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Asset Management

Carbon Crusade

California's insurance commissioner calls coal a risky investment. Others see possible political motives and regulatory overreach.

by Tim Dobbyn

AP Photo/Rich Pedroncelli

California Insurance Commissioner Dave Jones defends his request for insurers to divest from coal as entirely consistent with his role as a financial regulator charged with ensuring the safety and soundness of carriers doing business in his state.

To ignore the dangers overhanging carbon-related investments would be similar to the run-up to the financial crisis of nearly a decade ago, Jones said. "Just about every financial analyst and investor thought real estate would never decline in value," Jones told *Best's Review*. "That was the common and conventional wisdom, and you know how well that turned out."

Governments at local to international levels are increasingly curbing the emission of carbon dioxide in response to global warming, spurring

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>
> **Dave Jones**
> **California Insurance Commissioner**

Jones’ January request for insurers to voluntarily divest from thermal coal to guard against the value of their holdings declining. He also announced a mandatory call for data on insurers’ holdings in coal, oil and natural gas.

“My request with regards to divestment is limited to thermal coal because I believe thermal coal as an investment is not a good investment,” Jones said, adding that data on other fossil fuel investments will help both the regulator and insurers better understand future risks. Replies were due July 1, with results to be made public once checked and verified.

Key Points

Risky Business: California’s insurance commissioner has requested insurers divest from coal, saying investments in fossil fuels are at risk as nations move to lower-carbon economies.

Another View: Critics say to restrict investment in utilities, which often rely on coal to generate energy, would be counterproductive to the goal of developing alternative sources of energy and that risks can be adequately managed by the insurance industry.

State of Play: Insurance companies may feel pressure to reduce their investments in fossil fuels, but insurers are unlikely to flee from positions offering good returns at a time of very low yields.

Indiana Department of Insurance Commissioner Stephen Robertson, however, sees things differently. Robertson is particularly worried about how Jones’ action could restrict investment in utilities that might currently be heavy users of coal but are likely to transition to cleaner power sources in the future.

Drawing an analogy to the way traditional phone companies transitioned to wireless providers, he said the development of substantial and reliable amounts of alternative energy is going to take years and is more likely to come from existing utilities. To restrict investments in utilities by insurance companies seems counterproductive to that transition, he said.

As one of the nation’s leading manufacturing states, Indiana needs affordable and reliable electrical power, Robertson said, and for now, nearly 80% of that power produced in state comes from coal.

Robertson said he had worked with Jones on several National Association of Insurance Commissioners’ projects and thinks he is a good state regulator, “but I think the California approach is kind of missing the mark.”

Industry Groups React

Industry groups representing already highly regulated insurers are also generating plenty of steam over what they say is regulatory overreach with possible political motivation—even while a May report from the nonprofit sustainability group Ceres, which pushes insurers to shift investments to clean energy, acknowledged that coal investments are already small. They warn that cutting fossil fuel investments from portfolios would hurt earnings to the point where premiums would have to rise. They also assert that markets are already pricing in the regulatory risk to carbon investments and that insurers are sophisticated investors.

Insurers should be the ones deciding about insurers' investments, said Robert Detlefsen, vice president of public policy with the National Association of Mutual Insurance Companies. "I don't think they really need instruction from the likes of Commissioner Jones as to what investments are likely to be profitable in the future or not."

Data Haul

Jones' request for voluntary divestment from thermal coal holdings applies to all 1,241 insurers admitted to California, the largest U.S. market for insurance, with $259 billion collected in premiums annually. The data call related to fossil fuel investments applies to California-admitted companies with 2015 written premiums equal to or greater than $100 million nationwide.

Jones' actions were a first for the insurance industry, although according to a law signed last year, California's two large public pension funds are being forced to divest from companies that receive at least half their revenue from thermal coal.

Electric utilities get caught in Jones' initiative because the divestiture request applies to all investments in power providers that generate 30% or more of their electricity from coal. A question and answer fact sheet posted on the internet by the California Department of Insurance says that threshold applies regardless of whether the utility is changing their energy mix.

Utilities are a very reliable investment for insurers with a stable set of customers and high dividends, said Insurance Information Institute President Robert Hartwig. "They are among the best alternatives in this very, very low interest rate environment that we are in today."

Hartwig said there was no escaping the math. If insurers were to completely remove themselves from carbon-generating assets, "the cost of insurance would be higher, everywhere, at all times," Hartwig said.

Asked about the income insurers currently derive from fossil fuel-related assets, Jones said: "Just because a particular asset class has always paid well and retained value doesn't mean it always will."

Jones said his decision to request divestiture was also prompted by the bankruptcies of top coal companies in the United States, and decisions by some major banks and insurers Axa and Allianz to divest from coal.

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Indiana Insurance Commissioner

The business of thermal coal, used for power generation, has been hit by slackening global demand, raised costs from environmental regulations and abundant supplies of cheap, cleaner-burning natural gas, which can compete with coal in making electricity.

In April, the world's largest coal producer, Peabody Energy Corp., filed for U.S. bankruptcy protection.

A.M. Best data on insurers shows some investment in thermal coal companies as of the first quarter of this year, including names such as Arch Coal Inc., Hallador Energy Co. and Cloud Peak Energy Inc. But diversified resource companies, such as BHP Billiton Ltd., and major oil companies, such as Chevron Corp., turned up far more often.

Ken Johnson, vice president in the life/health ratings division of A.M. Best said the rating agency talks to insurers about their energy exposures on a regular basis. He said he expects insurance companies to look for opportune times to lower their exposures and perhaps put the money to work in cleaner energy areas. "We will see overall reductions, but there will be no running to the exits."

The widely cited Ceres report found the top 40 U.S. insurance groups had collective investments in coal, oil and gas, and electric/gas utilities worth $459 billion, based on 2014 year-end regulatory filings.

The report, done in collaboration with investment consulting firm Mercer, found coal accounted for just $1.8 billion of the total and was a quarter of the $7.2 billion invested in renewable energy. Still, the study authors said insurers were underinvested in clean energy relative to what was required to avoid dangerous climate change.

Jones took part in the presentation of the Ceres report in May. He said he is approaching the issue as a financial regulator, although he does believe scientific evidence that the planet is warming, and that the cause of the warming is man-made.

Can't We Just Talk About It?

Some of Jones' critics see political motivations in his recent actions. Jones filed papers last year that would allow him to seek election as California's attorney general in 2018.

"It's hard to avoid the conclusion that these are moves that are calculated to position him

for a future election," said Detlefsen, from the mutual insurers group, adding that California is one of the greenest states.

David Snyder, vice president of policy and research development at the Property Casualty Insurers Association of America, said his group is very concerned about politicizing insurers' investments. "Investment decisions really need to be made in a purely financial context as this is essential to the safety and soundness of the system," he said.

"There is nothing political about it," Jones said. He said he is acting as a financial regulator should when confronted with policy changes that may turn thermal coal, and oil and gas investments into stranded assets. He also said his actions are consistent with unelected financial regulators, such as the Bank of England's governor, Mark Carney.

Carney, in a speech last year at a Lloyd's of London event, warned that insurers are heavily exposed to the risks of climate change from policy claims on more extreme weather events and the devaluation of investments in fossil fuels as nations move to lower-carbon economies.

The discussion of carbon investments by insurers is muddied by the politics woven into the issue in the United States, according to Jim Jones, executive director of the Katie School of Insurance and Financial Services at Illinois State University.

"The rationale [insurers] sometimes jump to is that this is some sort of imposed corporate social responsibility, it's not voluntary anymore and that there's social engineering going on here," said the Katie School's Jim Jones. "It's unfortunate, because there are some very fundamental business reasons that they should be exploring this."

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A.M. Best

Insurance advocates insist the industry is aware of the risks. Hartwig of the Insurance Information Institute said he does not believe Commissioner Jones' actions would change how insurers operate.

Energy companies will evolve, and insurance companies will adjust their investments. "That's just good investment policy, not just because a regulator is arbitrarily singling out an industry," said Hartwig, who called the California action a slippery slope.

Snyder said there were property/casualty insurers who were globally very active on a whole range of environmental issues. "And that's fine, but they do that in the context of being able to manage their investments so as to maximize both the safety and the [investment] return, which in turn then benefits consumers."

Detlefsen, from the mutual insurers' group, said the response to California's request would vary from insurer to insurer. "Some of the insurers with more name recognition with the public would think it prudent to kind of play along with this," he said.

Indiana's Robertson sees California's action as an example of regulatory overreach that could wind up increasing costs to insurance consumers and even utility customers.

The risks of investing in utilities can be adequately managed by the insurance industry, said Robertson. "Quite frankly, on behalf of Indiana, I'm going to continue to oppose this type of initiative because I feel it's really counterproductive to the goal of developing alternative sources of energy." BR