. *See, e.g.*, Christina Ross, Evan Mills & Sean B. Hecht, *Limiting Liability in the Greenhouse: Insurance Risk-Management Strategies in the Context of Global Climate Change*, 26 STAN. ENV'T L.J. 251, 252 (2007) ("The most widely discussed insurance-related consequences of climate change are the impacts of property damage from extreme weather events."); Christopher D. Stone, *Beyond Rio: "Insuring" Against Global Warming*, 86 AM. J. INT'L L. 445, 477 (1992) ("In many ways, the application of insurance in the commercially conventional, risk-spreading sense appears quite suited to many of the perils of climate change."). One notable exception is Professors Kunreuther and Michel-Kerjan, who predicted in 2007 that D&O insurers would increase their monitoring of board oversight regarding climate risk. Howard C. Kunreuther & Erwann O. Michel-Kerjan, *Climate Change, Insurability of Large-Scale Disasters, and the Emerging Liability Challenge*, 155 U. PA. L. REV. 1795, 1841, 1846 (2007) ("We expect that insurers will be more concerned with providing D&O liability coverage to firms that they believe are not behaving responsibly in this area.").

[17] *See* William T.J. de la Mare, *Locality of Harm: Insurance and Climate Change in the 21st Century*, 20 CONN. INS. L.J. 189, 256 (2013) ("To allow climate change liability to pass to the insurance industry in the absence of *specific* policy coverage would be to indulge a massive moral hazard problem in unsustainable industry while causing valuable insurance resources to be depleted.").

insureds.[18] Examples are familiar and wide-ranging—property liability insurers require fire safety measures and conduct site inspections,[19] auto liability insurers provide credits for safe driving,[20] and so on.

These active monitoring measures may be useful for reducing loss in other insurance contexts, but Tom Baker and Sean Griffith's comprehensive empirical study concluded that "D&O insurers do almost nothing to monitor the public corporations they insure."[21] Consequently, without active monitoring, D&O insurance is merely a backstop preventing directors and officers from feeling the pressure of shareholder litigation and regulatory investigations. As Andrew Verstein has summed up, "Nearly everyone agrees that [D&O insurance] is part of the problem" contributing to poor corporate governance.[22]

Why have scholars and policymakers concluded that D&O insurers are unfit to monitor corporate boards? First, D&O insurers have traditionally lacked the incentives to monitor their insureds.[23] Although they ultimately pay for claims, they can also set their premiums to cover the cost of claims.[24] Insurance is also a competitive business, and insureds do not want their carriers prying into the inner workings of the board.[25] Second, even if they had the *incentives*, D&O insurers lack the *ability* to monitor their insureds.[26] Active monitoring is expensive and requires idiosyncratic knowledge about each insured.[27] How can D&O insurers possibly compete with the governance expertise of law firms, whose analysis is highly tailored and cloaked with attorney-client privilege?[28] Moreover, given that corporations generate value from risk-taking, D&O

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[18] *See* TOM BAKER & SEAN J. GRIFFITH, ENSURING CORPORATE MISCONDUCT: HOW LIABILITY INSURANCE UNDERMINES SHAREHOLDER LITIGATION 60 (2010) [hereinafter BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT] (defining moral hazard as "the tendency of insurance to increase loss by reducing an insured's incentive to take care to avoid loss"); *see also* discussion *infra* Section I.B.

[19] *See* Rob Galbraith, *The Power of Insurance Incentives to Promote Fire Adapted Communities*, INT'L ASS'N OF WILDLAND FIRE (June 2017), https://www.iawfonline.org/article/the-power-of-insurance-incentives-to-promote-fire-adapted-communities/ [https://perma.cc/EHN8-CRZR] ("For carriers looking to reduce their overall exposure to losses from wildland fire in a particular geographic location, a common technique is to impose some requirements to perform mitigation activities by the time the insurance policy renews (often 60 days).").

[20] *See Safe Driving Bonus Program*, ALLSTATE, https://www.allstate.com/auto-insurance/safe-driver-savings [https://perma.cc/B9J6-38ZC] (last visited Aug. 26, 2024).

[21] BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 18, at 109.

[22] Andrew Verstein, *Changing Guards: Improving Corporate Governance with D&O Insurer Rotations*, 108 VA. L. REV. 983, 985 (2022).

[23] *See infra* Section I.B.2.

[24] *See infra* Part III.

[25] *See infra* Part I; Section IV.A.

[26] *See infra* Section I.B.2.

[27] *See* Baker & Griffith, *Missing Monitor*, *supra* note 13, at 1836.

[28] *See infra* Section I.B.2.

insurance may be working as designed—giving directors the freedom to take business risks.[29] For D&O insurance, then, scholars have assumed that moral hazard may be a hardwired feature, not a bug.[30]

Board oversight of corporate governance remains one of the most salient issues in corporate law. Scholars are actively debating the virtues and vices of various external monitors.[31] Yet there is little remaining faith in the ability of D&O insurers to influence corporate boards.[32] This Article argues that the novel nature of climate risk is resurrecting the promise of D&O insurers as corporate governance monitors. By examining the intersection of D&O insurance and climate risk, this Article makes three contributions.

The first contribution is an original, empirical study of how climate risk affects the insurance industry and D&O underwriting.[33] Relying on qualitative interviews and roundtable discussions, this Article illuminates how D&O insurers are becoming monitors of their insureds' climate governance.[34] These practices, though nascent, still mark a notable departure from D&O insurers' traditionally passive approach to corporate governance; for instance, the Marsh Initiative enlists the governance expertise of law firms to help insurers underwrite environmetal, social, and governance ("ESG") risks, including

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[29] *See infra* Section I.B.2.

[30] *See infra* Section I.B.

[31] A rich literature in corporate law has addressed the promise and limitations of internal and external gatekeepers for improving corporate governance. *See, e.g.*, Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53, 54 (1986) (explaining concept of gatekeepers); JOHN C. COFFEE JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 2-3 (2006) (discussing history of auditors, attorneys, securities analysts, and credit rating in monitoring corporate governance). For a discussion of how gatekeepers protect the public interest, see John C. Coffee, *Why Do Auditors Fail? What Might Work? What Won't?*, 49 ACCT. & BUS. RSCH. 540, 540 (2019) (proposing ways to reduce gatekeeper agency costs); Merritt B. Fox, *Gatekeeper Failures: Why Important, What to Do*, 106 MICH. L. REV. 1089, 1089 (2008) ("Each of these professions can serve as a watchdog for the public."); Stavros Gadinis & Amelia Miazad, *The Hidden Power of Compliance*, 103 MINN. L. REV. 2135, 2154-56 (2019) (noting similarities between in-house compliance officers and accountants, bankers, and attorneys); Sung Hui Kim, *The Banality of Fraud: Re-Situating the Inside Counsel as Gatekeeper*, 74 FORDHAM L. REV. 983, 988 (2005) (arguing inside counsel can serve as gatekeeper); Yaron Nili, *Board Gatekeepers*, 72 EMORY L.J. 91, 96-99 (2022) (discussing limitations of independent director as gatekeeper); and Andrew F. Tuch, *Multiple Gatekeepers*, 96 VA. L. REV. 1583, 1589-91 (2010) (reviewing literature on gatekeepers).

[32] *See* Baker & Griffith, *Missing Monitor*, *supra* note 13, at 1808 ("In practice, D&O insurers do almost nothing to monitor the public corporation they insure, and D&O insurers do not condition the sale of insurance on complicance with loss prevention requirements in any systematic way.").

[33] *See infra* Parts III, IV.

[34] See *infra* Appendix A for methodology and participants. Consistent with best practices for anonymized qualitative interviews, the specific dates of the interviews have not been provided.

climate risk.[35] This Article's qualitative approach uncovers the insurance industry's approach to climate governance at a very early stage. Though many questions remain unanswered, these emerging developments invite scholarly and policy interventions at a crucial juncture—before internal practices become "hardwired."

This Article's second contribution is a rich theoretical justification for why D&O insurers are starting to incorporate climate governance into their underwriting, as well as an argument that this trend will continue.[36] As opposed to observing D&O insurers in a vacuum, this account situates them within the political economy of the insurance industry in which they operate.[37] Notoriously resistant to change, the insurance industry has lagged behind the financial industry in incorporating climate governance into their business strategies. Consequently, insurers are now facing unprecedented business, legal, and regulatory pressure to minimize their own impact on the climate crisis.[38] For the first time, shareholder and stakeholder pressure on both insureds *and* insurers to address climate risk is converging, increasing the incentives and ability of D&O insurers to monitor their insureds' climate governance.

The business model of insurance helps contextualize why climate risk is uniquely problematic for the insurance industry.[39] The financial risks arising from climate change threaten *both* sides of the insurers' balance sheet. On one hand, insurers collect premiums and promise to pay for losses arising out of

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[35] *See infra* Part IV. This Article focuses on climate risk oversight, or "climate governance." While ESG encompasses many topics, climate governance is a core pillar of ESG. *See, e.g.*, Tyson Dyck & Henry Ren, *ESG and Climate Change*, TORYS Q., https://www.torys.com/Our%20Latest%20Thinking/Publications//2021/03/esg-and-climate-change/ [https://perma.cc/J685-ZHZM] (last visited Aug. 26, 2024) ("Given the potential for climate change to drive transformation across entire economic sectors, the fact that it often dominates the environmental, social and governance (ESG) conversation is hardly surprising."); *see also* Press Release, Marsh, Marsh to Recognize Clients with Robust ESG Frameworks (Oct. 24, 2021), https://www.marsh.com/us/about/media/marsh-to-recognize-clients-with-robust-esg-frameworks.html [https://perma.cc/CXK9-X9WL] (announcing initiative wherein international law firms review, evaluate, and bolster D&O insureds' ESG frameworks).

However, D&O insurers are also monitoring their insureds' governance of social risk, especially DEI initiatives. *See, e.g.*, ADRIAN JENNER & ANOUSHKA PRAMANIK, ZURICH, WHITEPAPER ON THE ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS FOR DIRECTORS AND OFFICERS 10 (2022), https://edge.sitecorecloud.io/zurichinsur6934-zwpcorp-prod-ae5e/media/project/zurich/dotcom/products-and-services/docs/environmental-social-and-governance-considerations-for-directors-and-officers.pdf [https://perma.cc/EPZ9-4Y6A].

[36] *See infra* Parts II; Section IV.A.

[37] The term "D&O insurer" can obscure that D&O insurance is one type of insurance that major insurance companies—such as Chubb and AIG, among others—offer. The shifts in how these insurance companies monitor their own climate risk is impacting various types of insurance, including D&O. *See infra* Section IV.C.

[38] *See infra* Section IV.A.

[39] *See infra* Section IV.A.

covered claims. This is the "liabilities" side of insurers' balance sheets, which is where the corporate law literature has focused. Understanding why the insurance industry is bracing for an increase on the liabilities side of the balance sheet is not hard; climate disasters are multiplying in force and frequency around the globe.[40] However, the other side of insurers' balance sheets has gone largely unnoticed in the literature, though it is equally vulnerable to climate risk—if not more so.

On the "assets" side of the balance sheet, insurers generate profit by investing the premiums they collect; indeed, some insurers are among the largest and most diversified investors in the world. According to modern portfolio theory, such diversification is a powerful protection against risk.[41] But this logic is upended in the presence of "systematic risk" that affects the economy broadly, such as climate change. By definition, systematic risk cannot be diversified away.[42] Indeed, the largest and most diversified investors are especially exposed to such systematic risks.[43]

This Article illuminates how climate risk pressures both sides of insurers' balance sheets. These pressures are prompting insurers to develop new climate governance practices. For instance, some are instituting board-level oversight of climate risk (and ESG more broadly).[44] Others are creating executive positions

[40] *See infra* Section III.A.

[41] Harry Markowitz is the seminal contributor to modern portfolio theory. *See generally* HARRY M. MARKOWITZ, PORTFOLIO SELECTION: EFFICIENT DIVERSIFICATION OF INVESTMENTS (1959); Harry Markowitz, *Portfolio Selection*, 7 J. FIN. 77 (1952). *See also* James Hawley & Andrew Williams, *The Emergence of Universal Owners: Some Implications of Institutional Equity Ownership*, 43 CHALLENGE 43, 45 (2000); James Hawley & Andrew Williams, *Universal Owners: Challenges and Opportunities*, 15 CORP. GOVERNANCE: INT'L REV. 415, 415-16 (2007).

[42] Markowitz, *supra* note 41, at 79 (arguing returns from securities are too intercorrelated for diversification to reduce systemic risk). *See generally* JAMES P. HAWLEY & ANDREW T. WILLIAMS, THE RISE OF FIDUCIARY CAPITALISM: HOW INSTITUTIONAL INVESTORS CAN MAKE CORPORATE AMERICA MORE DEMOCRATIC 21-23 (2000) (framing environmental issues as "economy-wide, macroeconomic issues" with respect to which one company's performance impacts a universal owner's entire portfolio).

[43] For example, regulators, shareholders, NGOs, and other stakeholders are pressuring insurers not to underwrite fossil fuel companies because fossil fuel companies' activities harm insurers' underwriting *and* investment portfolios. *See infra* Section III.B. This Article acknowledges that most insurers are not yet incorporating climate risk into their investment decisions. Rather, it argues that insurers ought to do so, and that increasing pressure from stakeholders could motivate this outcome.

[44] *See* KARA VOSS, STEVEN M. ROTHSTEIN & MICHAEL PETERSON, CERES, CLIMATE RISK MANAGEMENT IN THE U.S. INSURANCE SECTOR: AN ANALYSIS OF CLIMATE RISK DISCLOSURES 23 (2023), https://assets.ceres.org/sites/default/files/reports/2023-07/Climate%20Risk%20Management%20in%20the%20US%20Insurance%20Sector.pdf [https://perma.cc/6MAY-M9Q2] (analyzing insurance companies' governance documents and concluding that "292 reports out of the 494 . . . included some kind of information on the role of the governing board in management of climate risk"); Sara Sciammacco, *New Report Highlights U.S.*

tasked with developing company-wide strategies to address climate risk.[45] Moreover, though insurance is a competitive business, insurers are starting to collaborate on climate governance through initiatives like the Forum for Insurance Transition to Net Zero ("FIT").[46]

While insurers are starting to address climate risk, D&O insurance is currently under-utilized in climate governance efforts. Therefore, this Article's third contribution is a normative argument that the insurance industry and policy makers should harness the unique potential of D&O insurers as climate governance monitors.[47] After all, D&O insurers offer a uniquely proactive solution to mitigate climate risk. As Kunreuther and Michel-Kerjan have argued, D&O insurers can incentivize boards to minimize their corporations' climate risk because they underwrite the behavior of directors and officers.[48]

This Article responds to several debates in corporate law. First, it contributes to the theory of "insurance as regulation" by arguing that D&O insurers can augment efforts by regulators to enhance boards' oversight of climate risk.[49] Second, given the salience of climate risk to shareholders, there is a renewed scholarly focus on how to encourage boards to monitor environmental externalities, though scholars have overlooked D&O insurers' potential.[50] This

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Insurance Sector's Efforts in Addressing Climate Change Risk, CERES (July 25, 2023), https://www.ceres.org/resources/news/new-report-highlights-us-insurance-sectors-efforts-in-addressing-climate-change-risk [https://perma.cc/3RC2-V7H7]; *see also* Don Jergler, *A First Look at How U.S. Insurers Are Adopting Global Climate Reporting Guidelines*, INS. J. (July 25, 2023), https://www.insurancejournal.com/news/national/2023/07/25/731967.htm [https://perma.cc/8K2G-W94M].

[45] *See* VOSS ET AL., *supra* note 44, at 25 (highlighting Argo Group's Sustainability Working Group, which includes a climate risk and sustainability officer from the executive committee).

[46] *See Forum for Insurance Transition to Net Zero*, UN ENV'T PROGRAMME FIN. INITIATIVE, https://www.unepfi.org/forum-for-insurance-transition-to-net-zero/ [https://perma.cc/PSD8-UCKR] (last visited Aug. 26, 2024). FIT evolved out of the Net-Zero Insurance Alliance (the "NZIA"), an association of thirty insurers representing 15% of global premiums that committed to net-zero greenhouse gas emissions in their underwriting and investment portfolios by 2050. *See* UN ENV'T PROGRAMME FIN. INITIATIVE, THE NET-ZERO INSURANCE ALLIANCE: STATEMENT OF COMMITMENT BY SIGNATORY COMPANIES (2021), https://www.unepfi.org/psi/wp-content/uploads/2021/07/NZIA-Commitment.pdf [https://perma.cc/YV3Y-35B8]. The NZIA was disbanded on April 25, 2024, because several major insurers left the alliance in response to pressure by Republican politicians who claimed net-zero alliances violated U.S. antitrust laws. Alastair Marsh, *Insurers Group Targeted by Anti-ESG Campaign Is Being Replaced*, BLOOMBERG (Apr. 25, 2024, 4:00 AM), https://www.bloomberg.com/news/articles/2024-04-25/insurers-group-targeted-by-anti-esg-campaign-is-being-replaced.

[47] *See infra* Section V.A.

[48] *See* Kunreuther & Michel-Kerjan, *supra* note 16, at 1856.

[49] *See infra* Section I.B.

[50] *See* SARAH BARKER, CYNTHIA WILLIAMS & ALEX COOPER, COMMONWEALTH CLIMATE & L. INITIATIVE, FIDUCIARY DUTIES AND CLIMATE CHANGE IN THE UNITED STATES 6-8 (2021),

Article argues that D&O insurers can augment other external gatekeepers in encouraging boards to monitor climate risk. Third, it contributes to the emerging literature on how large, diversified investors, like pension funds and asset managers, are disproportionately exposed to systematic risks, such as climate change.[51] Insurers, too, are highly diversified investors, but unlike other investors, they are *doubly* exposed to climate risk, because they also must pay claims on covered losses.[52] Finally, by demonstrating how underwriting decisions by D&O insurers function as effective private environmental governance, this Article adds to a small but growing literature at the intersection of corporate law and environmental law.[53]

Part I traces the theoretical roots of insurance as regulation. Part II describes the pressure on directors and officers to monitor climate risk and how those pressures are materializing into claims. Part III shows there are parallel pressures on the insurance industry to monitor climate risk. Part IV offers an original, descriptive account of efforts by the insurance industry to monitor their insureds' climate governance. Part V argues that D&O insurers are uniquely positioned to serve as climate governance monitors and offers next steps for both private and public actors toward realizing that promise.

I. THE PROMISE AND LIMITS OF INSURANCE AS REGULATION

What is the purpose of insurance? The traditional contractual conception of insurance describes it as a voluntary and bilateral agreement between the insurer and policyholder for the purpose of transferring risk and compensating victims for loss.[54] Thus, insurance law is grounded in contract theory. But there is a

https://ccli.ubc.ca/wp-content/uploads/2021/12/Fiduciary-duties-and-climate-change-in-the-United-States.pdf [https://perma.cc/DY7S-SG9Q] (arguing directors' fiduciary duty of oversight applies to climate-related risks).

[51] *See infra* Section III.B; *see also, e.g.*, Madison Condon, *Externalities and the Common Owner*, 95 WASH. L. REV. 1, 1 (2020) (arguing "diversified investors should rationally be motivated to internalize intra-portfolio negative externalities"); John Armour & Jeffrey N. Gordon, *Systemic Harms and Shareholder Value*, 6 J. LEGAL ANALYSIS 35, 54-70 (arguing for different fiduciary duty for directors to maximize portfolio values, as opposed to firm-specific shareholder value).

[52] *See infra* Part IV.

[53] Michael P. Vandenbergh, *Private Environmental Governance*, 99 CORNELL L. REV. 129, 133 (2013) (framing private environmental governance as "play[ing] the standard-setting, implementation, monitoring, enforcement, and adjudication roles traditionally played by public regulatory regimes"); *see also* Sarah E. Light & Christina P. Skinner, *Banks and Climate Governance*, 121 COLUM. L. REV. 1895, 1898 (2021) (arguing banks that "push debtors to be more environmentally responsible represent significant new forms of private environmental governance").

[54] There are other, less common conceptions of insurance, including "public utility conception," which views insurance as the sale of an essential good requiring regulation, or the "product conception," which views insurance as the sale of a tangible good regulating the quality of certain products. *See generally* Kenneth S. Abraham, *Four Conceptions of*

loftier view of insurance as a form of private regulation.[55] This view is not new, but it has recently gained momentum. The promise of insurance to *reduce* risk, as opposed to merely shift or spread risk, is wide-ranging. Proponents claim that insurance can improve health and safety, enhance cybersecurity, and even increase diversity.[56] Others caution against this exuberance and point out that because insurance is a tool for encouraging *risk-taking*, it will, by design, increase losses.[57] These critics argue that the essential feature of insurance also invites its greatest bug—moral hazard, the idea that an insured party will be inclined to take less care because it is not bearing the cost, or at least the full cost, of harm.[58] The job of insurers, then, is not to reduce the damage to zero, but to calibrate the balance between risk-taking and moral hazard to a socially optimal level.[59] They argue that it is very difficult to reduce the amount of loss to a level below that which would exist without insurance.[60]

This Part offers an introduction to the theory of insurance as regulation. Section A describes the arguments in support of this theory. Section B examines the theory's many limitations, setting the stage for this Article's key argument—the traditional limitations of insurance as regulation either do not apply, or apply less forcefully, to climate risk.

A. *The Promise of Insurance as Regulation*

Political gridlock and polarization, among other factors, have sparked renewed interest in private regulatory efforts, reviving a long-standing debate.[61]

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*Insuranc*e, 161 U. PA. L. REV. 653, 653-54 (2013) (describing different conceptions of insurance).

[55] Ben-Shahar & Logue, *supra* note 14, at 243-47 (2012) (describing ability of insurance to regulate risk in ways superior to government regulation).

[56] *See, e.g.*, John Rappaport, *How Private Insurers Regulate Public Police*, 130 HARV. L. REV. 1539, 1540 (2017); Trey Herr, *Cyber Insurance and Private Governance: The Enforcement Power of Markets*, 15 REGUL. & GOVERNANCE 98, 99 (2021); Anat Lior, *Insuring AI: The Role of Insurance in Artificial Intelligence Regulation*, 35 HARV. J.L. & TECH. 467, 471 (2022) (proposing insurance as regulatory mechanism to mitigate emerging AI risks).

[57] Abraham & Schwarcz, *supra* note 15, at 274 (2022) (arguing that because insurance is designed to promote productive risk-taking, it cannot "produce a net-positive effect on loss").

[58] Rappaport, *supra* note 56, at 1543 (describing moral hazard as "the propensity of insurance to reduce the insured's incentive to prevent harm").

[59] *See generally* Tom Baker, *On the Genealogy of Moral Hazard*, 75 TEX. L. REV. 237 (1996).

[60] Abraham & Schwartz, *supra* note 15, at 267.

[61] The focus on private versus public regulation is a core debate in corporate governance today. *See generally* Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 177 (2020) (arguing private regulatory efforts "would impede or delay legal, regulatory, and policy reforms that could provide real, meaningful protection to stakeholders"); Dorothy S. Lund, *Asset Managers as Regulators*, 171 U. PA. L. REV. 77, 137-44 (2023) (highlighting concerns with asset managers acting as

Critics warn that relying on the private sector to advance the public interest is normatively misguided and practically infeasible.[62] Proponents disagree and point to the many ways that private regulators routinely reinforce the public interest by informing, shaping, testing, refining, and legitimizing regulation.[63] For example, Michael Vandenbergh finds that private regulatory initiatives have "important effects on environmental behavior and environmental quality."[64] Relatedly, Kishanthi Parella argues that private governance can address regulatory gaps, particularly when the harm spans jurisdictions or when government regulators are too entrenched to act in the public interest.[65]

Sociologist Richard Ericson was the first to conceptualize insurance as a form of private regulation that is separate from, and collaborates with, the state.[66] Rather than adhering to the contractual theory of insurance, advocates of this view describe insurance as "a crucial form of delegated state power."[67] Insurance companies, they argue, are not merely private companies, but operate as "social institutions . . . that serve important, particularized functions in modern society—often acting as adjunct arms of governance and reflecting social and

"private regulators" in response to government dysfunction). *But see* Aneil Kovvali, *Stark Choices for Corporate Reform*, 123 COLUM. L. REV. 693, 723 (2023) (revealing false dichotomy between internal and external regulation).

[62] *See, e.g.*, Ralf Michaels, *The Mirage of Non-State Governance*, 2010 UTAH L. REV. 31, 33 (2010) (criticizing notion of non-state governance as conceptually, empirically, and normatively unattractive).

[63] *See, e.g.*, Michael P. Vandenbergh, *The Private Life of Public Law*, 105 COLUM. L. REV. 2029, 2033 (2005) (describing how private regulation reinforces public environmental law through incorporation into insurance policies); Cary Coglianese & David Lazer, *Management-Based Regulation: Prescribing Private Management to Achieve Public Goals*, 37 L. & SOC'Y REV. 691, 693 (2003) (analyzing management-based regulation in context of social goals, including pollution reduction).

[64] Vandenbergh, *supra* note 53, at 139; *see also* Pammela S. Quinn, *Regulation in the Shadows of Private Law*, 28 DUKE J. COMPAR. & INT'L L. 327, 337 (2018) (discussing Vandenbergh's analysis of private regulation's impact on environmental governance).

[65] *See* Kishanthi Parella, *Outsourcing Corporate Accountability*, 89 WASH. L. REV. 747, 767-69 (2014) (examining limitations of regulation in reducing human rights violations).

[66] *See* RICHARD V. ERICSON, AARON DOYLE & DEAN BARRY, INSURANCE AS GOVERNANCE 45 (2003) (arguing insurance acts as private form of governance). Ericson, Doyle, and Barry identify nine ways that insurance governs: it objectifies risks into degrees of chance and harm; converts risks into costs and probabilities; creates a pool of people interested in minimizing loss; protects against loss of capital; manages risk through surveillance and audit; subjects risk to contract and adjudication; offers a cultural framework for conceptions such as responsibility; offers "a social technology of justice;" and "combines aspects of collective well-being and individual liberty." *Id.* at 47-49.

[67] Tom Baker & Jonathan Simon, *Embracing Risk*, *in* EMBRACING RISK: THE CHANGING CULTURE OF INSURANCE AND RESPONSIBILITY 1, 13 (Tom Baker & Jonathan Simon eds., 2002).

commercial norms."[68] For example, various legal mandates require insurance for risky activities, and the government essentially outsources compliance monitoring to insurers.[69] Insurance scholars also point to tort law as an example of this symbiotic relationship between the government and insurers. While rare, this prosocial articulation of insurance occasionally appears in judicial opinions that distinguish insurance contracts from other purely commercial contracts.[70]

In sum, insurance-as-regulation adherents believe that their view is normatively grounded.[71] But they also support their claims with empirical accounts, both qualitative and quantitative, of how insurers use various tools to reduce socially harmful behavior.[72] These tools include underwriting, monitoring, claims management, and external advocacy.[73]

1. Underwriting

At the outset of an insurance relationship, insurers influence behavior through the way they underwrite risks. At one extreme, insurers may simply refuse to provide coverage to certain industries, locations, entities, or individuals.[74] Their sweeping authority to refuse to underwrite risks enables insurers to effectively dictate who engages in certain activities, and often whether the activity occurs

[68] Jeffrey W. Stempel, *The Insurance Policy as Social Instrument and Social Institution*, 51 WM. & MARY L. REV. 1489, 1495 (2010).

[69] *See* KENNETH S. ABRAHAM, DISTRIBUTING RISK: INSURANCE, LEGAL THEORY, AND PUBLIC POLICY 57 (1986) (describing insurance for toxic torts and environmental risks as "surrogate regulation").

[70] *See, e.g.*, Aecon Bldgs., Inc. v. Zurich N. Am., 572 F. Supp. 2d 1227, 1238 (W.D. Wash. 2008) ("[T]he 'business of insurance is one affected by the public interest.'"); Schwartz v. Liberty Mut. Ins. Co., 539 F.3d 135, 150 (2d Cir. 2008) (quoting Cates Constr., Inc. v. Talbot Partners, 980 P.2d 407, 416 (Cal. 1999)) ("Unlike most other contracts for goods or services, an insurance policy is characterized by elements of . . . public interest . . . .").

[71] *See, e.g.*, Deborah Stone, *Beyond Moral Hazard: Insurance as Moral Opportunity*, *in* EMBRACING RISK: THE CHANGING CULTURE OF INSURANCE AND RESPONSIBILITY 52, 61 (Tom Baker & Jonathan Simon eds., 2002) (arguing both private and public insurance convey normative perception through their existence and marketing); Stempel, *supra* note 68, at 1495 ("The concept I am advancing could accurately be termed the insurance policy as social instrument, . . . public policy instrument, or even political instrument.").

[72] *See* Ben-Shahar & Logue, *supra* note 14, at 228-38 (describing insurance's ability to regulate risk in ways superior to government regulation).

[73] For an overview of the ways that insurers engage in risk reduction, see *id.* at 199; and Tom Baker, *Liability Insurance as Tort Regulation: Six Ways That Liability Insurance Shapes Tort Law in Action*, 12 CONN. INS. L.J. 1, 10-12 (2005).

[74] *See* Noor Zainab Hussain & Carolyn Cohn, *Insurer AIG Steps Back from Coal, Arctic Energy Underwriting*, REUTERS (Mar. 1, 2022, 1:15 PM), https://www.reuters.com/business/sustainable-business/insurer-aig-steps-back-coal-arctic-energy-underwriting-2022-03-01/ [https://perma.cc/U2M7-TAZ6].

at all.[75] If insurers choose to underwrite risk, the terms and conditions of the insurance policy can incentivize risk reduction or encourage risk-taking. Moreover, insurers have robust tools for "information acquisition, aggregation, and prediction."[76] Motivated by a business interest to accurately price risks, insurance companies invest resources in gathering data both from and about their insureds.[77] Arguably, this access to information makes insurers superior to government actors in reducing moral hazard, as insurers use data to create an optimal level of risk and price accordingly.[78] This risk-based pricing can, of course, be inaccurate or imbued with bias,[79] but those defects also apply to government regulation. Other tools available to insurers include "experience rating," in which they offer benefits for risk-minimizing insureds, such as discounts for a good driving record.[80] A similar strategy is "feature rating," where insurers provide a discount to insureds that adopt a specific safety measure, such as a house alarm.[81]

Through underwriting, insurers often bolster the effectiveness of legal or regulatory efforts by conditioning insurance on strict compliance. Insurers also encourage compliance with voluntary codes and standards that go beyond legal mandates by incorporating them into the insurance agreement. In this regard, insurers are often creating much needed "teeth," or enforcement mechanisms, for otherwise voluntary codes of conduct, including climate risk oversight standards.[82] Therefore, insurers often augment standard-setting and safety-monitoring functions that the government traditionally performs. Through their underwriting, insurers also legitimize voluntary standards. Given the politicization of climate change, particularly in the US, insurers can play a

[75] *See* Stempel, *supra* note 68, at 1498-1501 (describing types of insurance required as condition of engaging in activities including driving, operating business, and even obtaining mortgage). Notably, some argue that we should expand the scope of mandatory insurance to other areas of harm, such as cybersecurity. *See* Minhquang N. Trang, *Compulsory Corporate Cyber-Liability Insurance: Outsourcing Data Privacy Regulation to Prevent and Mitigate Data Breaches*, 18 MINN. J.L. SCI. & TECH. 389, 409-16 (2017).

[76] Ben-Shahar & Logue, *supra* note 14, at 198.

[77] *See id.* at 218-19 (describing advantage products liability insurers have over private insurers due to use of information gathering and processing).

[78] *See id.*

[79] *See* Jeff Larson, Julia Angwin, Lauren Kirchner & Surya Mattu, *How We Examined Racial Discrimination in Auto Insurance Prices*, PROPUBLICA (Apr. 5, 2017), https://www.propublica.org/article/minority-neighborhoods-higher-car-insurance-premiums-methodology [https://perma.cc/RF7V-CY5U] (examining bias in auto insurance premiums for insureds living in minority neighborhoods).

[80] Abraham & Schwarcz, *supra* note 15, at 236.

[81] *Id.*

[82] William McGeveran, *The Duty of Data Security*, 103 MINN. L. REV. 1135, 1143 (2019) (describing insurance underwriting as complementary tool to industry standards as form of private regulation).

crucial role in legitimizing climate risk as a financial risk as opposed to merely a social value.[83]

2. Monitoring

After they issue a policy, insurers sometimes monitor their insureds' practices. Given that insurance contracts are renewed annually, insureds arguably have an incentive to heed their insurers' demands. Even in a more competitive market, there are transaction costs to switching insurers, and insureds rarely do.[84] Moreover, given their informational advantage and ability to track and compare their insureds' practices, insurers are uniquely equipped to offer their insureds valuable information about how to minimize loss. An obvious example is property insurers, who conduct site visits and provide guidance on safety measures.[85] More recently, ransomware claims have skyrocketed, prompting cyber-insurers to begin advising their insureds on best practices to protect against cyberattacks.[86]

3. Claims management

Active claims management practices by insurers can help companies reduce loss *after* an adverse event has occurred. Across industries, most insurance policies require a covered party to follow certain post-injury steps to reduce loss, or coverage may be waived.[87] A clear example is automobile insurance, in which insurance companies are heavily involved in the repair process. Ben-Shahar and Logue have found that this form of post-accident monitoring helps "reduce the magnitude" of loss.[88] The insurers' experience in dealing with similar claims may help them manage costs as well. Cyber insurance is another example. After a breach, some insurers help stem the tide by creating teams of cybersecurity, forensics, legal, and public relations experts.[89] These teams can help a breached party recover hacked information, respond to regulators, and deal with ransom demands.

[83] Roundtable Discussion # 1 with Insurance Industry Participants (Jan. 2023) (discussing unique role that insurers, as experts and trusted advisors in risk, can play in advancing public discourse on climate change as financial risk).

[84] Verstein, *supra* note 22, at 1019.

[85] Baker & Griffith, *Missing Monitor*, *supra* note 13, at 1829 n.163 (stating some property insurers require "installation of sprinkler systems to reduce the risk of fire").

[86] *See* NCC GROUP, ANNUAL THREAT MONITOR 26 (2022).

[87] Ben-Shahar & Logue, *supra* note 14, at 214.

[88] *Id.*

[89] Shauhin A. Talesh, *Data Breach, Privacy, and Cyber Insurance: How Insurance Companies Act as "Compliance Managers" for Businesses*, 43 L. & SOC. INQUIRY 417, 433 (2018). *But see* JAMES SULLIVAN & JASON R C NURSE, ROYAL UNITED SERVS. INST., UNIV. KENT, CYBER SECURITY INCENTIVES AND THE ROLE OF CYBER INSURANCE 14-17 (2020), https://static.rusi.org/246_ei_cyber_insurance_final_web_version.pdf [https://perma.cc/Q48Q-RKKD] (surveying opportunities and challenges for such efforts).

4. External efforts to mitigate loss

Outside of the insurance agreement, insurers attempt to reduce loss in other ways, including public policy advocacy and lobbying. Of course, these efforts are designed to advance the insurance industry's business interests, but they can also be prosocial when they reduce aggregate harm. For example, insurance companies were among the first to advocate for the use of airbags,[90] seat belts, and fire sprinklers.[91] In these contexts and many others, insurers use data to pinpoint which safety measures are most effective, providing "legislative blueprints" to policymakers.[92] Insurers have also formed various public-private partnerships to develop industry codes of conduct to fill regulatory gaps, particularly with respect to health and safety. The Underwriters Laboratories, created in 1894 for the purpose of developing safety standards, is one long-standing example.[93]

B. *The Limits of Insurance as Regulation*

As hope in insurance as regulation proliferates, some warn that this rosy view is bound to disappoint. Kenneth Abraham and Daniel Schwarcz have argued that, while insurance can spread risk and compensate for loss, it is woefully ill-equipped to *monitor* risk and *reduce* loss.[94] The failures are not absolute—they concede that insurance as a regulatory tool can reduce harm in certain niche cases, including police liability and legal malpractice insurance.[95] But they argue D&O insurance is not one of the exceptions to the rule.[96] Before turning to why that is so, it is important to contextualize how D&O insurance functions.

1. D&O coverage, explained

D&O insurance provides three basic types of coverage to corporate directors and officers and the companies they serve. "Side A" provides coverage for claims that would otherwise hold directors personally liable. Demand for Side A insurance increased after the Enron and WorldCom financial crisis scandals,

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[90] *See* MARTIN ALBAUM, INS. INST. FOR HIGHWAY SAFETY, SAFETY SELLS: MARKET FORCES AND REGULATION IN THE DEVELOPMENT OF AIRBAGS 35 (2005).

[91] *See* Verstein, *supra* note 22, at 1009.

[92] Ben-Shahar & Logue, *supra* note 14, at 213.

[93] UNDERWRITERS LAB'YS INC., ENGINEERING PROGRESS: THE REVOLUTION AND EVOLUTION OF WORKING FOR A SAFER WORLD 261 (2016), https://www.ul.com/sites/default/files/2019-05/EngineeringProgress.pdf.

[94] Abraham & Schwarcz, *supra* note 15, at 230-31 (describing "mixed results" from empirical studies on insurers' historical attempts to monitor risks and meaningfully reduce losses).

[95] *See id.* at 233-34; *see also* Tom Baker & Rick Swedloff, *Mutually Assured Protection Among Large U.S. Law Firms*, 24 CONN. INS. L.J. 1, 39-40 (2017) (investigating malpractice insurance effectiveness for loss reduction); Rappaport, *supra* note 56, at 1543 (describing police liability insurance as theoretical regulatory tool).

[96] *See* Abraham & Schwarcz, *supra* note 15, at 231.

in which outside directors were held personally responsible for some of the damages.[97] Side A insurance may be problematic because its presence likely increases risk to shareholders.[98] Indeed, Baker and Griffith have argued that D&O insurers do not engage in effective monitoring, resulting in a "moral hazard"[99] whereby directors and officers are not deterred by the threat of shareholder litigation because Side A insurance will cover any personal liabilities.[100]

"Side B" reimburses the company for the indemnification payments it makes to its directors and officers.[101] "Side C," or entity coverage, covers the company for claims against it.[102] For publicly-traded companies, Side C coverage is typically limited to securities law claims.[103] With Side A coverage, individual directors and officers are the insureds, whereas with Side B and C coverage, the entity is the insured. Sides B and C coverage are also subject to large deductibles, whereas Side A coverage rarely is.[104] This lack of "skin in the game" is one reason why some commentators argue that Side A coverage is designed to incentivize directors and officers to *take*, as opposed to avoid, risks.[105]

Whether a claim is covered depends on the terms of the D&O policy, but policies typically cover "wrongful acts," defined broadly as "any actual or alleged error, misstatement, misleading statement, neglect, breach of duty, omission or act by the insured employee in their capacity as such."[106] Fraud is specifically excluded, but only when a court adjudicates it as such, which rarely

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[97] *Side A Coverage: How It Can Help During and After the COVID-19 Pandemic?*, GALLAGHER, https://www.ajg.com/us/news-and-insights/2020/jun/side-a-coverage-covid-19-newsletter/ [https://perma.cc/4TZS-HZEK] (last visited Aug 26, 2024).

[98] *See* Baker & Griffith, *Missing Monitor*, *supra* note 13, at 1799.

[99] *Id.*

[100] *See id.* at 1841.

[101] *Id.* at 1802.

[102] *Id.*

[103] Priya Cherian Huskins, *The ABCs of Your Private Company D&O (Policy Terms)*, WOODRUFF SAWYER (May 7, 2014), https://woodruffsawyer.com/do-notebook/do-abc/ [https://perma.cc/XQC7-C97W].

[104] *See id.*; Baker & Griffith, *Missing Monitor*, *supra* note 13, at 1819.

[105] *See, e.g.*, Tzu-Ching Weng, Guang-Zheng Chen & Hsin-Yi Chi, *Effects of Directors and Officers Liability Insurance on Accounting Restatements*, 49 INT'L REV. ECON. & FIN. 437, 437 (2017) (finding higher levels of D&O insurance increase incidence of accounting restatements); Zhihong Chen, Oliver Zhen Li & Hong Zou, *Directors' and Officers' Liability Insurance and the Cost of Equity*, 61 J. ACCT. & ECON. 100, 100 (2016) (concluding D&O insurance increases cost of equity by mitigating disciplining effect of shareholder litigation).

[106] *Directors' and Officers' Liability Insurance*, AON, https://www.aon.com/solutions/commercial-risk/directors-officers-insurance/ [https://perma.cc/53K9-FUX6] (last visited Aug. 26, 2022).

occurs since most fraud claims settle.[107] Therefore, as a practical matter, insurers pay defense and settlement costs even for fraud claims.[108]

For most large entities, an individual insurer is not able to underwrite the entire D&O policy. As a result, D&O brokers construct "insurance towers," or several layers of primary and excess insurance coverage from different insurers.[109] Moreover, multinational companies with global subsidiaries often require an international insurance solution to protect directors and officers.[110]

2. Insurers often lack the ability and incentives to monitor their insureds

The purported limitations of insurers as effective loss monitors fall under two categories. First, insurers lack the incentive to reduce loss. Second, even if insurers had the incentive, they are ill-equipped to reduce loss. As Abraham and Schwarcz have argued, the entire purpose of insurance is "to encourage productive and valuable risk-taking."[111] Consequently, they infer that it is unsurprising that insurance cannot reduce total aggregate loss.[112] Further, corporations purchase D&O insurance, so the board can take business risks without worrying about the threat of litigation.[113]

While a shield from liability for shareholder litigation often creates business upside, it can also encourage corporate misconduct.[114] Since insurers pay the bill for this misconduct, there is little incentive for corporate actors to avoid the risk of shareholder litigation.[115] Therefore, by design, D&O insurance *increases* the risk of corporate misconduct by merely "pocket-shifting" the risk of shareholder litigation from directors and officers to D&O insurers.[116] The unfortunate result is that D&O insurance strips shareholder litigation of its sting and encourages risky behavior that runs counter to shareholder interests.[117] The resultant paradigm benefits both insurers and insureds at the expense of shareholders and society at large. For this reason, scholars have concluded that D&O insurance

[107] *See* Huskins, *supra* note 103.

[108] *See id.*

[109] *What is D&O Insurance?*, *supra* note 8.

[110] *Considering D&O Policies Outside the US?*, MARSH (May 6, 2022), https://www.marsh.com/us/services/financial-professional-liability/insights/considering-directors-and-officers-policies-outside-us.html [https://perma.cc/964Q-522A].

[111] Abraham & Schwarcz, *supra* note 15, at 219.

[112] *See id.* at 219-20.

[113] Jason Metz, *Directors and Officers (D&O) Insurance for Small Business*, FORBES, https://www.forbes.com/advisor/business-insurance/directors-and-officers-insurance/ [https://perma.cc/DS5Q-HQHK] (last updated Dec. 21, 2023, 11:29 AM) (asserting D&O insurance is prerequisite to attracting and retaining qualified executives and board members).

[114] *See* BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 18, at 10-11.

[115] *See id.* at 10-11.

[116] *See id.* at 6-7.

[117] *See id.* at 10-11.

produces "significantly greater moral hazard than more traditional corporate property and casualty insurance."[118]

Moreover, while D&O insurers may nudge corporate directors to adopt one governance practice or another, they do not typically condition insurance terms on specific governance reforms or practices.[119] The reasons are market-driven. Insurance is a highly competitive business. In a competitive market, insureds might not agree to restrictive terms in a policy when another insurer is offering a similar policy without the restrictions.[120] As Andrew Verstein has argued, even in a "hard" insurance market where insurers have the upper hand, insureds rarely switch their carriers.[121]

Even if insurers have the incentives, scholars argue that they lack the ability. After all, loss prevention and risk mitigation in the context of D&O requires governance expertise, which is amply supplied by law firms and other consultants. Unlike property damage, or even cybersecurity, where insurers' risk mitigation services may be in demand, insurers and brokers can hardly compete with sophisticated outside counsel on corporate governance.[122] This reality is exacerbated by the fact that any corporate governance gaps identified by counsel are cloaked in attorney-client privilege.[123] In comparison, loss prevention efforts by D&O insurers are weak or symbolic.[124]

All these findings are consistent with Baker and Griffith's comprehensive empirical analysis of the D&O insurance industry, in which they concluded that, far from reducing loss, D&O insurance worsens corporate governance.[125] Andrew Verstein concurs with this sobering account and argues that D&O

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[118] *Id.* at 18.

[119] *See id.* at 109 ("D&O insurers do not condition the sale of insurance on compliance with loss-prevention requirements in any systematic way.").

[120] In-person Interview with Law Firm Partner # 1 (Dec. 2021).

[121] *See* Verstein, *supra* note 22, at 1022-26 (explaining how agency and transactional costs dampen switching in competitive D&O insurance market).

[122] Online Interview with Law Firm Partner # 3 (May 2022); Online Interview with Law Firm Partner # 5 (Aug. 2022).

[123] *See* Online Interview with Law Firm Partner # 3; Online Interview with Law Firm Partner # 5 (Aug. 2022). Although information provided to underwriters can remain confidential, it does not have the same level of protection as the attorney-client privilege provides.

[124] *See* Verstein, *supra* note 22, at 1013.

[125] BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 18, at 3 ("D&O insurance significantly erodes the deterrent effect of shareholder litigation, thereby undermining its effectiveness as a form of regulation."); Baker & Griffith, *Missing Monitor*, *supra* note 13, at 1808. *See generally* Tom Baker & Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors' and Officers' Liability Insurance Market*, 74 U. CHI. L. REV. 487 (2007) [hereinafter Baker & Griffith, *Predicting Corporate Governance Risk*]; Tom Baker & Sean J. Griffith, *How the Merits Matter: Directors' and Officers' Insurance and Securities Settlements*, 157 U. PA. L. REV. 755 (2009) [hereinafter Baker & Griffith, *How the Merits Matter*].

insurance is to blame for the rather uninspiring approach many directors take toward risk oversight.[126]

What, then, must change to encourage insurers to use the tools at their disposal to improve corporate governance and reduce D&O losses? One obvious motivating factor is loss.[127] If the expected loss to the D&O insurer exceeds the value of the premiums, it will tip the scale in favor of loss monitoring. Cyber insurance is an example of this phenomenon at play. According to some coverage counsel specializing in cybersecurity risk, the loss prevention efforts imposed by cyber insurers amounted to little more than window dressing just two to three years ago.[128] Today, however, many cyber insurance underwriters condition coverage on the insured's cybersecurity protocols and processes.[129] Insurers also engage in active monitoring of their insureds' cybersecurity efforts. This shift occurred after the spike in claims, paid by insurers, to resolve ransomware attacks.[130] Analogously, as Part II details, climate-related legal and regulatory risks facing directors and officers have increased, and those risks are materializing in an increase in covered claims.[131]

II. THE MOUNTING PRESSURE ON BOARDS TO MONITOR CLIMATE RISK

This Part describes the forces that pressure boards to prioritize climate governance as a crucial pillar of corporate governance. Section A details investor pressure on boards to step up their oversight of climate risk. Section B discusses regulatory pressures on boards to disclose and mitigate climate risk. Section C explains how such regulatory pressure prompts climate governance-related D&O claims. In sum, these pressures are increasing insurers' incentives to invest in monitoring their insureds' climate governance.

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[126] Verstein, *supra* note 22, at 985.

[127] Interview with Insurance Broker # 4 (Nov. 2021); Interview with D&O Underwriter # 3 (July 2022).

[128] Interview with Law Firm Partner # 4 (Apr. 2022).

[129] Talesh, *supra* note 89, at 429-30.

[130] Interview with Law Firm Partner # 4, *supra* note 128; *see also, e.g.*, BAKER & GRIFFITH, ENSURING CORPORATE MISCONDUCT, *supra* note 18, at 44; Talesh, *supra* note 89, at 425-26 (comparing cybersecurity with D&O insurance monitoring); Abraham & Schwarcz, *supra* note 15, at 226-27, 226 n.49; Ben-Shahar & Logue, *supra* note 14, at 204 (stating business drivers, like competition and premiums, incentivize insurers to regulate insureds' risk reduction).

[131] It is not just the *quantity*, but the *quality* of ESG-related claims that is causing insurers to behave differently. *See infra* Sections II.B-C. As Part IV examines, unlike most discreet risks, ESG risks are systemic and threaten the viability of the insurance industry. *See infra* Part IV.

A. *Investor Pressure*

As BlackRock CEO Larry Fink has repeatedly stressed, "[C]limate risk is investment risk."[132] This recognition from the largest asset manager in the world is not anomalous among today's institutional investors. Climate governance has consistently been a top ESG priority for U.S. institutional investors.[133] Such investor focus on climate risk is a product of how large investors experience systematic risk.[134] Due to the rise of index investing, a small number of "universal owners" manage portfolios that are highly diversified.[135] Modern portfolio theory teaches that diversification allows universal owners to avoid idiosyncratic risks arising from a particular company or industry, but diverse portfolios are, by design, exposed to systematic or unhedgeable risks[136] that affect the entire economy.[137] Climate change is one such systematic risk.[138] While estimates vary, experts project that climate risk threatens 18% of the global GDP, with a loss of 10% of GDP forecasted for the United States.[139] Moreover, in 2023, climate disasters in the United States amounted to a combined $92.9 billion in damages in the United States alone.[140]

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[132] *See* Fink, *supra* note 1.

[133] Chris Hall, *Climate Tops ESG Priorities for US Institutional Investors*, ESG INV. (Dec. 13, 2022), https://www.esginvestor.net/climate-tops-esg-priorities-for-us-institutional-investors/ [https://perma.cc/6UZA-T5JZ]; *see also* Emirhan Ilhan, Philipp Krueger, Zacharias Sautner & Laura T. Starks, *Climate Risk Disclosure and Institutional Investors*, 36 REV. FIN. STUD. 2617, 2617 (empirical study finding "institutional investors value and demand climate risk disclosures").

[134] *See* Condon, *supra* note 51, at 5-6 (arguing "institutional investors' climate activism is motivated by their desire to mitigate climate change risks and damages to their [diversified] portfolios"); Armour & Gordon, *supra* note 51, at 53-56, 69-70 (explaining large investors' exposure to market-wide risk cannot be avoided through diversification).

[135] Condon, *supra* note 51, at 5-6 (describing "universal owners" as large institutional investors with "economy-mirroring portfolios" across industries).

[136] *Id.*

[137] *Id.* at 5-6, 17; *see* Armour & Gordon, *supra* note 51, at 54 ("[G]enuinely systemic harm will reduce expected returns across such a wide cross-section of firms as to undermine diversification."). *But see* Roberto Tallarita, *The Limits of Portfolio Primacy*, 76 VAND. L. REV. 511, 517-19 (2023) (explaining limits to portfolio primacy's meaningful impact on climate change); Marcel Kahan & Edward Rock, *Systemic Stewardship with Tradeoffs*, 48 J. CORP. L. 497, 499-500 (2023).

[138] *See* Kahan & Rock, *supra* note 137, at 499.

[139] Natalie Marchant, *This Is How Climate Change Could Impact the Global Economy*, WORLD ECON. F. (June 28, 2021), https://www.weforum.org/agenda/2021/06/impact-climate-change-global-gdp/ [https://perma.cc/N2G7-VD5M].

[140] *See* Adam B. Smith, *2023: A Historic Year of U.S. Billion-Dollar Weather and Climate Disasters*, NOAA (Jan. 8, 2024), https://www.climate.gov/news-features/blogs/beyond-data/2023-historic-year-us-billion-dollar-weather-and-climate-disasters [https://perma.cc/X8B7-BXBJ]; *see also* Damian Shepherd, *The World Paid a Huge*

To address these portfolio-wide and economy-wide impacts, investors have recognized that they need to work together, prompting the rise of Investor Climate Alliances.[141] Consider Climate Action 100+ ("Climate Action"), which represents 700 global investors and over $68 trillion in assets under management.[142] Of the three goals central to Climate Action's engagement agenda, improving climate governance—such as board oversight of climate risk—is ranked first.[143] The coalition seeks transition plans from companies for the short-term, medium-term, and long-term.[144] Similarly, the Glasgow Financial Alliance for Net Zero ("GFANZ") is a UN-backed coalition of several net zero alliances that span the financial services industry.[145] Alliances like GFANZ and Climate Action are reinforcing public regulatory efforts to address climate risk, which the next Section examines.

B. *Legal and Regulatory Changes*

1. U.S. regulators and lawmakers

In March 2024, the SEC adopted final climate disclosure rules, which have been described as "the most sweeping overhaul of corporate disclosure rules in more than a decade."[146] Consistent with the Task Force for Climate-Related

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Financial Price for Climate-Driven Extreme Weather in 2021, TIME (Dec. 26, 2021, 9:34 PM), https://time.com/6131659/climate-disaster-extreme-weather-cost/.

[141] This is a recent phenomenon. Climate Action is one of at least eight investor alliances that have formed over the past three years. *See Climate Programmes and Investor Initiatives*, PRI (Mar. 15, 2023), https://www.unpri.org/climate-change/climate-programmes-and-investor-initiatives/10745.article [https://perma.cc/L7YL-ATA3]; *see also* Amelia Miazad, *Investor Climate Alliances*, 102 WASH. U. L. REV. (forthcoming Jan. 2025) (available at https://ssrn.com/abstract=4580556).

[142] *About Climate Action 100+*, CLIMATE ACTION 100+, https://www.climateaction100.org/about/ [https://perma.cc/Y6Y9-ACKL] (last visited Aug. 26, 2024).

[143] *The Three Asks*, CLIMATE ACTION 100+, https://www.climateaction100.org /approach/the-three-asks/ [https://perma.cc/VW29-EG72] (last visited Aug. 26, 2024) (describing Climate Action's goals for its focus companies).

[144] Bailey McCann, *Investors Put New Weight Behind ESG Mandates*, PENSIONS & INV. (June 6, 2022, 12:00 AM), https://www.pionline.com/largest-money-managers/investors-put-new-weight-behind-esg-mandates/ [https://perma.cc/MS6Y-8EWR] (detailing increased influence of and demands from ESG investors).

[145] *About Us*, GFANZ, https://www.gfanzero.com/about/ [https://perma.cc/TA5J-5HUL] (last visited Aug. 26, 2024); *see also* GFANZ, 2023 PROGRESS REPORT (2023), https://assets.bbhub.io/company/sites/63/2023/11/GFANZ-2023-Progress-Report.pdf [https://perma.cc/YE88-ANFR].

[146] Douglas MacMillan & Maxine Joselow, *SEC Plans to Force Public Companies to Disclose Greenhouse Gas Emissions*, WASH. POST (Mar. 15, 2022, 6:00 AM), https://www.washingtonpost.com/business/2022/03/15/sec-climate-emissions-rule/; *see also* Press Release, U.S. SEC, SEC Proposes Rules to Enhance and Standardize Climate Related

Financial Disclosures ("TCFD") framework, disclosures must specify how the board oversees climate-related risks, including a description of board committees responsible for climate-risk oversight and the processes by which the board receives information on climate risk.[147] Legal and insurance advisors warn that directors will now owe a "heightened level of diligence."[148] The SEC has also made it easier to file shareholder proposals on ESG issues more broadly.[149] In 2023, California became the first state to enact laws requiring businesses to disclose their greenhouse gas emissions and climate-related financial risks.[150]

In opposition to these efforts, Republican politicians are enacting laws preventing companies and investors from considering ESG factors, including climate change. Think tanks such as the Heartland Institute help to facilitate this

Disclosures for Investors (Mar. 21, 2022), https://www.sec.gov/news/press-release/2022-46 [https://perma.cc/2FYE-YFY6].

[147] The Enhancement and Standardization of Climate-Related Disclosures for Investors, 17 C.F.R. §§ 210, 229, 230, 232, 239, 249 (2024); Press Release, U.S. SEC, SEC Adopts Rules to Enhance and Standardize Climate-Related Disclosures for Investors (Mar. 6, 2024), https://www.sec.gov/news/press-release/2024-31 [https://perma.cc/2LXK-KQAE]; *see also* PAUL A. DAVIES, SARAH E. FORTT & BETTY M. HUBER, LATHAM & WATKINS, THE SEC'S FINAL CLIMATE DISCLOSURE RULES: REQUIREMENTS, PRACTICALITIES, AND NEXT STEPS 4 (2024), https://www.lw.com/en/esg-resource-hub/admin/upload/SiteAttachments/the-secs-final-climate-disclosure-rules-requirements-practicalities-and-next-steps.pdf [https://perma.cc/NN49-9A7T].

[148] Lenin Lopez, *Governance Disclosure and the SEC's Proposed Climate Rules*, WOODRUFF SAWYER (May 4, 2022), https://woodruffsawyer.com/do-notebook/governance-disclosure-and-the-sec-proposed-climate-rules/ [https://perma.cc/5VEP-PRSK]; *see also Climate Change in the American Boardroom*, NACD, https://www.nacdonline.org/all-governance/governance-resources/trending-oversight-topics/climate-risk/us-climate-governance-initiative/ [https://perma.cc/6LUM-RUXQ] (last visited Aug. 26, 2024).

[149] The SEC did so by issuing a bulletin acknowledging it would "no longer focus on determining the nexus between a policy issue and the company, but will instead focus on the social policy significance of the issue that is the subject of the shareholder proposal." *Shareholder Proposals: Staff Legal Bulletin No. 14L (CF)*, U.S. SEC (Nov. 3, 2021), https://www.sec.gov/corpfin/staff-legal-bulletin-14l-shareholder-proposals [https://perma.cc/4DMJ-F8G9] (explaining shareholder proposals that raise issues with broad societal impact may no longer be excluded from shareholder meetings).

[150] Climate Corporate Data Accountability Act, S.B. 253, 2023-2024 Leg. (Cal. 2023); Greenhouse Gases: Climate-Related Financial Risk, S.B. 261, 2023-2024 Leg. (Cal. 2023); Christine Mai-Duc, *California Legislature Passes Sweeping Emissions Bill*, WALL ST. J., https://www.wsj.com/politics/policy/california-legislature-passes-sweeping-emissions-bill-398b586c (last updated Sept. 12, 2023, 8:11 PM). In New York, the State Assembly is considering requiring global fashion and apparel companies to map their supply chains, disclose critical climate risks, and publish mitigation plans. *See* Fashion Sustainability and Social Accountability Act, S.B. S4746B, 2023-2024 S., Reg. Sess. (N.Y. 2023).

"ESG backlash"[151] and have proposed model legislation to help states "fight back against progressive ESG initiatives and the attempt to redefine the purpose of businesses."[152] To date, twenty-six states have passed some form of anti-ESG legislation.[153] This reaction is taking place at all levels of the U.S. government, including through a wave of congressional hearings.[154] All in all, these conflicting legal regimes muddle boards' playbooks and increase pressure on boards to reinforce their climate governance.[155]

2. International law on climate risk monitoring

Unlike the US, in which ESG has become a partisan issue, the European Union is on the forefront of a growing global movement to transform voluntary

[151] *Conservative Attacks on Environmental, Social and Governance (ESG) Investing*, AM. OVERSIGHT, https://www.americanoversight.org/investigation/conservative-attacks-on-environmental-social-and-governance-esg-investing [https://perma.cc/5N3D-CMHR] (last updated Aug. 17, 2023); *see also Navigating State Regulation of ESG*, ROPES & GRAY, https://www.ropesgray.com/en/sites/navigating-state-regulation-of-esg [https://perma.cc/Q4WK-JHLZ] (last updated July 23, 2024).

[152] *State Pension Fiduciary Duty Act*, HERITAGE FOUND., https://www.heritage.org/article/state-pension-fiduciary-duty-act [https://perma.cc/J3UF-RUCR] (last visited Aug. 26, 2024).

[153] *Anti-ESG Legislation*, MORRISON FOERSTER, https://www.mofo.com/esg-resources/anti-esg-legislation [https://perma.cc/JSH2-JH56] (last visited Aug. 26, 2024); *see also, e.g.*, Leah Malone, Emily Holland & Carolyn Houston, *ESG Battlegrounds: How the States Are Shaping the Regulatory Landscape in the U.S.*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 11, 2023), https://corpgov.law.harvard.edu/2023/03/11/esg-battlegrounds-how-the-states-are-shaping-the-regulatory-landscape-in-the-u-s/ [https://perma.cc/9E2X-RSYG].

[154] Erik Wasson, *BlackRock, Other Investment Firms Next Target in House ESG Probe*, BLOOMBERG, https://www.bloomberg.com/news/articles/2023-12-12/blackrock-other-investment-firms-next-target-in-house-esg-probe (last updated Dec. 12, 2023, 6:17 PM); *see also* Letter from Dan Bishop, Member, House of Representatives, et al., to Mindy S. Lubber, Inv. Network Representative, N. Am., Climate Action 100+ & Simiso Nzima, Inv. Representative, N. Am., Climate Action 100+ (Dec. 6, 2022), https://nsjonline.com/wp-content/uploads/2022/12/2022-12-06-612712009-House-Republican-letter-to-Climate-Action-100.pdf [https://perma.cc/XM9J-VNNM].

[155] Due in part to the backlash against ESG and an increase in greenwashing accusations, boards must ensure that their climate commitments can be supported by data that verifies that climate risks are financially material, rather than mere values-based statements. *See* Gurbir S. Grewal, Dir., Div. of Enf't, U.S. SEC, Remarks at Ohio State Law Journal Symposium 2024: ESG and Enforcement of the Federal Securities Laws (Feb. 23, 2024), https://www.sec.gov/news/speech/grewal-ohs-022324 [https://perma.cc/PJQ6-8D8Y] (asserting company statements on climate issues must not be false or misleading because such issues are increasingly material to investors); Kevin LaCroix, *NYAG Sues Meat Company for Its Net Zero Emissions Claims*, D&O DIARY (Feb. 29, 2024), https://www.dandodiary.com/2024/02/articles/esg/nyag-sues-meat-company-for-its-net-zero-emissions-claims/ [https://perma.cc/23LN-QTLK].

ESG norms and standards into "hard law."[156] Since 2014, European companies have been required to report on various social and environmental matters.[157] In January 2022, the EU increased the reporting burden to include more rigorous and quantifiable data.[158] However, EU efforts go beyond corporate disclosure. EU regulations require large companies to ensure their own activities—and those of their supply chains—comply with human rights and environmental sustainability criteria.[159] This directive created an affirmative "corporate duty . . . to identify, prevent, mitigate and account for external harm resulting from adverse human rights and environmental impacts" in value chains.[160]

Looking beyond traditional regulatory action, the Paris Agreement was the first climate treaty to grant public and non-state actors a role, marking a new era in "polycentric" governance.[161] Indeed, nations as well as individual companies are signatories to the Agreement. Commentators have argued that climate change demands such an all-hands approach.[162] However, making empty climate commitments—or potentially even failing to fulfill earnest climate commitments—can expose companies to additional D&O liability.

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[156] HOGAN LOVELLS, NEW AND EMERGING ESG LAWS (2021), https://www.hoganlovells.com/~/media/hogan-lovells/pdf/2021%20PDFs/2021_05_05_New_and_Emerging_ESG_laws.pdf [https://perma.cc/E9C9-DM5V] (noting EU is forerunner on ESG regulatory development).

[157] Joanna Kuc, Marijn Bodelier & Alessio Gerhart Ruvolo, *EU to Make Changes to Its Sustainability Reporting Rules and Impose New Obligations on Non-European Companies*, GREENBERG TRAURIG (Sept. 28, 2022), https://www.gtlaw.com/en/insights/2022/9/eu-to-make-changes-sustainability-reporting-rules-impose-new-obligations-non-european-companies [https://perma.cc/PE44-27W2].

[158] *Id.*

[159] Press Release, Eur. Comm'n, Just and Sustainable Economy: Commission Lays Down Rules for Companies to Respect Human Rights and Environment in Global Value Chains (Feb. 23, 2022), https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1145 [https://perma.cc/V7VP-8MQN]; *see also Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and Amending Directive (EU) 2019/1937*, at 1-8, COM (2022) 71 final (Feb. 23, 2022) [hereinafter *EU Corporate Sustainability Proposal*] (proposing expansion of EU corporate sustainability due diligence requirements).

[160] *EU Corporate Sustainability Proposal*, *supra* note 159, at 4.

[161] *See* Elinor Ostrom, *A Polycentric Approach for Coping with Climate Change* 32-39 (World Bank Pol'y Rsch. Working Paper, Paper No. 5095, 2009), https://documents1.worldbank.org/curated/en/480171468315567893/pdf/WPS5095.pdf [https://perma.cc/XNP4-BR5V] (asserting polycentric approach encourages experimentation and enables comparison of different strategies across ecosystems).

[162] Charlotte Streck, *Strengthening the Paris Agreement by Holding Non-State Actors Accountable: Establishing Normative Links Between Transnational Partnerships and Treaty Implementation*, 10 TRANSNAT'L ENV'T L. 493, 496 (2021); *see also* Elinor Ostrom, *A Multi-Scale Approach to Coping with Climate Change and Other Collective Action Problems*, 1 SOLS. J. 27, 27 (2010) (declaring no country can solve global climate change problem acting alone); Ostrom, *supra* note 161.

C. *Increased Climate Risks Result in D&O Coverage Obligations*

Climate risk is starting to materialize into cognizable claims against directors and officers. Climate-related D&O claims include: (1) shareholder lawsuits, (2) shareholder activist campaigns, and (3) regulatory investigations.

1. Shareholder litigation

Event-driven securities litigation: Directors and officers of publicly traded companies can be liable under federal securities laws[163] for failing to disclose material information.[164] In the past, securities litigation largely arose out of financial misstatements.[165] If the stock price fell in response to restated financial results, shareholders would sue, often alleging that the restatement itself was an admission that directors misstated financials. More recently, shareholders have found a new avenue for securities litigation.[166] This breed of shareholder suit is often filed after the press exposes a corporate crisis, such as an environmental disaster or a sexual harassment claim.[167] The ensuing negative press tarnishes the company's reputation, precipitating a drop in the share price. Shareholders can then argue that the directors and officers concealed material financial risks, as exposed by the disaster at hand.[168]

Corporate disasters arising from climate issues are triggering an increase in so-called "event-driven" securities litigation.[169] For example, California's well-

[163] 17 C.F.R. § 240.10b-5 (2023). There is also D&O exposure for violating state securities laws or "blue sky" laws. *See also* Paul G. Mahoney, *The Origins of the Blue-Sky Laws: A Test of Competing Hypotheses*, 46 J.L. & ECON. 229, 234 (2003).

[164] Such an omission is material if "the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder." TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

[165] For a comparison of traditional "fraud on the market" securities litigation to event-driven litigation, see generally Matt Levine, *Everything Everywhere Is Securities Fraud*, BLOOMBERG (June 26, 2019, 12:01 PM), https://www.bloomberg.com/opinion/articles/2019-06-26/everything-everywhere-is-securities-fraud [https://perma.cc/5XA8-BWX3] (distinguishing traditional securities fraud cases from "event-driven" litigation). *See also* Merritt B. Fox & Joshua Mitts, *Event-Driven Suits and the Rethinking of Securities Litigation*, 78 BUS. LAW. 1, 1 (2022).

[166] These suits may be filed as either a securities class action suit (alleging harm to investors) or a shareholder derivative lawsuit (alleging harm to the company).

[167] *See* Donald C. Langevoort, *Disasters and Disclosures: Securities Fraud Liability in the Shadow of a Corporate Catastrophe*, 107 GEO. L.J. 967, 974 (2019) ("In terms of fraud-on-the-market liability exposure, disasters are an ideal, if disturbing, setting for thinking through the background norms of corporate discourse . . . .").

[168] *See id.* at 969; *see also* Kevin LaCroix, *Guest Post: "Stock Drop" Lawsuits*, D&O DIARY (June 28, 2020), https://www.dandodiary.com/2020/06/articles/securitieslitigation/guest-post-stock-drop-lawsuits/ [https://perma.cc/7TH7-QVBL].

[169] Brian Mastellone, *Environmental Event-Driven Litigation: An Evolving Risk for Directors and Officers*, ZURICH (Sept. 15, 2021),

publicized wildfires led to lawsuits against Pacific Gas & Electric Company ("PG&E"), alleging poor climate governance.[170] A unique feature of these lawsuits is that the underlying victims are not shareholders.[171] For instance, in accounting fraud cases, shareholders suffer only financial harm, and "money surely compensates for money."[172] On the other hand, in the PG&E litigation, the true victims were non-shareholders who lost their lives or their homes. Critically, as Emily Strauss points out, shareholder lawsuits involving non-shareholder victims succeed more often and garner higher settlement values.[173]

These results suggest some courts have, at least implicitly, endorsed a prosocial articulation of corporate law. In the climate context, environmental harms enabled by poor climate governance victimize non-shareholders. Thus, as Part V will argue, the "pocket-shifting" nature of D&O insurance is normatively untenable. If boards' insufficient climate governance harms society at large, the moral hazard at play is more harmful than the traditional moral hazard of reducing shareholder value.

That problem notwithstanding, scholars have found a positive correlation between good governance and avoidance of shareholder litigation.[174] Regardless, the increase in event-driven litigation is causing D&O insurance brokers to caution that policy terms "will be tested."[175] Insurance experts further

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https://insights.zurichna.com/Environmental-event-driven-litigation-An-evolving-risk-for-directors-and-officers [https://perma.cc/SY2F-TGT8].

[170] *See* Sean L. Litteral, *After the Wildfires: PG&E, Bankruptcy, and Corporate Sustainability*, 43 ENVIRONS 119, 122 (2020).

[171] Emily Strauss, *Is Everything Securities Fraud?*, 12 U.C. IRVINE L. REV. 1331, 1334 (2022) (reviewing 500 securities class actions and finding about 16.5% arose from misconduct where most direct victims were non-shareholders).

[172] Baker & Griffith, *Missing Monitor*, *supra* note 13, at 1819.

[173] Strauss, *supra* note 171, at 1346 (finding when shareholders are primary victims, cases are nearly twenty percentage points more likely to be dismissed than event-driven securities cases).

[174] Baker & Griffith, *How the Merits Matter*, *supra* note 125, at 776-77. Of course, some argue that these lawsuits are designed to line the pockets of plaintiff's attorneys, not to benefit shareholders or society. CHUBB, FROM NUISANCE TO MENACE: THE RISING TIDE OF SECURITIES CLASS ACTION LITIGATION (2019), https://www.chubb.com/content/dam/chubb-sites/chubb-com/ca-en/microsites/rims/documents/pdf/from-nuisance-to-menace--the-rising-tide-of-scas--chubb.pdf [https://perma.cc/LFQ9-YGAQ] (arguing securities class action lawsuits primarily benefit shareholder plaintiffs' lawyers).

[175] AON, CLIENT ALERT: THE NEW WAVE OF SECURITIES CLASS ACTION LITIGATION – MISMANAGEMENT OF CORPORATE EVENTS CAN CREATE VULNERABILITY 4 (2019), https://www.aon.com/getmedia/c071e33d-8469-492f-976c-b9d4378c453c/Aon-April-2019-Event-Litigation-April-Client-Alert.aspx [https://perma.cc/K9LX-LQER]; *see also* Robert D. Chesler, Dennis J. Artese & Joseph C. Vila, *D&O Coverage for Climate Change-ESG-Related Liabilities*, ANDERSON KILL (Apr. 7, 2022), https://www.andersonkill.com/Publications/D&O-Coverage-for-Climate-Change-ESG-Related-Liabilities [https://perma.cc/5VJ8-AA9B] (noting some insurers are considering climate change exclusion in D&O policies).

predict that the SEC's rules on climate-related disclosure are likely to "provide fruitful hunting grounds" for shareholder litigation.[176] In these cases, plaintiffs allege that the board's failure to disclose climate change risks caused the company's stock to trade at artificially inflated prices.[177] For example, Chemours Company stockholders sued the company in 2019 for "knowingly and systematically understat[ing] its known environmental liabilities exposure," relying on a lawsuit filed by Chemours accusing its parent company, DuPont, of secretly offloading its significant environmental liabilities onto Chemours.[178] Thus, as climate-related litigation proliferates, it builds a foundation for later lawsuits that can use the preceding cases as evidence of "red flags." With over 1,800 climate-related cases pending worldwide, and an increase in climate change legislation, we can expect this trend to continue.

Caremark: In Delaware, the landmark *Caremark* decision of 1996 instilled directors with a proactive duty to monitor corporate wrongdoing but required an exceedingly high pleading burden.[179] Accordingly, legal scholars have overwhelmingly dismissed *Caremark*'s ability to magnify board risk oversight.[180] D&O insurers could previously take some comfort from the fact that shareholders ultimately failed to meet their pleading burden in each *Caremark* case, but recent Delaware decisions are disrupting this sense of assurance. For example, in *Marchand v. Barnhill*,[181] an ice cream

[176] Kevin M. LaCroix, *Thinking About the SEC's Proposed Climate Change Disclosure Requirements*, D&O DIARY (Mar. 22, 2022), https://www.dandodiary.com/2022/03/articles/climate-change/thinking-about-the-secs-proposed-climate-change-and-greenhouse-gas-disclosure-requirements/ [https://perma.cc/4WEJ-8VTZ]. In particular, an increase in greenwashing claims is prompting warnings that insurers may introduce broader coverage exclusions. David Halbreich, Ben Fliegel & Kya Coletta, *Will SEC's Climate Disclosure Proposal Trigger D&O Coverage?*, PROPERTYCASUALTY360 (May 24, 2022, 5:00 AM), https://www.propertycasualty360.com/2022/05/24/how-the-secs-climate-disclosure-proposal-may-trigger-insurance-coverage/?slreturn=20220424154716 [https://perma.cc/8DP3-GQRN].

[177] Francis Kean, *Climate Change Litigation Threats to Directors and Officers*, WTW (Nov. 27, 2019), https://www.willistowerswatson.com/en-US/Insights/2019/11/climate-change-litigation-threats-to-directors-and-officers [https://perma.cc/7M4A-939M].

[178] Kevin M. LaCroix, *Environmental Liability-Related Securities Suit Filed Against DuPont Spin-Off Chemours*, D&O DIARY (Oct. 13, 2019), https://www.dandodiary.com/2019/10/articles/environmental-liability/environmental-liability-related-securities-suit-filed-against-dupont-spin-off-chemours/ [https://perma.cc/4WVK-CJJH].

[179] *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996).

[180] *See generally* Jennifer Arlen, *The Story of* Allis-Chalmers*,* Caremark*, and* Stone*: The Directors' Evolving Duty to Monitor*, *in* CORP. L. STORIES 323 (J. Mark Ramseyer ed., 2009) (arguing importance of *Caremark* may have been exaggerated). *But see* Claire A. Hill, Caremark *as Soft Law*, 90 TEMP. L. REV. 681, 687-88 (2018) (arguing *Caremark* has meaningful impact on how boards oversee risk).

[181] 212 A.3d 805 (Del. 2019).

manufacturer's listeria outbreak led to deaths, a product recall, and a stock price plummet.[182] The Delaware Supreme Court held that the plaintiffs adequately pleaded the claim that the board failed to oversee food safety.[183] *Marchand* introduced the concept of "mission-critical" business functions that require enhanced board oversight because they are, or should be, so central to the company's business operation that compliance with them is an absolute necessity; here, food safety was the "mission-critical" sector of business.[184] As Cynthia Williams has argued, oversight of climate risk is arguably becoming "mission-critical" for every company, requiring active monitoring by the board.[185]

Subsequent cases warn that *Marchand* is not an anomaly.[186] As Roy Shapira has argued, we are amid a "new *Caremark* era"[187] propelled by the Delaware court's increasingly receptive posture toward Section 220 demands in *Caremark* cases. These demands allow stockholders to examine corporate documents, such as board minutes and directors' personal emails, placing boards' risk oversight processes in the spotlight.[188] Though a series of cases limited *Caremark*'s scope to legal violations, the new line of cases holding that *Caremark* applies to

[182] *Id.* at 809 (reversing denial of motion to dismiss in food safety context).

[183] *Id.*

[184] *See id.*; *see also* SARAH BARKER, CYNTHIA WILLIAMS & ALEX COOPER, COMMONWEALTH CLIMATE & L. INITIATIVE, FIDUCIARY DUTIES AND CLIMATE CHANGE IN THE UNITED STATES 4 (2021), https://ccli.ubc.ca/wp-content/uploads/2021/12/Fiduciary-duties-and-climate-change-in-the-United-States.pdf [https://perma.cc/HJ6P-7Z9C].

[185] *See* BARKER ET AL., *supra* note 184, at 4; Jonathan Drimmer, Paul Hastings, Yousuf Aftab, Enodo Rights & Atelier Aftab; *ESG and Mission-Critical Issues for Director & Officer Liability*, CORP GOV (2019), https://corpgov.com/esg-and-mission-critical-issues-for-director-officer-liability/ [https://perma.cc/JP9E-YAUU] ("For global companies across sectors, a growing array of ESG issues increasingly play a similar [mission-critical] role and are increasingly being regulated as such."); *see also* Cole A. Gray, Note, *More Than Mission Critical: Climate Enterprise Risk as Socially Critical*, 57 U.C. DAVIS L. REV. 3169, 3174 (2024) (arguing climate change risk should be considered "mission critical" for most companies).

[186] Roy Shapira, *A New* Caremark *Era: Causes and Consequences*, 98 WASH. U. L. REV. 1857, 1859 (2021); *see also In re* Clovis Oncology, Inc. Derivative Litig., No. 2017-0222, 2019 WL 4850188, at *10 (Del. Ch. Oct. 1, 2019) (denying motion to dismiss in pharmaceutical regulatory approval context); *In re* Boeing Co. Derivative Litig., C.A. No. 2019-0907, 2021 WL 4059934, at *1 (Del. Ch. Sept. 7, 2021); Hughes v. Xiaoming Hu, No. 2019-0112, 2020 WL 1987029, at *1 (Del. Ch. Apr. 27, 2020) (denying motion to dismiss in financial reporting and oversight context); Inter-Mktg. Grp. USA, Inc. *ex rel.* Plains All Am. Pipeline, L.P. v. Armstrong, C.A. No. 2017-0030, 2020 WL 756965, at *1 (Del. Ch. Jan. 31, 2020) (denying motion to dismiss in part in environmental compliance context).

[187] Shapira, *supra* note 186, at 1860 ("Delaware courts have been carving a constantly-growing exception to the deferential standard, in the form of 'mission critical compliance': in situations where meeting certain regulatory demands is critical to the firm's success, directors should be especially alert to yellow and red flags, and proactively monitor compliance.").

[188] *See id.* at 1867.

"mission-critical" risks is causing scholars and legal experts to wonder if the restriction is obsolete.[189] As the court in *Boeing* explained, "[T]he fact that the company's product facially satisfies regulatory requirements does not mean that the board has fulfilled its oversight obligations to prevent corporate trauma."[190] The *Boeing* holding, which led to the largest *Caremark* settlement in Delaware history, emphasized the absence of a board committee tasked with overseeing airplane safety and the lack of information the board received on airplane safety,[191] placing increased scrutiny on how boards oversee "mission critical risks."[192]

In sum, *Caremark* liability for boards "remains exceedingly rare," but legal advisors warn it is "the obvious cause of action for plaintiffs seeking to complain about board inaction in the face of climate-related exposure, or in response to high-profile corporate trauma."[193] This blurring of the lines between legal and enterprise risk is prompting commentators[194] and practitioners[195] to warn that directors have a duty to oversee climate change risks and ESG risks more broadly. Further, under the *Caremark* standard, underlying lawsuits are themselves red flags to which boards must respond.[196] Given the increase in lawsuits on environmental damage, the "red flags" will increase, signaling to investors that the time is ripe for shareholder lawsuits. For all these reasons,

[189] *See* Roy Shapira, *Mission Critical ESG and the Scope of Director Oversight Duties*, 2022 COLUM. BUS. L. REV. 732, 790 (arguing *Caremark* analysis is properly applied to ESG issues because it focuses on the process of board and managerial decision-making as opposed to the merits of a course of action); Gray, *supra* note 185, at 20-24 (arguing *Citigroup*'s distinction between legal and business risk under *Caremark* is irrelevant because, among other reasons, *Citigroup* is founded on business judgment rule, while *Caremark* does not or should not implicate business judgment rule).

[190] *In re* Boeing Co. Derivative Litig., 2021 WL 4059934, at *28.

[191] *Id.* at *5 ("None of Boeing's Board committees were specifically tasked with overseeing airplane safety, and every committee charter was silent as to airplane safety.").

[192] Jeff Montgomery, *Chancery OKs Record $237.5M Boeing 737 Max Damage Deal*, LAW360 (Feb. 23, 2022, 8:53 PM), https://www.law360.com/articles/1467870/chancery-oks-record-237-5m-boeing-737-max-damage-deal.

[193] William Savitt, *Wachtell Lipton Discusses Tectonic Forces to Watch in Corporate Litigation*, CLS BLUE SKY BLOG (Jan. 30, 2020), https://clsbluesky.law.columbia.edu/2020/01/30/wachtell-lipton-discusses-tectonic-forces-to-watch-in-corporate-litigation/ [https://perma.cc/MN87-J495].

[194] *See* Gray, *supra* note 185, at 20-21 (arguing climate risk should be considered mission critical for most companies because distinction in *Citigroup* between legal and enterprise risk is obsolete).

[195] DEBEVOISE & PLIMPTON LLP, THE DUTY OF US COMPANY DIRECTORS TO CONSIDER RELEVANT ESG FACTORS 7 (2020), https://www.unpri.org/download?ac=11696 [https://perma.cc/3SJ6-3ERJ].

[196] *See* Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 369 (Del. 2006); *In re* Lear Corp. S'holder Litig., 967 A.2d 640, 654-55 (Del. Ch. 2008).

D&O insurers and brokers are bracing for an increase in *Caremark* lawsuits alleging board failures to oversee "mission-critical" climate change risks.[197]

International D&O litigation: Louise Fournier, legal counsel for Greenpeace International, predicts "[c]ommunities impacted by the climate emergency and shareholders will increasingly sue directors, officers, and board members of large polluting companies."[198] Indeed, on February 9, 2023, ClientEarth—a UK-based environmental law charity—filed a derivative suit against Shell's directors for failing to adopt a strategy that "truly aligns" with both the 2015 Paris Agreement and the company's legal obligation to reduce its greenhouse gases by 45% by 2030.[199] Similar cases in France, the Netherlands, Germany, and Australia allege that governments and private companies are not living up to the commitments they made to meet the Paris Agreement's goals.[200] These suits are revealing a new line of exposure for boards that make empty promises on climate practices. Indeed, the Bank of England recently warned that the biggest exposure for D&O policies today is climate litigation, including greenwashing allegations.[201]

2. Shareholder proposals & director 'no' votes

The increase in shareholder activism on ESG issues is impacting D&O insurance. In 2023, shareholders filed a record 630 proposals relating to

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[197] Priya Cherian Huskins, *Duty of Oversight Claims: Hard to Prove but Boards Need to Be Proactive*, WOODRUFF SAWYER (Mar. 3, 2021), https://woodruffsawyer.com/do-notebook/duty-oversight-claims-proactive/ [https://perma.cc/BJ5B-9ZLC].

[198] Isabella Kaminski, *Legal Action Against Shell Board Previews Wave of Lawsuits Against Company Directors*, DESMOG (Mar. 15, 2022, 12:59 PM PDT), https://www.desmog.com/2022/03/15/client-earth-shell-board-climate-lawsuits-directors/ [https://perma.cc/D9Q2-AKE4].

[199] James Denison, *ClientEarth v Shell: Alleged Breaches of Board Duties*, WEIGHTMANS (Mar. 24, 2022), https://www.weightmans.com/insights/clientearth-v-shell-alleged-breaches-of-board-duties/ [https://perma.cc/S22S-3TZ7]; *see also* Sam Meredith, *Shell's Board of Directors Sued Over Climate Strategy in a First-of-Its-Kind Lawsuit*, CNBC (Feb. 9, 2023, 4:44 AM), https://www.cnbc.com/2023/02/09/oil-shell-board-of-directors-sued-by-investors-over-climate-strategy.html [https://perma.cc/UU6E-Q6ZR] (last updated Feb. 9, 2023, 4:44 AM); Press Release, ClientEarth, We're Taking Legal Action Against Shell's Board for Mismanaging Climate Risk (Mar. 15, 2022), https://web.archive.org/web/20220315105955/https://www.clientearth.org/latest/latest-updates/news/we-re-taking-legal-action-against-shell-s-board-for-mismanaging-climate-risk/.

[200] Denison, *supra* note 199 (noting *Shell* litigation "is the latest in a developing line of global jurisprudence").

[201] *Climate Biennial Exploratory Scenario: Insurance Insights – Speech by Stefan Claus*, BANK OF ENG. (June 8, 2022), https://www.bankofengland.co.uk/speech/2022/june/anna-sweeney-speech-at-the-association-of-british-insurers-climate-change-summit-2022 [https://perma.cc/8KXC-3QQY].

environmental and social issues, 368 of which were voted on ballots.[202] Of those "E&S" proposals, 139 of them focus on climate change, which continued to constitute the biggest single topic.[203] However, the average vote dropped to 22.3% from its peak of just over 50% in 2021.[204] In recent years, institutional investors have been increasingly willing to use the power of their vote. For example, in the 2022 proxy season, BlackRock voted against 176 directors and 234 companies on climate-related issues.[205] Similarly, in a 2022 letter, State Street emphasized that it would use its proxy vote to press companies that are falling behind on ESG.[206] When traditional institutional investors like these get involved, boards are forced to pay attention. For instance, BlackRock supported Engine No. 1's bid to replace three Exxon directors. The activist fund accused the world's largest oil company of failing to oversee climate risk and shocked the world by succeeding in its campaign.[207] While some policies already cover

[202] *2023 Proxy Season Review*, PROXYREVIEW, https://www.proxypreview.org/2024/report-blog/2023-proxy-season-review [https://perma.cc/S62S-ZSNH] (last visited Aug. 26, 2024).

[203] *Id.*

[204] *Id.*

[205] BLACKROCK, 2022 VOTING SPOTLIGHT 20 (2022) [hereinafter BLACKROCK, 2022 VOTING SPOTLIGHT], https://www.blackrock.com/corporate/literature/publication/2022-investment-stewardship-voting-spotlight.pdf [https://perma.cc/YAR8-SWQM]. BlackRock may be pulling back. In 2021, the firm voted against 255 directors and 319 companies. Similarly, after supporting 46% of environmental and social shareholder proposals in 2021, BlackRock voted in favor of just 21% E&S proposals in 2022. *See* BLACKROCK, INVESTMENT STEWARDSHIP ANNUAL REPORT, JANUARY 1 – DECEMBER 31, 2021, at 11 (2022); BLACKROCK, INVESTMENT STEWARDSHIP ANNUAL REPORT, JANUARY 1 – DECEMBER 31, 2022, at 15 (2023). BlackRock said many 2022 proposals were "more prescriptive or constraining on companies and may not promote long-term shareholder value." BLACKROCK, 2022 VOTING SPOTLIGHT, *supra*, at 34 n.3; Sandra Boss & Michelle Edkins, *BlackRock on Climate-Related Shareholder Proposals*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 12, 2022), https://corpgov.law.harvard.edu/2022/05/12/blackrock-on-climate-related-shareholder-proposals/ [https://perma.cc/46QN-A5B4].

[206] Cyrus Taraporevala, *CEO's Letter on SSGA 2022 Proxy Voting Agenda*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 18, 2022), https://corpgov.law.harvard.edu/2022/01/18/ceos-letter-on-ssga-2022-proxy-voting-agenda/ [https://perma.cc/XH5E-8B8H] ("[O]ur focus will be to drive both broad climate action in the market across sectors as well as more targeted action for companies with the most significant emissions.").

[207] Svea Herbst-Bayliss, *BlackRock Backs 3 Dissidents to Shake Up Exxon Board*, REUTERS (May 25, 2021, 3:36 PM), https://www.reuters.com/business/energy/exclusive-blackrock-backs-three-director-nominees-challenging-exxons-board-2021-05-25/ [https://perma.cc/8BVM-W9DA]; *see also* John C. Coffee, Jr., *The Coming Shift in Shareholder Activism: From "Firm-Specific" to "Systematic Risk" Proxy Campaigns (and How to Enable Them)*, 16 BROOK. J. CORP. FIN. & COM. L. 45, 54-55 (2021).

shareholder activism, D&O brokers are also negotiating expanded coverage terms[208] or bespoke stand-alone policies to cover this emerging risk.[209]

3. Government investigations

Federal and state regulatory agencies are beginning to step up enforcement of ESG issues, with a specific focus on climate risk. In 2021, the SEC formed an ESG Task Force to "proactively identify ESG-related misconduct" and has since sprung into action on a number of fronts.[210] The task force has launched numerous ESG-related enforcement actions against companies, such as BNY Mellon Investment Adviser, for "greenwashing" its investment products.[211] According to insurance expert Kevin LaCroix, the "SEC's actions . . . will have a lot to say about the ultimate meaning of ESG issues in the D&O world."[212] The DOJ has gotten involved as well, responding to President Biden's call for "a comprehensive, [g]overnment-wide strategy" on climate-related financial risk[213] by creating the first Office of Environmental Justice.[214] At the state level, attorneys general are preparing to launch their own investigations on climate risk disclosures.[215] This marshaling of government regulatory power is spawning

[208] Anthony Rapa, *Shareholder Activism and D&O Insurance: A Valuable but Overlooked Resource*, WTW (Nov. 12, 2018), https://www.wtwco.com/en-US/Insights/2018/11/finex-observer-shareholder-activism-d-o-insurance [https://perma.cc/5FHF-2Z2L].

[209] *Shareholder Activist Protection Insurance*, MARSH, https://www.marsh.com/uk/services/financial-professional-liability/products/shareholder-activist-protection-insurance.html [https://perma.cc/CY2G-74VM] (last visited Aug. 26, 2024) (presenting world's first shareholder activism insurance solution); *see also* Rapa, *supra* note 208 (clarifying "crisis response coverage [is] now standard in many D&O policies").

[210] Press Release, U.S. SEC, SEC Announces Enforcement Task Force Focused on Climate and ESG Issues (Mar. 4, 2021), https://www.sec.gov/news/press-release/2021-42 [https://perma.cc/KW7M-Q9YU].

[211] Press Release, U.S. SEC, SEC Charges BNY Mellon Investment Adviser for Misstatements and Omissions Concerning ESG Considerations (May 23, 2022), https://www.sec.gov/news/press-release/2022-86 [https://perma.cc/6R5X-5UPT].

[212] Kevin M. LaCroix, *Attention: The ESG Cops Are on the Beat*, D&O DIARY (May 24, 2022), https://www.dandodiary.com/2022/05/articles/regulatory-enforcement-2/attention-the-esg-cops-are-on-the-beat [https://perma.cc/TB7V-BG2C].

[213] Exec. Order No. 14030, 86 Fed. Reg. 27967, 27967 (May 25, 2021); Jonathan D. Brightbill, *New DOJ Policies Impact Environmental and ESG Enforcement*, WINSTON & STRAWN LLP (Nov. 9, 2021), https://www.winston.com/en/winston-and-the-legal-environment/new-doj-policies-impact-environmental-and-esg-enforcement.html [https://perma.cc/4ZFH-H6HK].

[214] Merrick B. Garland, U.S. Att'y Gen., U.S. DOJ, Remarks Launching Comprehensive Environmental Justice Strategy (May 5, 2022), https://www.justice.gov/opa/speech/attorney-general-merrick-b-garland-delivers-remarks-launching-comprehensive-environmental [https://perma.cc/DUH7-WAER].

[215] Jonathan Brightbill & Jennie Porter, *An Early Look at What State AGs Want from ESG Disclosures*, LAW360 (July 8, 2021, 2:55 PM), https://www.law360.com/articles/1401457/an-early-look-at-what-state-ags-want-from-esg-disclosures.

warnings from insurance experts and board advisors of an increased risk of enforcement actions against misrepresentations in ESG disclosures.[216] The next Part will discuss how these pressures come to bear upon the insurance industry.

III. THE MOUNTING PRESSURE ON INSURERS TO MONITOR CLIMATE RISK

If climate-related D&O claims continue to rise, it is logical to predict that D&O insurers will step up their monitoring of insureds' climate governance.[217] Such analysis has commonsense appeal and is accurate in many contexts, such as cybersecurity. However, scholars are less convinced that increased D&O claims activity will provide a strong enough incentive for insurers to monitor corporate governance. The reason is simple: insurers can charge higher premiums to cover losses.[218] This Part responds to that argument, positing that unlike the traditional D&O claims (i.e., securities fraud), climate risk is a systematic risk threatening the financial viability of the insurance industry.[219] Therefore, merely increasing premiums is not a sufficient response to these risks, as they threaten both sides of the insurer's balance sheet. Indeed, climate governance—good or bad—has cascading effects for insurers, far beyond the bargained-for contractual risk.[220] For instance, climate disasters enabled by poor climate governance trigger claims across lines of coverage, from property insurance to life insurance. Meanwhile, good climate governance creates cost savings that span insurers' entire portfolios. As such, climate risk provides potent incentives for insurers to monitor climate governance.

This Part argues that the financial consequences of climate risk should rationally motivate the insurance industry to *reduce*, rather than merely spread, climate risk. Section A examines how the insurance business model renders insurers uniquely exposed to climate risk. Section B explains how climate risk exposure is prompting insurance industry stakeholders to demand that insurers

[216] Jay A. Dubow et al., *Recent SEC Complaint Signals Increased Enforcement Risk for Companies on ESG Disclosures*, TROUTMAN PEPPER (May 10, 2022), https://www.troutman.com/insights/recent-sec-complaint-signals-increased-enforcement-risk-for-companies-on-esg-disclosures.html [https://perma.cc/53X8-CMB9] (referencing recent SEC complaint against mining company as example of increased ESG enforcement).

[217] *See* Talesh, *supra* note 89, at 428; In-person Interview with Law Firm Partner # 1, *supra* note 120.

[218] *See* Baker & Griffith, *Predicting Corporate Governance Risk*, *supra* note 125, at 533-34.

[219] *Insurers Need to Fundamentally Change Business Models to Achieve Climate Resiliency*, CAPGEMINI (May 19, 2022), https://www.capgemini.com/us-en/news/insurers-need-to-fundamentally-change-business-models-to-achieve-climate-resiliency/ [https://perma.cc/DYG3-62DR] (reporting "climate change is hurting the insurance industry," and only 8% of insurers are preparing adequately for its impact).

[220] *See* INT'L ASS'N OF INS. SUPERVISORS, GLOBAL INSURANCE MARKET REPORT (GIMAR) 50 (2023) (describing cascading effects of climate risk beyond individual insurance policies or insurers with "spillover to other financial sectors—as well as to the real economy—through increased market, credit and operational risks").

improve their climate governance by embedding climate risk across their underwriting, investment, and operational decisions.

A. *The Two Sides of the Insurer's Balance Sheet & Systematic Risk*

Insurers create revenue through both underwriting and investing.[221] On the underwriting side of the balance sheet, insurers assume risk on behalf of their policyholders in exchange for a premium. When an insured suffers a covered loss, the insurer is contractually obligated to pay. Thus, to remain profitable, payouts cannot exceed premiums. Obviously, then, insurers bear risk if they either charge insufficient premiums or underwrite losses that, in the aggregate, exceed premiums.

It is well-understood that insurers are also exposed on the liability side of the balance sheet because they are obligated to pay for losses arising out of climate change-related disasters. On the other side of the balance sheet, insurers invest the premiums they collect to generate profits and capitalize long-term liabilities.[222]

Though prior scholarship has focused almost exclusively on underwriting and claims management, poor climate governance also poses risks to insurers' *assets*, particularly in the long term.[223] In part, this is because many insurers are investing in "stranded assets," or companies and industries that are failing to account for financially material climate risks.[224] For instance, as of 2019, the U.S. insurance industry had roughly $536 billion invested in fossil fuel-related activities.[225] Similar to other financial institutions such as banks, investments

[221] *See* AM BEST, BEST'S GUIDE TO UNDERSTANDING THE INSURANCE INDUSTRY 5 (2019) (explaining general operations of insurance industry).

[222] *See* Helmut Gründl, Ming (Ivy) Dong & Jens Gal, *The Evolution of Insurer Portfolio Investment Strategies for Long-Term Investing*, 2016 OECD J. FIN. MKT. TRENDS 1, 5 (noting life insurance contracts are long-term compared to non-life insurance policies); *Insurers as Investors*, ABI, https://www.abi.org.uk/data-and-resources/tools-and-resources/regulation/insurers-as-investors/ [https://perma.cc/6VZ7-LAS4] (last visited Aug. 26, 2024).

[223] Hailey Ross, *Climate Risks for Insurers: Why the Industry Needs to Act Now to Address Climate Risk on Both Sides of the Balance Sheet*, S&P GLOB. (Aug. 27, 2021), https://www.spglobal.com/esg/insights/climate-risks-for-insurers-why-the-industry-needs-to-act-now-to-address-climate-risk-on-both-sides-of-the-balance-sheet [https://perma.cc/LLT2-KVMY] (explaining insurance industry's substantial investments in fossil fuel and liabilities through property and casual underwriting create exposure to climate risk on two fronts).

[224] Eli Flesch, *How Climate Change Threatens to 'Strand' Insurer Assets*, LAW360 (June 3, 2022, 6:35 PM), https://www.law360.com/insurance-authority/articles/1498803/how-climate-change-threatens-to-strand-insurer-assets (describing warnings by experts that insurers still investing significantly in fossil fuels could find investments losing value).

[225] S&P GLOB., CLIMATE RISK & RESILIENCE ANALYSIS 8 (2022), https://interactive.web.insurance.ca.gov/apex_extprd/cdi_apps/r/260/files/static/v58/Analysis%20of%20Insurance%20Company%20Investments%20-CDI-Final-Reportv2.pdf [https://perma.cc/R7QP-S9NT].

expose insurers' portfolios to massive financial risk. But for insurers, these liabilities impact both sides of the insurance industry's balance sheet.[226]

As highly diversified investors, insurers are the paradigmatic example of a "universal owner."[227] As Madison Condon has argued, given their systematic risk exposure and long-term horizons, universal owners are less tolerant of companies that externalize costs.[228] Unlike traditional investors, universal owners do not benefit from an *individual* company's gains if they come at the expense of other companies in their portfolio.[229] John Armour and Jeffrey Gordon have also argued that, while diversified investors typically want an individual firm to take on more risk compared to a concentrated shareholder, this logic falls apart if that firm is taking on systematic risks.[230] This growing body of scholarship argues that, for universal owners, the cost-benefit analysis of externalities must be made not at the individual company level, but at the portfolio level.[231] A systematic risk, by definition, cannot be eliminated through diversification.[232] While the concept can be amorphous, climate risk is the paradigmatic example of a systematic risk, causing economy-wide harms.[233]

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[226] *See* Flesch, *supra* note 224.

[227] For an overview of universal ownership, see generally Condon, *supra* note 51, at 66-67 (defining "universal owners" as "investors that are significantly diversified across the entire economy such that they have a long-term interest in the health of the economy as a whole, as opposed to the relative performance of one firm over another"); and Ellen Quigley, Universal Ownership and the Polycrisis: Social Norms, Feedback Loops, and the Double Hermeneutic (May 21, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3612928 [https://perma.cc/F7QM-TYEB]. For a historical account, see *Universal Ownership: Why Environmental Externalities Matter to Institutional Investors*, PRI (Oct. 1, 2010), https://www.unpri.org/environmental-issues/universal-ownership-why-environmental-externalities-matter-to-institutional-investors/4068.article/ [https://perma.cc/G4EL-S3AH].

[228] *See, e.g.*, Condon, *supra* note 51, at 1 (arguing "diversified investors should rationally be motivated to internalize intra-portfolio negative externalities"); Armour & Gordon, *supra* note 51, at 54-70 (arguing for a different fiduciary duty for directors to maximize portfolio values, as opposed to firm-specific shareholder value); *see also* John C. Coffee, *The Future of Disclosure: ESG, Common Ownership, and Systematic Risk*, 2021 COLUM. BUS. L. REV. 602, 614 (claiming "institutional investors are more concerned with 'systematic risk' than are individual investors").

[229] *See* Condon, *supra* note 51, at 7.

[230] *See* Armour & Gordon, *supra* note 51, at 57 (describing systematic risks as "risk[s] of very large losses that are widely distributed throughout the economy and of which a large component is indirect").

[231] *See id. But see* Tallarita, *supra* note 137, at 5.

[232] *See* RICHARD A. BREALEY, STEWART C. MYERS & FRANKLIN ALLEN, PRINCIPLES OF CORPORATE FINANCE 178-81 (13th ed. 2020) (explaining diversification eliminates "specific risk" surrounding individual company but not "economywide perils that threaten all businesses"). *See generally* HAWLEY & WILLIAMS, *supra* note 42.

[233] *See* Jeffrey N. Gordon, *Systematic Stewardship*, 47 J. CORP. L. 627, 629 (2022) ("A salient form of systematic risk is climate change risk.").

Between 2020 and 2022, natural disasters caused between $720 and $800 billion in damages globally, according to Munich Re.[234]

Investor focus on climate change reflects how these diversified investors experience systematic risks.[235] John Coffee has predicted an era in which they optimize for total portfolio value, recognizing "that change at one firm can affect the value of other firms in the portfolio."[236] Indeed, as the SEC has emphasized, this era has already arrived:

> [I]nvestors often employ diversified strategies, and therefore do not necessarily consider risk and return of a particular security in isolation but also in terms of the security's effect on the portfolio as a whole, which requires comparable data across registrants.[237]

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[234] Shepherd, *supra* note 140 (describing $170 billion in damages caused by ten weather events in 2021); Press Release, Munich Re, Record Hurricane Season and Major Wildfires - The Natural Disaster Figures for 2020 (Jan. 7, 2021), https://www.munichre.com/en/company/media-relations/media-information-and-corporate-news/media-information/2021/2020-natural-disasters-balance.html [perma.cc/5QPJ-K6D5] (placing global monetary losses from natural disasters in 2020 at $210 billion); Press Release, Munich Re, Climate Change and La Niña Driving Losses: The Natural Disaster Figures for 2022 (Jan. 10, 2023), https://www.munichre.com/en/company/media-relations/media-information-and-corporate-news/media-information/2023/natural-disaster-figures-2022.html [perma.cc/X95H-DQQE] (adjusting 2021 global monetary losses from natural disasters upwardly to $320 billion and reporting 2022 losses at $270 billion); Press Release, Munich Re, Hurricanes, Cold Waves, Tornadoes: Weather Disasters in USA Dominate Natural Disaster Losses in 2021 (Jan. 10, 2022), https://www.munichre.com/en/company/media-relations/media-information-and-corporate-news/media-information/2022/natural-disaster-losses-2021.html [perma.cc/D5ZG-Y476] (totaling global monetary losses in 2021 from natural disasters at $280 billion).

[235] *See* Condon, *supra* note 51, at 5-8.

[236] *See* Coffee, *supra* note 207, at 46-47 ("This recognition that change at one firm can affect the value of other firms in the portfolio implies a new goal for activism: namely, to engineer a net gain for the portfolio, possibly by reducing 'negative externalities' that one firm is imposing on other firms in the investor's portfolio.").

[237] The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. at 21336 (establishing duty of broadly diversified investors to evaluate risk of individual assets in terms of their effect on portfolio as a whole and providing CalPERS as exemplar for successful integration of climate risk assessment into investment process); *see also* Carine Smith Ihenacho & Severine Neervoort, *The Proposed SEC Climate Disclosure Rule: A Comment from Norges Bank Investment Management*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 24, 2022), https://corpgov.law.harvard.edu/2022/07/24/the-proposed-sec-climate-disclosure-rule-a-comment-from-norges-bank-investment-management/ [https://perma.cc/LAS3-M3JG] ("We welcome the Commission's proposed rules, which we believe will lead to more consistent, comparable, and reliable climate-related reporting from companies, and thereby help investors get a better picture of companies' value. Better sustainability reporting can also contribute to well-functioning and efficient markets."); Press Release, Amalgamated Bank, Amalgamated Bank Statement on Proposed SEC Climate Disclosures (Mar. 21, 2022), https://amalgamatedbank.com/news/amalgamated-bank-

The universal owner phenomenon is even more acute for insurers because they are feeling the impacts of climate change on both their liabilities and their assets.[238] Climate risk, such as biodiversity loss, impacts multiple types of insurance and assets.[239] However, unlike most universal owners who cannot exit, insurers also have the unique ability to *prevent* the activities that threaten the value of their assets by refusing to underwrite firms or industries that externalize their costs onto the broader economy.[240] Moreover, they have the incentive to do so: if they fail to exercise this power, they threaten their own financial sustainability. This is not a theoretical argument—it is consistent with a growing sentiment among insurance industry regulators and experts. For example, economists at the Swiss Re Institute, the research arm of the world's largest reinsurer, have warned that insurers must act swiftly to prevent climate change from creating economy-wide harms that insurers will disproportionately bear.[241] And the European Central Bank's Financial Stability Report has stressed that extreme weather events will only exacerbate these financial harms to insurers:

> The floods and wildfires in Europe earlier this year illustrate financial impacts of climate-related hazards. This includes not only impacts on bank lending, but also on insurers directly exposed to losses from natural catastrophes. From a systemic perspective, insufficient and potentially diminishing insurability of climate-related risks and associated risk pooling could also significantly amplify future economic losses.[242]

statement-proposed-sec-climate-disclosures [https://perma.cc/M3PK-JMPQ] ("Evaluation and disclosure of climate risk to investors is central to the work of companies and investors the world over.").

[238] *See* Ross, *supra* note 223 ("[Insurers'] investments face climate risk on the asset side of the balance sheet, and they face underwriting risk, particularly in the property and casualty line, on the liability side.").

[239] *See infra* Part IV. For example, commentators are predicting that failure to oversee biodiversity loss risk has the potential to "impact multiple classes of insurance." Wynne Lawrence, *Biodiversity Risk Will Become Material by 2024*, INSURANCEDAY (Mar. 21, 2022), https://insuranceday.maritimeintelligence.informa.com/ID1140218/Biodiversity-risk-will-become-material-by-2024 [https://perma.cc/JGU4-YNX2] (arguing biodiversity loss will potentially increase insurance claims and make premiums more expensive for businesses).

[240] *See* VINCENT HUCK, J.P. MORGAN ASSET MGMT. & INS. ASSET RISK, INSURERS' SUSTAINABLE INVESTING JOURNEY 21 (2021).

[241] SWISS RE INST., THE ECONOMICS OF CLIMATE CHANGE: NO ACTION NOT AN OPTION 28-30 (2021), https://www.swissre.com/dam/jcr:e73ee7c3-7f83-4c17-a2b8-8ef23a8d3312/swiss-re-institute-expertise-publication-economics-of-climate-change.pdf/ [https://perma.cc/7ZPS-TQ92].

[242] EUR. CENT. BANK, FINANCIAL STABILITY REVIEW 14 (2021), https://www.ecb.europa.eu/pub/pdf/fsr/ecb.fsr202111~8b0aebc817.en.pdf [https://perma.cc/UEH2-DXGZ].

Despite this, few insurers consider the impact of climate risk on their investment decisions.[243] Insurers are also exposed on the liability side of the balance sheet because they are obligated to pay for losses arising out of climate change-related disasters. These losses necessarily manifest across insurance lines. For example, a failure to oversee climate change risk can trigger both a D&O claim and a property damage claim.

B. *The Insurance Industry Faces Pressure to Monitor Climate Risk*

Given the industry's unique exposure to climate risk, regulators, investors, and other stakeholders are imploring insurers to incorporate climate risk analysis into their underwriting and investment decisions.[244]

1. Regulatory pressure

State and federal insurance regulation: The 1945 McCarran-Ferguson Act clarified that states have the right to regulate the insurance industry.[245] Thus, state regulators are playing a more central role than the federal government on addressing climate change risks in the insurance industry.[246] For instance, the New York Department of Financial Services ("NYDFS") analyzed over $550

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[243] LISA GROSHONG ET AL., NAT'L ASS'N OF INS. COMM'RS, CTR FOR INS. POL'Y & RSCH., ASSESSMENT OF AND INSIGHTS FROM NAIC CLIMATE RISK DISCLOSURE DATA (2020), https://content.naic.org/cipr-article/naic-assesses-provides-insight-insurer-climate-risk-disclosure-survey-data [https://perma.cc/NQK6-WYGZ].

[244] Alex D'Amico, Grier Tumas Dienstag, Jay Gelb & Zane Williams, *A Better Investor Story for Insurers*, MCKINSEY & CO. (Sept. 20, 2021), https://www.mckinsey.com/industries/financial-services/our-insights/insurance-blog/a-better-investor-story-for-insurers [https://perma.cc/V2LT-REBN].

[245] McCarran-Ferguson Act of 1945, Pub. L. No. 79-15, 59 Stat. 33 (codified at 15 U.S.C. §§ 1011-1015).

[246] The Federal Insurance Office ("FIO") has traditionally played a limited role in the industry. But commentators predict that the Biden administration's executive order on climate-related financial risks has "the potential to reinvigorate the role of the FIO." DELOITTE, CREATING CLIMATE OF CHANGE DIGEST: ISSUE 5, at 1 (2021); *see also* Exec. Order No. 14030, 86 Fed. Reg. 27967, 27968 (May 20, 2021) (directing FIO to analyze climate matters pertaining to the insurance sector, including threats of disrupting private insurance coverage in vulnerable regions). The FIO's current priorities include: (1) assessing climate-related gaps in insurance regulation; (2) assessing and planning for potential disruptions of insurance coverage in climate change-vulnerable U.S. markets; and (3) leveraging the insurance sector's ability to help achieve climate-related goals. *See* DELOITTE, *supra*, at 2. This newfound focus on climate change portends a more expansive role for the FIO and is sparking a backlash against climate and ESG regulation more broadly. *See* Scott M. Seaman, *Comments Due to the Federal Insurance Office on Its Wide-Ranging Work Relating to the Insurance Sector and Climate-Related Financial Risks*, HINSHAW (Oct. 12, 2021), https://www.hinshawlaw.com/newsroom-updates-insights-for-insurers-federal-insurance-office-climate-change-rfi-comments.html/ [https://perma.cc/6NY7-S9EN] (predicting FIO "could greatly diminish or virtually supplant many aspects of state regulation of insurance").

billion of insurer-owned assets and concluded that the investment portfolios of New York insurers are overexposed to carbon-intensive sectors, with looming financial risks on the horizon.[247] To address this, the report issued guidance requiring New York's domestic insurers to adopt and disclose a climate risk policy with details on board oversight as well as risk mitigation at the management level.[248]

Similarly, in California, the fourth-largest insurance market in the world,[249] insurers have invested $536 billion of assets into fossil fuel companies.[250] In 2016, the state's insurance department asked insurers to divest from coal and carbon-based investments.[251] In April 2022, the department launched an effort to reduce fossil fuel investments.[252] Going even further, lawmakers are proposing legislation to require insurance companies to disclose fossil fuel investments and underwriting.[253]

The National Association of Insurance Commissioners: States regulate the insurance industry and the National Association of Insurance Commissioners ("NAIC") coordinates national insurance standards.[254] The NAIC recently

[247] Press Release, N.Y. Dep't of Fin. Servs., Superintendent Lacewell Announces New DFS Report on New York Domestic Insurers' Exposure to Financial Risks Arising from the Low-Carbon Transition (June 10, 2021), https://www.dfs.ny.gov/reports_and_publications/press_releases/pr202106101 [https://perma.cc/WE5Z-4BEH].

[248] *See, e.g.*, Andrew Otis & Brittany Batts, *Insurers Can Use an ESG Program to Implement New York's New Climate Change Financial Risk Guidance*, N.Y. L.J. (Jan. 5, 2022, 11:00 AM), https://www.law.com/newyorklawjournal/2022/01/05/insurers-can-use-an-esg-program-to-implement-new-yorks-new-climate-change-financial-risk-guidance/ [https://perma.cc/6T4G-3LSR].

[249] California is not only the largest insurance market in the US, but the fourth largest market in the world. *$332B in Premiums Makes California World's 4th Largest Insurance Market*, INS. J. (Apr. 5, 2018), https://www.insurancejournal.com/news/west/2018/04/05/485527.htm [https://perma.cc/4NDA-HJC7].

[250] Carmen Balber, *California Climate Insurance Disclosure Bill Stalls*, CONSUMER WATCHDOG (Apr. 18, 2022), https://consumerwatchdog.org/insurance/california-climate-insurance-disclosure-bill-stalls [https://perma.cc/C97C-N9XJ].

[251] Press Release, Cal. Dep't of Ins., California Insurance Commissioner Dave Jones Calls for Insurance Industry Divestment from Coal (Jan. 25, 2016), https://www.insurance.ca.gov/0400-news/0100-press-releases/archives/statement010-16.cfm [https://perma.cc/P6VF-UTHH].

[252] Press Release, Cal. Dep't of Ins., Commissioner Lara Holds Insurance Companies Accountable in Push for More Investment in Solutions to Fight Climate Change (Apr. 18, 2022), https://www.insurance.ca.gov/0400-news/0100-press-releases/2022/release028-2022.cfm [https://perma.cc/QPV3-9J3Y] (describing website launch and report publication as part of "Sustainable Insurance Roadmap" that includes increasing green investments and sustainable insurance products).

[253] Balber, *supra* note 250.

[254] The NAIC is a U.S. standard-setting and regulatory support organization created and governed by chief insurance regulators from all fifty U.S. states, the District of Columbia, and

established a Climate and Resiliency Task Force,[255] and announced a new standard aligning with the TCFD for reporting insurance company climate risks.[256] Insurance commissioners in fifteen states have committed to using the new standard, which requires specific disclosures concerning climate governance.[257] Only twenty-eight insurance companies published TCFD-aligned reports in 2021, but nearly 400 insurance companies—or 80% of the U.S. insurance market—committed to publishing such reports in 2022.[258]

International insurance regulation: Insurers are regionally regulated, but insurance is a global business. Accordingly, global regulation places pressure on insurers, regardless of where they are domiciled. Notwithstanding the recent developments discussed above, US state and federal regulators have generally lagged behind their international counterparts on climate risk regulation.[259] For example, while California is considering requiring TCFD-aligned reports from insurers, insurance regulators from France, Switzerland, and the UK, among

five U.S. territories. *See Our Story*, NAIC, https://content.naic.org/about [https://perma.cc/4RGN-U9L2] (last visited Aug. 26, 2024). A similar organization exists at the international level. The International Association of Insurance Supervisors ("IAIC") published a recent paper providing recommendations for insurance supervisors to strengthen efforts to address climate-related risks. *See* INT'L ASS'N INS. SUPERVISORS, APPLICATION PAPER ON THE SUPERVISION OF CLIMATE-RELATED RISKS IN THE INSURANCE SECTOR 1, 6 (2021), https://www.iaisweb.org/uploads/2022/01/210525-Application-Paper-on-the-Supervision-of-Climate-related-Risks-in-the-Insurance-Sector.pdf [https://perma.cc/AVS6-C33U] ("Climate-related risks are material for the insurance sector as they impact the insurability of policyholder property and assets as well as insurers' operations and investments.").

[255] *Climate and Resiliency (EX) Task Force*, NAIC, https://content.naic.org/cmte_ex_climate_resiliency_tf.htm [https://perma.cc/5QPZ-VT8W] (last visited Aug. 26, 2024).

[256] J. Paul Forrester & Lawrence R. Hamilton, *US NAIC Prioritizes Climate Risk and Resilience with a Focus on Related Disclosure*, MAYER BROWN (Feb. 16, 2021), https://www.mayerbrown.com/en/perspectives-events/publications/2021/02/us-naic-prioritizes-climate-risk-and-resilience-with-a-focus-on-related-disclosure [https://perma.cc/59B8-WWBB].

[257] *See* Press Release, Cal. Dep't of Ins., U.S. Insurance Commissioners Endorse Internationally-Recognized Climate Risk Disclosure Standard for Insurance Companies (Apr. 8, 2022), https://www.insurance.ca.gov/0400-news/0100-press-releases/2022/release025-2022.cfm/ [https://perma.cc/AQ62-4WGQ].

[258] *Id.*

[259] Thomas M. Dawson, *The Future of Climate Change Risk Regulation for Insurers in America?*, MCDERMOTT WILL & EMERY (Mar. 12, 2021), https://www.mwe.com/insights/the-future-of-climate-change-risk-regulation-for-insurers-in-america/ [https://perma.cc/AQ62-4WGQ] (discussing how political polarization in United States limits efforts to incorporate climate change into insurance regulation); *see also* Bill Marcoux, *The ESG Agenda and Insurance: Regulatory Developments, Goals and Limitations*, INT'L INS. SOC'Y (Apr. 2021), https://www.internationalinsurance.org/sites/default/files/2021-04/ESG%20Agenda%20and%20Insurance%204.12.2021_0.pdf [https://perma.cc/Y7M4-DZBC] (discussing global regulatory efforts).

others, already require such reports.[260] Insurance authorities in the Netherlands and the UK were among the first to request a formal assessment of climate change risks in 2018 and 2019, respectively.[261] In 2021, the European Insurance and Occupational Pensions Authority issued an opinion setting forth the expectation for companies to integrate climate risk scenarios into short-term and long-term planning.[262] Finally, in 2021, the EU issued directives requiring integration of sustainability factors into the product oversight and governance requirements of insurance products.[263]

2. Investor pressure

The insurance industry is facing its own shareholder pressure to incorporate climate risk into its underwriting, investments, and operations. As an industry executive explained, investors are focused on insurers' climate governance, especially oversight of climate risk. Climate risk governance is on the agenda in engagement meetings with insurance industry board members and executives.[264] When engagement fails, investors turn to more public channels, such as shareholder proposals. In the 2023 proxy season, a record 513 proposals were filed on ESG topics compared to 466 in 2022.[265] In the 2022 proxy season, a record eleven climate-related shareholder proposals gained majority support from shareholders at companies like Boeing, Chevron, Costco, and Exxon.[266]

[260] Press Release, Nat'l Ass'n of Ins. Comm'rs, U.S. Insurance Commissioners Endorse Internationally Recognized Climate Risk Disclosure Standard for Insurance Companies (Apr. 8, 2022), https://content.naic.org/article/us-insurance-commissioners-endorse-internationally-recognized-climate-risk-disclosure-standard [https://perma.cc/66J7-9FGE].

[261] VALERIE STEPHAN & KEVEN ROY, J.P. MORGAN ASSET MGMT., BUILDING CLIMATE-AWARE STRESS TESTS 1 (2021), https://am.jpmorgan.com/content/dam/jpm-am-aem/global/en/institutional/investment-strategies-/insurance/climate-stress-test-web.pdf [https://perma.cc/BY29-ZTE4].

[262] *EIOPA Issues Opinion on the Supervision of the Use of Climate Change Risk Scenarios in ORSA*, EIOPA (Apr. 19, 2021), https://www.eiopa.europa.eu/media/news/eiopa-issues-opinion-supervision-of-use-of-climate-change-risk-scenarios-orsa_en [https://perma.cc/7AU6-7D2M].

[263] Commission Regulation 2021/1257, 2021 O.J. (L 227) 18-24 (EU).

[264] Online Interview with Insurance Executive #1 (July 2022).

[265] *Despite Record Shareholder Proposals in the 2023 Proxy Season, Companies Should Brace for Even More in 2024*, PR NEWSWIRE (Oct. 19, 2023, 09:00 ET), https://www.prnewswire.com/news-releases/despite-record-shareholder-proposals-in-the-2023-proxy-season-companies-should-brace-for-even-more-in-2024-301961794.html [https://perma.cc/UXL5-NK4Z].

[266] Press Release, Conf. Bd., Proposals on Climate Disclosures Gained Momentum in 2022 (Sept. 28, 2022), https://www.conference-board.org/press/climate-disclosures-2022-proxy-season [https://perma.cc/7XZE-NKZG]. Because bank lending is contingent on insurance, insurers are in a unique position to impact the viability of new fossil fuel projects. Shareholders recognize this, as one aptly summed up, "Without insurance, almost none of the [new fossil fuel] projects can go forward." *See* Emile Hallez, *Chubb Faces New Kind of*

Similarly, 2021 resolutions at Chubb and Travelers demanding climate change disclosures received 72% and 56% support, respectively.[267] These proposals reflect shareholders' exasperation with U.S. insurance companies driving "climate risk to investors, insurers, and the global economy."[268] The SEC has ruled against major insurers' attempts to exclude such proposals from their proxy statements, paving the way for more such proposals in the future.[269]

Shareholders and investors are relying on credit rating agencies to assess financial resilience of insurance companies.[270] Crucially, these credit rating agencies can impact the cost of capital for *both* public and private insurers. For example, AM Best, the largest global credit rating agency specializing in the insurance industry, was the first to incorporate climate risk into insurers' credit ratings.[271] Morningstar, another major agency, was not far behind, and now

Shareholder Vote over Fossil Fuels, INV. NEWS (Mar. 29, 2022) (alteration in original), https://www.investmentnews.com/chubb-shareholder-resolution-green-century-219240 [https://perma.cc/96M9-7HVJ]. However, proposals asking insurers to reduce or eliminate fossil fuel underwriting gained much less support. Investors at Chubb (19.4% support), The Hartford (8.8%), and Travelers (13.2%) rejected proposals to end fossil fuel underwriting in 2022. Jen Frost, *Travelers Swerves Fossil Fuel Insurance Block*, INS. BUS. (May 30, 2022), https://www.insurancebusinessmag.com/us/news/environmental/travelers-swerves-fossil-fuel-insurance-block-407833.aspx [https://perma.cc/NS2D-YBRH]; *see also* Elizabeth Dilts Marshall & Ross Kerber, *Bank Shareholder Proposals to Curb New Fossil Fuel Lending Get Slim Support*, REUTERS (Apr. 26, 2022, 4:55 PM), https://www.reuters.com/business/sustainable-business/bank-shareholder-proposals-curb-new-fossil-fuel-lending-get-slim-support-2022-04-26/ [https://perma.cc/C7RC-58WV] (discussing similar shareholder proposals aimed at banks, which also gained little support in 2022).

[267] Eli Flesch, *Chubb Investors Split on Approving 2 Climate Proposals*, LAW360 (May 19, 2022, 9:51 PM), https://www.law360.com/insurance-authority/articles/1495133/chubb-investors-split-on-approving-2-climate-proposal [https://perma.cc/329D-NANY]; Press Release, As You Sow, Investors Send Greenhouse Gas Reduction Message to National Insurance Companies (June 1, 2022), https://www.asyousow.org/press-releases/2022/6/1/investors-greenhouse-gas-reduction-message-insurance-companies.

[268] Press Release, As You Sow, *supra* note 267.

[269] Letter from Rule 14a-8 Review Team, U.S. SEC, to Edward S. Best, Mayer Brown LLP (Mar. 26, 2022), https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2022/greencenturychubb032522-14a8.pdf [https://perma.cc/BQ9C-JVB5]; Roxanne Libatique, *SEC Rules on Calls for Chubb to Stop Underwriting Fossil Fuels*, INS. BUS. (Mar. 28, 2022), https://www.insurancebusinessmag.com/us/news/breaking-news/sec-rules-on-calls-for-chubb-to-stop-underwriting-fossil-fuels-400303.aspx [https://perma.cc/R2AR-UQKF].

[270] Of course, these ratings themselves will face SEC scrutiny. *See SEC Flags Risks for Ratings Firms in ESG Boom*, BUS INS. (Feb. 1, 2022), https://www.businessinsurance.com/article/00010101/NEWS06/912347618/SEC-flags-risks-for-ratings-firms-in-ESG-boom [https://perma.cc/H555-54GA].

[271] *See* Press Release, AM Best, AM Best Issues FAQ on ESG and Insurance Credit Ratings, Announces Inclusion of ESG Section in Best's Credit Reports (Nov. 22, 2021, 8:04 AM), https://news.ambest.com/newscontent.aspx?refnum=237927&altsrc=174 [https://perma.cc/SME8-S59W].

incorporates "17 significant ESG factors" into its credit ratings.[272] And in 2021, the S&P 500 Global released its first-ever report detailing the ESG factors impacting insurers.[273] Relatedly, the S&P 500 has stressed its higher expectations for insurance companies when it comes to governance. Notably, S&P did not give a single insurance company a G1 rating (the highest score for governance), calling specifically for board oversight improvements before it could award higher scores.[274] It is widely predicted that "ESG-driven decisions will influence insurers' credit ratings in the medium term as social and regulatory pressures push more insurers to account for ESG considerations."[275]

3. Stakeholder pressure

In addition to regulators and shareholders, insurers are facing scrutiny from NGOs, environmental activists, employees, and communities. For instance, the "Insure Our Future" campaign releases an annual scorecard assessing global insurers' relationships with the fossil fuel industry.[276] The 2021 scorecard gave Chubb and Travelers low marks for both underwriting and investing in fossil fuels.[277] This spawned a letter from more than seventy environmental and public health groups to Chubb, claiming that the company "has gone from a leader to a laggard."[278] In response to widespread criticism, in September 2021, the company dropped its plan to insure the Trans Mountain Pipeline, a controversial

[272] Bethan Moorcraft, *Insurers Facing Greater Pressure to Manage ESG Risk Factors*, INS. BUS. (Mar. 1, 2021), https://www.insurancebusinessmag.com/us/news/breaking-news/insurers-facing-greater-pressure-to-manage-esg-risk-factors-247871.aspx [https://perma.cc/G96N-5SJ6] (explaining analysts will consider "five environmental, seven social, and five governance" factors when rating organizations).

[273] Daniel Wood, *S&P Releases First Ever ESG Report on Insurers*, INS. BUS. (Jan. 7, 2022), https://www.insurancebusinessmag.com/au/news/environmental/sandp-releases-first-ever-esg-report-on-insurers-321245.aspx [https://perma.cc/F5QG-3WX2].

[274] *Id.*

[275] Jahna Jacobson, *ESG Will Increasingly Influence Insurers' Strategies: Fitch Ratings*, INS. J. (Nov. 21, 2022), https://www.insurancejournal.com/magazines/mag-features/2022/11/21/695640.htm [https://perma.cc/YF76-K3J7].

[276] *See, e.g.*, INSURE OUR FUTURE, INSURING OUR FUTURE: 2021 SCORECARD ON INSURANCE, FOSSIL FUELS AND CLIMATE CHANGE 9 (2021), https://global.insure-our-future.com/wp-content/uploads/2021/11/2021-IOF-Scorecard.pdf [https://perma.cc/RX6Q-WB4H].

[277] *See id.* at 9, 17 ("Together, the world's biggest oil and gas insurers AIG, Travelers, Zurich, Allianz, Chubb and Liberty Mutual could end more than half the underwriting of the [fossil fuels] industry.").

[278] Ryan Smith, *Chubb CEO Underfire for Environmental Approach – 70 Groups Join Forces*, INS. BUS. (May 21, 2021), https://www.insurancebusinessmag.com/us/news/environmental/chubb-ceo-underfire-for-environmental-approach—70-groups-join-forces-255727.aspx [https://perma.cc/2SA2-7MC4]. The company was once a leader because it was among the first to pledge not to insure new coal projects. *See* INSURE OUR FUTURE, *supra* note 276, at 13 (showing Chubb adopted coal exit policies in 2019).

tar sands project considered "destructive and risky" by many.[279] These events show that insurers must compete on climate governance to attract new customers and avoid negative attention and stockholder action, mirroring an accelerating trend throughout the business world.[280]

With respect to D&O insurers in particular, a campaign led by Greenpeace in 2014 sought to put insurers on notice that climate risk is a D&O issue.[281] The NGO wrote letters to energy companies and their D&O insurers warning that attempts to defeat climate action or spread misleading information "could pose a risk to directors and officers personally."[282] These early warnings foreshadow an increase in climate governance shareholder litigation.[283]

IV. CLIMATE RISK PROMPTS ACTIVE D&O MONITORING

Insurers who seek to minimize their insureds' losses invest in a range of "active" strategies throughout the insurance contract. Conversely, so-called "passive" insurers wait until a loss occurs, then raise premiums.[284] Though the line between active and passive is blurry in practice, scholars have placed D&O insurers firmly in the "passive" category because they historically "devote essentially zero effort to monitoring their insureds' corporate governance."[285] Even if that is a fair account of D&O insurers' traditional practice, climate risk may usher in the era of active D&O insurance.

Active monitoring depends on information. Section A explains that insureds and insurers share climate risk information for reasons that go far beyond the insurance contract. Section B details how insurers are building their own climate risk governance procedures, which allow them to gather and analyze climate risk

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[279] *Chubb Is the 16th Insurer to Cut Ties with the Trans Mountain Tar Sands Pipeline*, WATERKEEPER ALL. (Sept. 14, 2021), https://waterkeeper.org/news/chubb-is-the-16th-insurer-to-cut-ties-with-the-trans-mountain-tar-sands-pipeline/ [https://perma.cc/2SA2-7MC4].

[280] *See* Mary Or, *Zurich Insurance Awarded Highest ESG Rating from MSCI*, INS. BUS. (June 1, 2022), https://www.insurancebusinessmag.com/us/news/breaking-news/zurich-insurance-awarded-highest-esg-rating-from-msci-408141.aspx [https://perma.cc/USA2-2HWB] ("An MSCI ESG rating measures a company's resilience to long-term environmental, social and governance risks, scoring companies on an industry-relative AAA to CCC scale.").

[281] Kevin M. LaCroix, *Is Climate Change a D&O Insurance Issue?*, LEXISNEXIS (June 2, 2014), https://www.lexisnexis.com/legalnewsroom/corporate/b/blog/posts/is-climate-change-a-d- amp-o-insurance-issue [https://perma.cc/L4PK-5NJ9].

[282] *Id.*

[283] Given the political backlash against ESG, directors and officers can also face litigation for making ESG commitments that harm the corporation's shareholders. *See* Kevin M. LaCroix, *And Now, The ESG Backlash*, D&O DIARY (Aug. 29, 2022), https://www.dandodiary.com/2022/08/articles/director-and-officer-liability/and-now-the-esg-backlash/ [https://perma.cc/QDW2-RQPS] (discussing how ESG commitments can increase D&O risk).

[284] For a discussion of active and passive insurance, see Verstein, *supra* note 22, at 988.

[285] *Id.* at 987.

information across their underwriting portfolios. Section C describes how this portfolio-wide approach to risk is prompting a more active approach to all lines of insurance, including D&O insurance.

A. *Insurers and Insureds Value Sharing Climate Risk Information*

The business of insurance hinges on information, and information is a two-way street. For insurance to function profitably, insurers must be able to gain information from and about their insureds and also share information with their insureds.[286] Insurers gather information from their insureds through questionnaires, formal engagement meetings, and more informal discussions.[287] This information can obviously be incomplete or biased, so insurers enlist an array of external sources, including data providers and consultants.[288] Then, they use this information in a variety of ways.

Most obviously, they use it to perform an actuarial analysis that weighs the likelihood of harm against its potential cost.[289] This analysis helps insurers set premiums or decide whether to refuse or limit coverage.[290] Insurers also use information to nudge, coach, or require their insureds to engage in safer conduct.[291] But gathering and sharing information is time-consuming and expensive. To warrant that investment, a few things must be true.

First, the information that insurers collect must have some correlation to reduced harms. For example, if home alarms do not actually prevent break-ins, then it does not make sense for insurers to survey insureds about home alarms. Second, the value of gathering the information must exceed the cost of gathering it. Third, the insured must be willing to provide information to their insurers. Fourth, the insured must value insurer input, such that they are willing to make reforms. Some of these circumstances may apply for some types of insurance, but historically, none of them have been true for D&O insurance.[292] Therefore, it did not make economic sense for insurers or insureds to gather and share

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[286] *See* Ben-Shahar & Logue, *supra* note 14, at 203 (calling information "critical to the business of insurance"); Charles Michael, *How Insurance Companies Are Using Data Collection Tools to Gain a Competitive Edge*, INSURGRID (Sept. 16, 2022), https://www.insurgrid.com/blog/insurance-data-collection [https://perma.cc/MV27-RPM4] (stating insurers collect "data to assess and prevent risk, target ideal customers, accurately price policies, provide quotes, conduct investigations, follow trends, and create new products").

[287] *See* Michael, *supra* note 286.

[288] *See* Anya E.R. Prince & Daniel Schwarcz, *Proxy Discrimination in the Age of Artificial Intelligence and Big Data*, 105 IOWA L. REV. 1257, 1259 (2020).

[289] *See* Ben-Shahar & Logue, *supra* note 14, at 203 ("Actuarialism—the basic methodology in insurance—is the skill of computing premiums according to information about probabilities and harms").

[290] *See id.*

[291] *See id.*

[292] *See* Baker & Griffith, *Missing Monitor*, *supra* note 13, at 1808 (explaining scant loss prevention advice provided by D&O insurers "is not highly valued by public corporations").

corporate governance information. Today, in contrast, climate risk information is valuable to both insurers and insureds for reasons that are both internal and external to the insurance agreement. This reality is prompting insurers and insureds to adopt a more collaborative approach to addressing climate risk.[293]

1. Good climate governance correlates to reduced securities risk

To an extent, the intuition that good governance leads to less D&O liability—or that "the merits do matter"—has always been reflected in underwriting.[294] Baker and Griffith's work revealed that D&O underwriters equate stronger ethical cultures with fewer risks.[295] But in the past, the tools insurers used to assess this "deep governance" amounted to little more than underwriters' gut reaction.[296] Without the ability to pinpoint the actual components of effective governance, insurers could not guide their insureds on which reforms made a difference or reduced loss.[297] Insurers' tools for loss mitigation thus remained quite blunt. Consequently, the correlation between strong governance and reduced D&O claims failed to convince insurers and insureds alike.[298] Over time, the few D&O insurers that invested in loss prevention services ultimately changed course because they could not "show the discount," or verify that their reforms reduced claims.[299]

Though insurers have not yet pinpointed every component of effective climate governance, there is a growing recognition that better board oversight of ESG issues, including climate risk, correlates with fewer shareholder lawsuits. Zurich Insurance Group recently observed a "solid connection between good governance and fewer, less severe D&O losses."[300] Recent academic studies

[293] This collaborative information sharing is also prevalent in meetings between companies and their investors. *See* Jill E. Fisch & Simone M. Sepe, *Shareholder Collaboration*, 98 TEX. L. REV. 863, 865 (2020) (positing collaboration between shareholders and corporate insiders provides a unique mechanism for enhancing firm value that neither side can provide unilaterally).

[294] Baker & Griffith, *How the Merits Matter*, *supra* note 125, at 790. For a historical perspective in the securities litigation context, see Stephen J. Choi, *The Evidence on Securities Class Actions*, 57 VAND. L. REV. 1465, 1476-1507 (2004) (summarizing recent empirical work on whether good governance aligns interests of managers and shareholders).

[295] *See* Baker & Griffith, *Missing Monitor*, *supra* note 13, at 1840.

[296] *See id.*

[297] *See id.* at 1837 ("[E]ven if financial and business risks do dominate corporate governance risk in current D&O insurance pricing, that may be the result of D&O insurers not being allowed sufficiently inside the corporation to evaluate the 'deep governance' factors that they find most important.").

[298] *See id.* at 1808-13.

[299] *Id.* at 1811.

[300] Adrian Jenner & Anoushka Pramanik, *ESG to Drive a New Wave of D&O Liability*, ZURICH (Aug. 30, 2022), https://www.zurich.com/en/products-and-services/protect-your-business/commercial-insurance-risk-insights/esg-to-drive-a-new-wave-of-d-o-liability [https://perma.cc/46LT-C9RT].

concur.[301] For instance, Adam Badawi and Frank Partnoy conducted the first empirical account of the correlation between "strong" or "good" ESG behavior and securities litigation.[302] Their study found an empirical link between firms with "bad" ESG ratings and more shareholder litigation.[303] Investors, too, are using strong climate governance as a proxy for financial resilience, as evidenced by their demands for increased climate disclosure.[304] In sum, unlike investments in traditional corporate governance, insurers can increasingly "show the discount" for their insureds' good climate governance.[305]

2. The value of climate risk information outweighs the expense

Given that improved climate governance likely reduces D&O claims, D&O insurers can justify investing in monitoring their insureds' climate governance. As Part II detailed, D&O claims are expected to increase due to global regulation mandating climate disclosure, as well as the intensifying effects of climate

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301 *See* Adam B. Badawi & Frank Partnoy, *Social Good and Litigation Risk*, 12 HARV. BUS. L. REV. 315, 335-51 (2022) (exploring relationship between ESG metrics and securities litigation). While scholarship on ESG and litigation risk is scant, there is a rich literature on ESG and financial sustainability. *See* Mozaffar Khan, George Serafeim & Aaron Yoon, *Corporate Sustainability: First Evidence on Materiality*, 91 ACCT. REV. 1697, 1703, 1716 (2016) (finding positive correlation between company rating on material sustainability issues and stock performance); Virginia Harper Ho, *Risk-Related Activism: The Business Case for Monitoring Nonfinancial Risk*, 41 J. CORP. L. 647, 651 (2016) (examining non-financial risks that can influence stock price).

302 While this is the first analysis of ESG and securities litigation, some have suggested that strong ESG performance can act as insurance against risk. *See* Ping-Sheng Koh, Cuili Qian & Heli Wang, *Firm Litigation Risk and the Insurance Value of Corporate Social Performance*, 35 STRATEGIC MGMT. J. 1464, 1478-80 (2014) (arguing positive social performance is worthwhile as insurance against litigation risk); *see also* Dylan Minor & John Morgan, *CSR as Reputation Insurance:* Primum Non Nocere, 53 CAL. MGMT. REV. 40, 41-44 (2011) (showing CSR activities can somewhat insure against reputation risk); Steven Freund, Nam H. Nguyen & Hieu V. Phan, *Shareholder Litigation and Corporate Social Responsibility*, 58 J. FIN. & QUANTITATIVE ANALYSIS 512, 512-17 (2023).

303 Badawi & Partnoy, *supra* note 301, at 340-44. Though it is difficult to disentangle climate risk from the "S" and "G" of ESG in Badawi & Partnoy's study, climate risk is a crucial pillar of ESG. *Id.* at 353 (explaining investors and practitioners frame ESG discussions in terms of risk, and "climate change is widely regarded as a significant ESG risk").

304 *See* The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21334 (proposed Mar. 21, 2022) (codified at 17 C.F.R. §§ 210, 229, 230, 232, 239, 249), https://www.sec.gov/rules/proposed/2022/33-11042.pdf [https://perma.cc/3VQC-WR7M]. The proposed rules frequently cite to investor letters written in support of the proposal. *See, e.g.*, *id.* at 21673 n.45, 21677 n.105, 21740 n.1119, 21847.

305 *See* Online Interview with Underwriter # 13 (Feb. 2023); Online Interview with Underwriter # 7 (July 2022); Online Interview with Underwriter # 9 (Oct. 2022) (explaining corporate directors are seeking out climate governance information from their D&O underwriters because it is valuable to their investors).

change.[306] If D&O claims are expected to increase, but insurers can reduce these claims by monitoring their insureds and gathering information on their climate governance practices, then such information has increasing value over time. Insurers that do not gather such information risk falling behind on both sides of the balance sheet, and failing to meet shareholder and stakeholder demands. Therefore, the value of insureds' climate governance information is far greater to insurers than other corporate governance information was in the past, warranting greater investment.

3. Insureds and insurers benefit from sharing climate risk information

Information sharing grants benefits to both insurers and insureds. Firms are already gathering and sharing climate risk information with their investors because doing so is an economic imperative for companies today; failure to disclose such risks shuts them out of the multitrillion-dollar ESG investment movement.[307] As one underwriter explained: "[T]here's a lot of pressure from investors, . . . customers[,] and clients . . . . [P]eople [want to] . . . support companies that are good corporate citizens. So, yes, . . . all that has impact on us and how we evaluate the risk."[308] Thus, insureds are already bearing the cost of this data-gathering because it is to their benefit. Brokers explained that they advise their insureds to use the information they assembled for quarterly investor presentations "and tweak it" for engagement meetings with underwriters.[309]

Such information-sharing could theoretically help both insurers and insureds. Insureds with "good" climate governance could receive improved rates, while insurers could calibrate terms to account for climate risk if they hold all the available information.

4. Insureds value insurer input and are willing to make reforms

In the recent past, most insureds did not value the loss prevention services or governance advice provided by their D&O insurers. In fact, exactly the opposite was true: "[r]educing the intrusiveness of their monitoring" was a competitive advantage for D&O insurers.[310] Making policy renewals contingent on implementation of insurer-suggested loss reduction measures was not

[306] The SEC's recent rules mean "climate-related misstatements" will prompt increased securities class actions, shareholder derivative claims, and SEC enforcement actions. Russ Banham, *SEC Climate Disclosure Rules Increase D&O Risk*, RISK MGMT. (Aug. 1, 2022), https://www.rmmagazine.com/articles/article/2022/08/01/sec-climate-disclosure-rules-increase-d-o-risk [https://perma.cc/QK2J-9HAH].

[307] Paul Polman & Andrew Winston, *Yes, Investing in ESG Pays Off*, HARV. BUS. REV. (Apr. 13, 2022), https://hbr.org/2022/04/yes-investing-in-esg-pays-off/ [https://perma.cc/3M9T-ZHL5].

[308] Online Interview with Underwriter # 5 (May 2022).

[309] Online Interview with Broker # 4 (June 2022) (noting insureds "talk to investors all the time, and in many cases it's a very similar presentation").

[310] Baker & Griffith, *Missing Monitor*, *supra* note 13, at 1840.

economically viable, particularly in buyer's markets.[311] The loss prevention services offered by D&O insurers necessarily constrained the freedom of directors, officers, and managers to take risks. But corporations purchased D&O insurance precisely so that they could take on *more* business risk, since the D&O policy would likely cover any potential loss from shareholder litigation. Insurance companies, then, not the insureds, were the beneficiaries of loss prevention efforts.

Under this paradigm, executives and risk managers procuring D&O coverage had little incentive to implement meaningful internal controls for already covered risks. Indeed, one of Baker and Griffith's key insights was identifying agency costs inherent in this system as a key culprit:

> Buying D&O insurance without monitoring increases the freedom of managers to take financial reporting and other risks that improve accounting measures of performance and, hence, their compensation, but not the long-term value of the firm. If these risks lead to shareholder litigation, D&O insurers step in to pay the claim.[312]

It is thus unsurprising that monitoring efforts remained nominal or symbolic.

Today, insurers' capability to assess industry-wide climate risk is extremely valuable to corporate managers. As one underwriter noted, "We see claims that the client may not be privy to. So, we may also be able to show where some of the vulnerabilities are a 'lesson learned' for them."[313] Consequently, some insureds are starting to turn to their brokers and insurers for industry-specific data on claims activity. Thus, D&O insurers can serve a complementary role to the external advisors that provide climate governance advice. For instance, insurers contribute superior expertise in predicting and pricing risk because they are staffed with large teams of actuarial professionals. Further, they are incentivized to track which investments in climate-risk governance lead to fewer losses—among other "policy entrepreneurs," such as lawyers, consultants, auditors, and brokers, insurers are the only ones that are "residual claimants on the litigation risks they insure."[314] Moreover, insurers' data is more representative than many other providers of climate risk expertise because they serve a broader section of the economy than, for instance, law firms. In sum,

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[311] *See id.* at 1809 (referring to buyer's markets for insurance as "[s]oft markets").

[312] *Id.* at 1833.

[313] Phone Interview with D&O Underwriter # 6 (July 2022); Online Interview with D&O Underwriter # 10 (Oct. 2022); Online Interview with D&O Underwriter # 11; Roundtable Discussion # 2 with Insurance Industry Participants (Feb. 2023).

[314] Verstein, *supra* note 22, at 1011; *see also* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1528-29 (2005) (describing how corporate governance consultants profit from proposals that make no meaningful difference); Baker & Griffith, *Missing Monitor*, *supra* note 13, at 1835 n.189 ("Because the insurer ultimately bears corporate governance risk, it is unlikely to be fooled by merely cosmetic governance features.").

D&O insurers bring valuable input to the table, which should be heeded by rational insureds.[315]

B. *The Insurance Industry's Novel, Holistic Approach to Climate Risk*

1. Corporate governance reforms

Though it lags behind others in the financial industry, climate risk is prompting insurers of all stripes to focus on their own climate governance. A review of the insurance industry's TCFD reports demonstrates that the insurance industry is investing in its own climate governance, including hiring executive level positions.[316] At AIG, for example, the board amended its Risk Committee's charter to include explicit oversight of climate risk.[317] The company also announced a new C-suite position: Executive Vice-President, Global Head of Strategy & ESG.[318] Similarly, Zurich has set up a Governance, Nominations, and Sustainability Committee to review and approve the group's sustainability goals.[319] The major insurer launched a Sustainability Leaders Council, composed of senior executives from all of Zurich's businesses and chaired by a Group Head of Sustainability.[320] Assignment of ESG responsibilities to a dedicated executive position is a preliminary step, but other insurance companies are likely to follow the major insurers' lead. These governance reforms are not cosmetic—the mandate of these new corporate executives is to

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[315] At a recent engagement meeting with a D&O insurer, the insured said to the underwriter, "[D]on't scold us [on our climate governance], help us." Interview with D&O Underwriter # 12 (Feb. 2023).

[316] *See* VOSS ET AL., *supra* note 44.

[317] AIG, AMERICAN INTERNATIONAL GROUP, INC. RISK COMMITTEE CHARTER 1 (2023) https://www.aig.com/content/dam/aig/america-canada/us/documents/about-us/legal/aig-risk-committee-charter.pdf [https://perma.cc/67TH-D8PR]. AIG's Risk and Capital Committee also assists the board in overseeing and reviewing climate-related risks, through reviewing policies, procedures, and practices employed to manage all of AIG's key risks that may be impacted by sustainability-related issues (e.g., liquidity, credit, market, operational, and insurance risks).

[318] *See* AIG, AIG 2021 ESG REPORT 102 (2021), https://www.aig.com/content/dam/aig/america-canada/us/documents/about-us/report/aig-esg-report_2021.pdf.coredownload.pdf [https://perma.cc/2R86-ZFVJ].

[319] *Sustainability Is Embedded in Our Governance*, ZURICH, https://www.zurich.com/sustainability/strategy-and-governance/governance [https://perma.cc/4L9Y-NVWN] (last visited Aug. 26, 2024).

[320] *Constance Hunter Joins AIG as Global Head of Strategy & ESG*, BUS. WIRE (Dec. 14, 2021, 4:16 PM), https://www.businesswire.com/news/home/20211214006239/en/Constance-Hunter-Joins-AIG -as-Global-Head-of-Strategy-ESG [https://perma.cc/E5LZ-JAPK]; AIG, *supra* note 318, at 5.

set and monitor climate risk reduction targets, including net-zero targets, within their portfolios. [321]

The insurance industry's newly emerging climate governance is also signaling a holistic approach toward underwriting and assets. For example, Chubb's 2021 TCFD report states: "The impact of climate risk on underlying credits will naturally be an increased factor in our investment decision-making over time given the future impact on certain long-dated asset classes, such as mortgages and municipal bonds."[322]

2. The beginning of a climate risk-integrated approach to underwriting

Insurers cannot issue TCFD reports or respond to investor demands without sharing information within and outside of the company.[323] For instance, climate commitments invariably force insurers to closely examine their business operations.[324] This compels departments to communicate with one another, breaking down corporate silos.[325] When these departments communicate, there is space for integrated underwriting practices that incorporate climate risk factors. For example, in 2022, AIG piloted an "ESG [U]nderwriting [F]ramework" for consistently integrating issues "across all product lines."[326] The framework includes intensely screening clients for ESG risks, including climate-related risks, sharing data across insurance lines to give AIG's underwriters "full visibility into ESG considerations," and implementing "a robust governance structure" for monitoring underwriting.[327] As AIG has

[321] *See, e.g.*, CHUBB, CHUBB 2021 CLIMATE-RELATED FINANCIAL DISCLOSURE & ENVIRONMENTAL REPORT 8 (2021), https://www.chubb.com/content/dam/chubb-sites/chubb-com/us-en/about-chubb/environment/doc/Chubb_2021_Climate-Related_Financial_Disclosure_and_Environmental_Report.pdf [https://perma.cc/LAK6-2ANL] (announcing new board and executive level climate governance including hiring of Climate Sustainability Manager tasked with coordinating Chubb's climate strategy across its underwriting and investment decisions).

[322] *Id.* at 13.

[323] Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401, 1458 (2020) ("ESG helps managers address diverse risks relating to the company's business by obtaining information from stakeholders that are ideally placed to understand such risks."); *see also* Lynn M. LoPucki, *Repurposing the Corporation Through Stakeholder Markets*, 55 U.C. DAVIS L. REV. 1445, 1447-48, 1512 (2022) (describing "ESG information system" as way to "measure the externalization of a variety of social costs").

[324] *See generally* Gadinis & Miazad, *supra* note 323; Robert G. Eccles, *Twenty Years of the Global Reporting Initiative: Interview with CEO Tim Mohin*, FORBES (Aug. 15, 2017, 9:35 AM), https://www.forbes.com/sites/bobeccles/2017/08/15/twenty-years-of-the-global-reporting-initiative-interview-with-ceo-tim-mohin/ [https://perma.cc/8HJB-D3CV].

[325] Online Interview with D&O Underwriter # 4 (July 2022) (explaining "pure silos" of traditional insurance companies meant "you never talked to anybody who didn't do your line of business").

[326] AIG, *supra* note 318, at 22.

[327] *Id.*

explained, it uses ESG ratings to "support responding to regulatory requirements, guide stress testing and provide a link between liabilities and investments."[328]

This is consistent with accounts from the insurance industry experts interviewed. As one senior executive charged with leading a major insurers' ESG integration stated, the insurer "want[s] to create a system where all parts of our company feel accountable and responsible for our ESG agenda."[329] This integration involves sharing a significant amount of information with both internal and external stakeholders—the company recently hired a Head of ESG Investment Strategy—and has increased its dialogue with external parties, like "regulators, investors, NGO, clients, brokers, [and] suppliers."[330]

C. *D&O Insurers Begin to Monitor Insureds' Climate Governance*

It is still in its early days, but D&O insurers are starting to monitor their clients' climate governance. This Section will discuss how climate governance is entering engagement meetings and changing underwriting practices. The Section concludes by discussing the Marsh Initiative, a novel system of monitoring organized by one of the world's largest brokers.

1. D&O insurers are addressing climate risks in engagement meetings

ESG issues, including climate governance, are increasingly on the agenda at engagement meetings. One underwriter noted that he has "yet to go to [an underwriting] meeting over the last couple years where ESG has not been mentioned."[331] Before, ESG had received virtually no attention.[332] Another underwriter said "the D&O underwriting meeting now has a very solid block of time devoted to ESG oversight and controls."[333] Shareholder and regulatory pressure played a major role in carving out a place for climate governance at engagement meetings. As one underwriter explained:

> We care [about ESG and climate governance] because . . . what we're facing are rules and laws being put in place mandating certain requirements . . . and what [insureds] disclose and what they do creates risk. . . . [T]he shareholders do care . . . and you're seeing that in some of the proxy issues that we're facing[.][334]

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[328] *Id. See generally* Witold J. Henisz & James McGlinch, *ESG, Material Credit Events, and Credit Risk*, 31 J. APPLIED CORP. FIN. 105 (2019).

[329] Online Interview with Insurance Industry Executive Specializing in ESG # 1 (July 2022).

[330] *Id.*

[331] Online Interview with D&O Underwriter # 5 (July 2022).

[332] *Id.*

[333] Phone Interview with D&O Underwriter # 6 (July 2022).

[334] Online Interview with D&O Underwriter # 5 (July 2022).

The proliferation of net-zero climate commitments is another factor increasing climate governance scrutiny by D&O insurers. Such commitments create D&O risk, as the SEC has warned.[335] Thus, D&O underwriters are incentivized to monitor companies' progress toward such commitments. In the words of one underwriter:

> So [a firm says], "We're going to have net zero emissions by 2030." Then, we want to see sort of a plan play out. Every year, we can evaluate that plan. In those one-on-one meetings, we can assess: "Where are you in this process? What hurdles did you hit? Do you feel like you're still on target?"[336]

Another underwriter explained that her team seeks to gain "a very particular understanding of that [client's] mission-critical exposure,"[337] given the increase in *Caremark* litigation. This means trying to ascertain how a company's "corporate structure" is set up to address mission-critical exposure and keep the board informed:

> What's the connectivity of the board? . . . Is it charged with overseeing that [mission critical] risk? Do they have a privacy expert? Do they have a safety expert? Do they have someone who was formerly a regulator? . . . Have they appointed a special committee to oversee that risk? . . . We spend time on understanding the interplay between the board and the C-suite governance, because it's not always immediately obvious how the board is measuring and overseeing internal controls . . . and there's no one right answer to that.[338]

Though there is "no one right answer,"[339] another insurer explained that they are ultimately "looking for ESG to deeply penetrate an organization."[340]

2. The prevalence of ESG issues in underwriting

Some insurers are going further and investing in verification of insureds' climate risk information. Before discussing this emerging practice in depth, it is worthwhile to review the underwriting process.[341]

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[335] The SEC's novel disclosure rules target companies that overpromise and underdeliver. Banham, *supra* note 306; Online Interview with D&O Underwriter # 9 (Oct. 2022).

[336] Online Interview with D&O Underwriter # 5 (July 2022).

[337] Online Interview with D&O Underwriter # 6 (July 2022).

[338] *Id.*

[339] *Id.*

[340] Online Interview with D&O Underwriter # 3 (July 2022).

[341] For a general overview of D&O insurance, see *What Is D&O Insurance?*, *supra* note 8; and Stephen D. Allred, *Key Issues in Evaluating and Negotiating D&O Insurance Coverage*, MONDAQ (June 18, 2014), https://www.mondaq.com/unitedstates/directors-and-officers/321374/key-issues-in-evaluating-and-negotiating-do-insurance-coverage [https://perma.cc/UJJ2-G6MP].

Insurers issue and renew policies once a year. D&O insurance is structured in "towers" of primary and excess coverage.[342] Thus, when a company seeks D&O insurance, the company's broker solicits bids from multiple D&O insurers.[343] Before offering policies, these insurers must gather information from the potential insured. This process begins with basic questionnaires from each insurer in the proposed "tower." The broker serves as an intermediary and provides responses to the insurers' questions.[344] Then, through a series of meetings, underwriters further scrutinize the insured before issuing a policy.

At this crucial step in the underwriting process, some insurers are beginning to invest more resources into analyzing insureds' climate risk information.[345] This includes utilizing ESG or climate data providers, raters, or rankers, among other strategies.[346] Some D&O insurers are also starting to develop their own predictive climate risk tools.[347] Insurers use this information to determine the scope of coverage, the price of premiums, and whether to offer a policy at all. As one underwriter noted, "Better ESG risks obviously translate into . . . better pricing."[348] Many underwriters noted that efforts to price climate-change risks suffer from a lack of reliable, predictive data.[349] Several underwriters reported that their companies are building proprietary risk assessment tools to address this shortage.[350] These investments will allow underwriters to accurately price climate-change risks. Given that certain aspects of climate governance remain qualitative, D&O insurers are seeking external validation, including from law firms.[351]

3. The Marsh Initiative

In 2021, Marsh McLennan ("Marsh") announced that clients "with superior environmental, social, and governance (ESG) frameworks" would be eligible for

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[342] *See* Allred, *supra* note 341.

[343] *See id.*

[344] *See id.*

[345] Roundtable Discussion # 1 with Insurance Industry Participants, *supra* note 83; Roundtable Discussion # 2 with Insurance Industry Participants (Feb. 2023).

[346] Roundtable Discussion # 1 with Insurance Industry Participants, *supra* note 83; Roundtable Discussion # 2 with Insurance Industry Participants, *supra* note 313.

[347] Roundtable Discussion # 1 with Insurance Industry Participants, *supra* note 83; Roundtable Discussion # 2 with Insurance Industry Participants, *supra* note 313.

[348] Online Interview with Underwriter # 3 (July 2022). Yet, the details of how better ESG risks impact pricing remains oblique.

[349] *See* Roundtable Discussion # 1 with Insurance Industry Participants, *supra* note 83; Roundtable Discussion # 2 with Insurance Industry Participants, *supra* note 313.

[350] *See* Roundtable Discussion # 1 with Insurance Industry Participants, *supra* note 83; Roundtable Discussion # 2 with Insurance Industry Participants, *supra* note 313.

[351] Press Release, Marsh, *supra* note 35.

favorable coverage terms.[352] Coming from the world's largest insurance broker, the "Marsh Initiative" reflected insurers' demand for climate governance information and assurance.[353] The initiative combines law firms' ESG oversight expertise with the actuarial capabilities of some of the largest D&O insurers.[354]

To participate, Marsh clients first engage a law firm to perform an independent evaluation of the client's ESG frameworks.[355] If the report is favorable, the client can share a summary of the evaluation with Marsh, and the broker will use it to negotiate better ESG-related terms with D&O underwriters.[356] Importantly, the client's full ESG assessment is never shared with the underwriters.[357] Only the summary is shared, and only at the client's discretion.[358] The participating carriers then apply their own underwriting analysis to determine whether the clients can get preferred terms—typically a discount.[359]

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352 *See id.* Marsh has also recently expanded this initiative to its clients globally. *See, e.g.*, Natalie Tan, *Marsh to Vary Director and Officer Insurance Terms Based on ESG Performance*, BUS. TIMES (Apr. 4, 2023, 9:04 PM), https://www.businesstimes.com.sg/esg/marsh-vary-director-and-officer-insurance-terms-based-esg-performance [https://perma.cc/V3HD-J7BK] ("Marsh's collaboration with our panel [of] insurers in Asia is a key step in recognising – and rewarding – the increasingly prominent role that robust ESG risk management plays in evaluating D&O liability risk profiles.").

353 *Top 20 Global Insurance & Reinsurance Brokers*, REINSURANCE NEWS, https://www.reinsurancene.ws/top-global-insurance-reinsurance-brokers/ [https://perma.cc/4SVN-KBHQ] (last visited Aug. 26, 2024) (reflecting $20.7 billion in 2022 revenue, putting Marsh far ahead of competitor brokers).

354 The initiative began with four underwriters but now includes six: American International Group, Inc., Berkshire Hathaway Specialty Insurance, Sompo International, Starr Insurance Cos., Hartford Financial Services Group, Inc., and Zurich Insurance Group. *See* Claire Wilkinson, *More Insurers Participating in D&O ESG Initiative: Marsh*, BUS. INS. (June 30, 2022), https://www.businessinsurance.com/article/20220630/NEWS06/912350866/More-insurers-participating-in-D&O-ESG-initiative-Marsh [https://perma.cc/SJ57-64HJ].

355 *Id.* ESG practices are proliferating at law firms. Helping boards perform sufficient climate risk oversight is a core part of that practice. Partners at two law firms that participate in the Marsh Initiative said their firms are developing proprietary methods for assessing clients' climate risk oversight, including helping clients develop their own TCFD reports. *See* Smith, *supra* note 278 (listing major firms creating specific ESG practices). Most of these firms view climate risk as a "central pillar" of ESG. DYCK & REN, *supra* note 35. In fact, some have argued an "open question is whether climate action has outgrown the ESG mandate and needs its own." *Id.*; *see also ESG Monthly Newsletter - October 2022*, SULLIVAN & CROMWELL LLP (Oct. 25, 2022), https://www.sullcrom.com/esg-newsletter-oct-2022 [https://perma.cc/2AL7-EUQR] (listing three recent updates in ESG, all of which directly relate to climate risk).

356 *See* Press Release, Marsh, *supra* note 35.

357 *See id.*

358 *See id.*

359 *See id.*

Given that they only see a summary of the independent evaluation, it is perhaps unclear what value D&O underwriters derive from an initiative that provides them with limited information. Underwriters will never know, for example, whether their insureds received an ESG assessment that found red flags, because neither the insured nor the broker would logically share that information. Even when potential insureds receive a positive assessment, underwriters receive very few specific details.[360] Why would underwriters trust a law firm assessment that gives them no ability to scrutinize the findings? Underwriters said, these challenges notwithstanding, the initiative helps them identify clients who are choosing to be proactive about "getting ahead" of legal and regulatory climate-related risks:

> We look for companies that are . . . going above and beyond, not just following rules and regulations . . . . [I]t is in our best interest. It is something we believe in. It's something that we monitor[.][361]

Another underwriter emphasized that the Marsh Initiative gives underwriters "more visibility [and] assurance than we might have in other instances. . . . [But] we're also pressing in the one-on-one engagement we have with these clients."[362] As Underwriter # 5 notes:

> [W]e [then] evaluate [clients] from an external perspective . . . and if we feel that . . . this is a good company and a good industry sector, and they've taken the initiative to go and get this assessment and [are] really trying to better themselves[,] . . . we'll give them some credit and . . . see if we should enhance the coverage in certain ways.[363]

By design, the insurers lack visibility into the clients who have gaps in their ESG programs.[364] Still, underwriters said that a firm's participation in the program is worth recognizing in the underwriting process.[365]

According to these accounts, the Marsh Initiative could be considered a contemporary example of an underwriting strategy known as "feature rating,"[366] which refers to the practice of setting premiums based on "features of the applicant's current operations" at the time the policy is issued.[367] A classic example of feature rating is when a property insurer requires an insured to install a certain type of fire sprinkler. In this way, the property insurer is leveraging the superior information it has—regarding which fire sprinklers reduce losses most effectively in the aggregate—to induce their insureds with discounts. Commentators have pointed out that feature rating often fails because it is

[360] Online Interview with D&O Underwriter # 5 (July 2022).

[361] *Id.*

[362] Phone Interview with D&O Underwriter # 6 (July 2022).

[363] Online Interview with D&O Underwriter # 5, *supra* note 360.

[364] *Id.*

[365] *Id.*

[366] Abraham & Schwarcz, *supra* note 15, at 236.

[367] *Id.*

challenging and expensive for insurers to verify that the efforts are ongoing, and insureds may abandon certain features after the policy is issued.[368] The Marsh Initiative avoids these obstacles. As noted above, the ESG reforms that clients are making are valuable to them for reasons outside of the insurance contract, and, unlike a fire sprinkler, reforming the composition of your board is not easily reversed. Moreover, the cost of the monitoring is borne by the insureds who are paying the law firms. While the Marsh Initiative's efficacy remains to be seen, it is a rare example of bundling monitoring and risk distribution efforts, which scholars have endorsed in the context of accountants:"[E]conomists have understood that monitoring can be an important benefit that corporate insurance provides to shareholders, and the obvious candidates to perform monitoring in the D&O insurance context are the accountants who are already deep inside the corporation."[369]

Though some D&O underwriters are starting to monitor their insureds, the promising potential of D&O insurance to advance climate governance remains untapped by regulators and the industry alike. In response, the next Part offers a normative argument for public and private actors to utilize D&O insurance to enhance climate governance.

V. IMPLICATIONS

This Article has argued D&O insurers have the incentives, and are gaining the ability, to monitor their insureds' climate governance. Though it is too early to prescribe policy interventions, Section A identifies a few next steps for policymakers and private actors to take. Section B concludes by summarizing key implications for corporate law. In doing so, it hopes to inspire further scholarly attention to the intersection of D&O insurance and climate risk.

A. *Next Steps*

1. Private ordering

Confronting climate risk requires broad collaboration.[370] To that end, investor climate alliances ("ICAs") have been an effective way to provide infrastructure and promote coordination among diverse and transnational actors.[371] However, some opponents to climate initiatives have turned to antitrust law, which has proved to be an effective tool and a threat to such collaboration. For instance, the Net Zero Insurance Alliance was dismantled and then rebranded just a week

[368] *Id.* at 240.

[369] Baker & Griffith, *Missing Monitor*, *supra* note 13, at 1838.

[370] *See* Miazad, *supra* note 141.

[371] Lamar Johnson, *UN's Net-Zero Insurance Alliance Disbands and Rebrands*, ESG DIVE (Apr. 29, 2024), https://www.esgdive.com/news/net-zero-insurance-alliance-disbands-rebrands-forum-insurance-transition-net-zero/714598/ [https://perma.cc/36AP-MKSR].

after a group of twenty-three Republican attorneys general accused the group of violating antitrust laws.[372]

This is especially important given the role that D&O insurance plays in climate initiatives. The UN-convened Principles for Sustainable Insurance ("PSI") initiative has committed (as NZIA committed before disbanding) to "insuring the net-zero transition."[373] This transition depends on the actions of officers and directors, and executives often risk shareholder litigation if they fail, so D&O insurance is in demand. Such demand creates a rare opportunity for D&O insurers to communicate with boards directly about climate governance. However, D&O insurance is currently not included in PSI's (and was never included in NZIA's) initiatives.[374] Thus, given the importance of climate governance to the climate transition, PSI should start a specific initiative or workstream for D&O insurance. As a first step, PSI could convene industry participants, policymakers, and scholars with expertise in D&O insurance, climate governance, and corporate law to address the following topics:

Information gathering and sharing: How can D&O underwriters share information with corporate boards in a way that facilitates the board's climate governance and transition to net-zero?

External advisors: Are there ways for insurers to collaborate with external advisors, in particular climate risk disclosure auditors and accountants or law firms, to enhance their capacity to monitor climate governance? Can this be achieved through new products, such as Climate Disclosure Insurance, to formalize the external monitoring within a new insurance product?[375]

Public policy advocacy: What are areas of public policy advocacy specifically for D&O insurers? Given that the inconsistent and voluntary nature of climate disclosure poses risk for directors and officers, should D&O insurers advocate for mandatory climate reporting and disclosure?

Along with these collaborative efforts, insurers should sharpen their focus on D&O insurance and incorporate D&O underwriting into their overall climate

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[372] *Id.*

[373] *Principles for Sustainable Insurance*, UN ENV'T PROGRAMME FIN. INITIATIVE, https://www.unepfi.org/insurance/insurance/ [https://perma.cc/EB74-UGWG] (last visited Aug. 26, 2024). While U.S. insurers remain unwilling to join these alliances, in part due to fears of antitrust scrutiny, the PSI includes one-third of global insurers. *See 2023 in Review: A Growing Membership Continues Ambitious Action on Sustainable Finance*, UN ENV'T PROGRAMME FIN. INITIATIVE, https://www.unepfi.org/industries/banking/2023-in-review-a-growing-membership-continues-ambitious-action-on-sustainable-finance/ [https://perma.cc/2XTE-2E95] (last visited Aug. 26, 2024).

[374] UNEP FIN. INITIATIVE, PSI: PRINCIPLES FOR SUSTAINABLE INSURANCE (2012), https://www.unepfi.org/psi/wp-content/uploads/2012/06/PSI-document.pdf [https://perma.cc/L7SJ-THQZ].

[375] This is similar to proposals for Financial Disclosure Insurance, in which the insurance company bundles risk transfer with risk monitoring and outsources the monitoring to accountants. *See, e.g.*, Angela K. Gore, Kevin Sachs & Charles Trzcinka, *Financial Disclosure and Bond Insurance*, 47 J.L. & ECON. 275, 281-82 (2004).

governance strategy. Insurance industry asset managers have a key role to play too.[376] But industry professionals report that investors and insurers are still not focused on D&O insurers potential role as climate governance monitors.[377]

2. The Federal Insurance Office

Climate governance requires data. As discussed above, D&O insurers are investing in data gathering and analytics. But this data remains largely proprietary. As discussions with insurance industry participants illuminated, insurance is a competitive business, and companies often lack the financial incentives to share data with their competitors.[378] Even if insurers would opt to share information, the fear of antitrust scrutiny is preventing them from doing so.[379]

The FIO has a unique role to play in overcoming obstacles to climate governance data sharing. Though the agency lacks supervisory authority over state insurance regulators, the Dodd-Frank Act grants it broad authority to collect data from insurance companies.[380] The agency has recently taken one important step toward centralizing climate data—on October 18, 2022, it requested public comment on a proposal to collect underwriting data on homeowners' insurance from property and casualty insurers.[381] Along similar lines, the FIO should use its power to gather climate governance data from D&O insurers, and store it in a centralized clearinghouse. There are normative arguments in favor of such public access to climate risk data given that "the private sector cannot be relied upon to provide climate services equitably or reliably."[382]

3. Insurance regulators

Although insurance regulators are incorporating climate risk into underwriting decisions, their focus is overwhelmingly on property and health

[376] *See supra* Section IV.B.

[377] Roundtable Discussion # 2 with Insurance Industry Participants, *supra* note 313; Interviews with Investors # 2 (Feb. 2023).

[378] Roundtable Discussion # 1 with Insurance Industry Participants, *supra* note 83.

[379] *See* Amelia Miazad, *Prosocial Antitrust*, 73 HASTINGS L.J. 1637, 1665-66 (2022) (discussing how antitrust prevents companies from sharing best practices on sustainability).

[380] For a discussion of how the FIO can use its authority to gather data from individual insurers, see Alex Fredman, *Regulators Should Identify and Mitigate Climate Risks in the Insurance Industry*, CAP 20 (June 13, 2022), https://www.americanprogress.org/article/regulators-should-identify-and-mitigate-climate-risks-in-the-insurance-industry/ [https://perma.cc/593H-Z8RU].

[381] Agency Information Collection Activities; Proposed Collection; Comment Request; Federal Insurance Office Climate-Related Financial Risk Data Collection, 87 Fed. Reg. 64134 (Oct. 21, 2022).

[382] *See* Madison Condon, *Climate Services: The Business of Physical Risk*, 55 ARIZ. ST. L.J. 147, 155 (2023).

insurance. Given that climate catastrophes are increasing in frequency and force, this is unsurprising. Consequently, however, regulators have thus far overlooked D&O insurance's unique power to advance environmental and social goals. Even California's Insurance Commission—widely considered a leader in addressing ESG risks—has not weighed in on the one-of-a-kind role D&O insurers can play.[383] This Article argues that prioritizing property insurance over D&O is a *reactive* approach to addressing climate risks. As a first step, then, the NAIC should convene a task force or working group to assess the potential of D&O insurers as climate governance monitors.

4. The SEC

Unlike some international regulatory regimes, the SEC does not require U.S. registrants to disclose the details of their D&O insurance policies.[384] Rather, Item 702 of Regulation S-K merely requires that registrants: "State the general effect of any statute, charter provisions, by-laws, contract or other arrangements under which any controlling persons, director or officer of the registrant is insured or indemnified in any manner against liability which he may incur in his capacity as such."[385]

This Article is not the first to bemoan the SEC's unwillingness to require disclosure of D&O details. As Sean Griffith has argued, the agency should require companies to disclose more information about their D&O insurance policies because D&O contract terms reveal useful information to investors about the quality of the insureds' corporate governance.[386] Other scholars agree that Griffith's "argument that D&O insurance premiums can be indicative of a company's corporate governance quality is theoretically correct."[387]

The agency's recent focus on enhancing ESG disclosure and preventing greenwashing provides an opportunity to reexamine its reluctance to require D&O policy disclosure. A comprehensive proposal for specific disclosures is beyond the scope of this Article, but the SEC could, for example, require insureds to disclose specific policy terms (such as credits or increases in retentions) that result from the insureds' ESG efforts. Of course, this raises many questions, but it would be a step in the right direction. Alternately, the SEC could require publicly listed insurers to disclose how they are using ESG ratings and

[383] *See California Climate Insurance*, CAL. DEP'T OF INS., https://www.insurance.ca.gov/cci [https://perma.cc/4UA9-V7GN] (last visited Aug. 26, 2024).

[384] Sean J. Griffith, *Uncovering a Gatekeeper: Why the SEC Should Mandate Disclosure of Details Concerning Directors' and Officers' Liability Insurance Policies*, 154 U. PA. L. REV. 1147, 1198 (2006).

[385] 17 C.F.R. § 229.702.

[386] Griffith, *supra* note 384, at 1203.

[387] René Otto & Wim Weterings, *D&O Insurance and Corporate Governance: Is D&O Insurance Indicative of the Quality of Corporate Governance in a Company?*, 24 STAN. J.L. BUS. & FIN. 105, 114 (2019).

rankings in their underwriting decisions, which would be consistent with several state laws that require such disclosure for credit rankings.[388]

B. *Implications for Corporate Law*

The intersection of D&O insurance and climate governance has important implications for corporate law. Most notably, by monitoring their insureds and encouraging climate governance reforms, D&O insurers can prevent or reduce corporate misconduct. This intervention comes at a vital time. In the traditional accounting fraud case, shareholders filed litigation and sought financial compensation—and "money surely compensates for money."[389] As Part II explained, shareholders today also file litigation to reduce environmental and social harms. Similarly, though the recent *Caremark* cases do not explicitly reference climate risk, they are unique in that "they are based on serious ESG-related concerns about externality risks to humans."[390] Shareholder litigation that alleges harms to non-shareholder constituents is not only more prevalent, but also more successful, which means that Delaware courts are at least implicitly endorsing this prosocial purpose for corporate law. In this new era of prosocial shareholder litigation, money cannot fully compensate for social and environmental harms, rendering D&O's traditional "pocket-shifting" normatively untenable.

Moreover, information-sharing between insurers and corporate boards signals a new era of collaborative corporate governance, which deserves more scholarly attention.[391] Under this cooperative mode of insurer/insured engagement, each party can access information they would not otherwise possess.[392] Such information sharing between D&O underwriters and corporate boards helps boards oversee climate risk more effectively, and allows insurers to underwrite risk more efficiently.[393] But there remain obstacles to collaborative governance, including antitrust concerns, the "ESG backlash," and investors' myopic focus on single firms, rather than portfolio-wide returns. This Article argues that the promise of D&O insurers as climate risk monitors offers another reason for

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[388] *See* Darcy Steeg Morris, Daniel Schwarcz & Joshua C. Teitelbaum, *Do Credit-Based Insurance Scores Proxy for Income in Predicting Auto Claim Risk?*, 14 J. EMPIRICAL LEGAL STUD. 397, 404 (2017).

[389] Baker & Griffith, *Missing Monitor*, *supra* note 13, at 1819.

[390] Badawi & Partnoy, *supra* note 301, at 364.

[391] As Jill Fisch and Simone Sepe have argued, corporate law scholarship remains beguiled by agency theory, but "the corporate world has moved on" to a far more collaborative approach. Fisch & Sepe, *supra* note 293, at 864; *see also* Miazad, *supra* note 141.

[392] Faith Stevelman & Sarah C. Haan, *Boards in Information Governance*, 23 U. PA. J. BUS. L. 179, 181 (2020).

[393] *See* Michael C. Jensen, *The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems*, 48 J. FIN. 831, 848 (1993); Benjamin E. Hermalin & Michael S. Weisbach, *Endogenously Chosen Boards of Directors and Their Monitoring of the CEO*, 88 AM. ECON. REV. 96, 101 (1998).

corporate law to accommodate a more collaborative approach to climate governance.

CONCLUSION

In their quest for a board monitor, scholars and policymakers have overlooked D&O insurers. In response, this Article describes how a recent convergence of factors is increasing the incentives and ability of D&O insurers to help their insureds reduce environmental harms. Further, it theorizes that the trend of "D&O insurers as climate governance monitors" is likely to continue because the long-term financial sustainability of the insurance industry (and insureds) depends on reducing environmental externalities. This insight comes at a crucial time; lawmakers, regulators, and investors are searching for ways to motivate boards to step up their climate governance. D&O insurers' potential impact on board oversight of climate risk is no longer utterly unexplored.

This Article took the first step by identifying and examining D&O insurers' potential to serve as climate governance monitors. Their changing role has wide-ranging implications, providing rich areas for future scholarship. By identifying these emerging forces within the insurance industry, this Article hopes to spark further dialogue at the intersection of D&O insurance and climate risk.

APPENDIX A

I. METHODOLOGY

In addition to an extensive review of publicly available sources, the findings in this Article are informed by original and semi-structured qualitative interviews and roundtables with insurance industry members.

Participants include executives at major insurers specializing in climate risk strategy; D&O insurance brokers; D&O insurance underwriters; law firm counsel specializing in board governance of ESG; law firm counsel specializing in shareholder litigation on ESG issues; corporate counsel; corporate risk managers; D&O coverage counsel representing policyholders; insurance industry investors; insurance industry asset managers; and NGOs focused on the intersection of climate change and insurance.

These participants are unique because they have firsthand experience with, and in some cases are designing or leading, the insurance industry's most high-profile efforts to incorporate climate risk into its business strategy. Moreover, each of the participants is a seasoned senior level executive in the insurance industry.

A snowball sampling technique was used to identify interview subjects, which relies on interview subjects to assist in identifying more participants. The major shortcoming of this technique is that it introduces bias into the sample. In this case, however, that is less of a concern because this Article is not relying on these interviews to argue that the participant's experiences are representative of the insurance industry. Rather, this Article has used the interviews to shed light on insurance industry climate governance initiatives that are in the public domain.

To encourage candid and detailed responses, the interview participants were also promised anonymity. For that reason, the table below does not include specific dates, but only the month that the interviews took place. The author has retained copies of each interview transcripts and/or detailed notes, with personal information removed. This research method has received IRB approval from the University of California, Davis School of Law.

Table 1. Interview Participants.

Type	General description/experience level	Date(s)
D&O Insurance Broker # 1	Managing Director at large D&O insurance broker with nearly forty years of experience in the D&O insurance industry.	March 2022
D&O Insurance Broker # 2	Managing Director at large D&O insurance broker with over thirty-five years of experience in the D&O insurance industry.	March 2022
D&O Insurance Broker # 3	D&O coverage specialist at large insurance broker with over twenty-one years of experience in the D&O insurance industry.	November 2021
D&O Insurance Broker # 4	D&O insurance broker specializing in insurance for asset managers with nearly twenty years of experience in insurance and asset management industry.	June 2022
D&O Insurance Broker # 5	D&O insurance broker with over thirty years of experience in the D&O insurance industry.	June 2022 November 2021
D&O Insurance Broker # 6	D&O liability product leader at major broker with over twenty-eight years of experience in the D&O industry.	November 2021 June 2022 June 2022 May 2022

Type	General description/experience level	Date(s)
D&O Underwriter # 1	D&O liability underwriter with over twenty years of experience in the insurance industry.	May 2022
D&O Underwriter # 2	Former D&O liability underwriter (recently transitioned) with over thirty years of experience in the D&O insurance industry.	June 2022
D&O Underwriter # 3	Chief Underwriting Officer at major insurer with over fifteen years of experience in the D&O insurance industry.	July 2022
D&O Underwriter # 4	D&O underwriter at major insurer with nearly thirty years of experience in the D&O insurance industry.	July 2022
D&O Underwriter # 5	Head of Financial Underwriting at major insurer with over twenty years of experience in the D&O insurance industry.	July 2022
D&O Underwriter # 6	Senior Vice President at major insurance company with over twenty-five years of experience in the D&O insurance industry.	July 2022
D&O Underwriter # 7	Senior D&O underwriter at major international insurer with over ten years of experience in insurance industry.	July 2022
D&O Underwriter # 8	Senior underwriter at major insurer with over fifteen years of experience in insurance industry.	October 2022
D&O Underwriter # 9	Senior underwriter at major insurer with over eight years of experience in insurance industry.	October 2022
D&O Underwriter # 10	Senior underwriter at major insurer with over ten years of experience in the D&O industry	October 2022

Type	General description/experience level	Date(s)
D&O Underwriter # 11	Underwriter at major D&O insurer specializing in ESG with over three years of experience.	October 2022
D&O Underwriter # 12	Senior underwriter at major D&O insurer with over fifteen years of experience in D&O insurance	February 2023
Insurance Industry Executive specializing in ESG # 1	Head of ESG at major insurer with over fifteen years of experience in insurance industry.	July 2022
Insurance Industry Executive specializing in ESG # 2	Public relations specialist focused on ESG at major insurance company with over twenty-five years of experience.	July 2022
Law Firm Partner # 1	Partner and head of law firm's insurance coverage practice group, with over twenty-five years of experience representing corporate policy holders in D&O coverage disputes.	December 2021 June 2022
Law Firm Partner # 2	Partner at major law firm filing litigation on behalf of shareholders, including "event-driven" litigation on diversity, equity, and inclusion. Over twenty-five years of experience.	April 2022
Law Firm Partner # 3	Partner and head of major law firm's ESG practice group, with over thirty-five years of experience.	May 2022
Law Firm Partner # 4	Antitrust partner and a part of major law firm's ESG practice group. Has specific experience advising insurers on Net Zero commitments, with over twenty-five years of antitrust experience.	April 2022
Law Firm Partner # 5	Partner and head of major law firm's ESG practice group, with twenty years of experience.	August 2022

Type	General description/experience level	Date(s)
Corporate Risk Manager # 1 at Fortune 100 company	Head of Risk at major airline who interfaces with all insurance brokers and underwriters with over ten years of experience.	June 2022
Corporate Risk Manager # 2 at Fortune 100 company	Head of corporate governance at major technology company who interfaces with D&O brokers and underwriters, with over ten years of experience.	July 2021
Roundtable Discussions	Roundtable discussions on climate risk and the insurance industry conducted in-person under Chatham House Rules with: (1) insurance industry underwriters and executives; (2) insurance industry asset managers; (3) insurance industry investors; (4) scholars specializing in insurance, ESG, and private environmental governance; and (5) representatives from civil society including NGOs. The discussions took place from 8:30 AM to 2:30 PM.	January 2023 February 2023 May 2024