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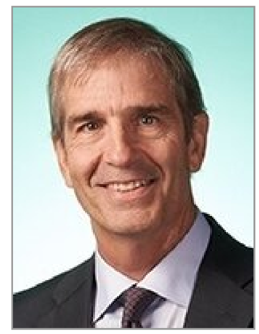
Biden Admin.'s Climate Strategy Should Include Insurance Innovations

By **Michael Hill and Paul Tetenbaum** (May 3, 2021, 5:53 PM EDT)



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As part of its January Executive Order No. 14008,[1] March infrastructure plan[2] and Earth Day pledge[3] to combat climate change, the Biden administration should add insurance innovations to its multipronged strategy.

Although under the McCarren-Ferguson Act, the federal government has left to states virtually all insurance regulation, states have not regulated environmental insurance since 1986, by which time what's known as the pollution exclusion had been added to virtually all regulated policies.

What little climate-related insurance regulation or even discussion there has been is limited to insurance that responds to climate impacts (e.g., floods) versus avoiding such impacts by reducing greenhouse gases in the first place. Given this history and the difficulties inherent in organizing a multistate effort, federal leadership is critical to the creation of insurance that proactively helps combat climate change.

Four Key Areas

At least four areas show that such leadership could be particularly effective, and at least three such areas will require substantial involvement by counsel in their applications.

Site Cleanups

The U.S. Environmental Protection Agency recognizes that the cleanup and redevelopment of contaminated properties, or brownfields, reduces urban sprawl and consequent vehicle-miles-traveled from new growth by 25-33%.[4]

Yet no government, state or federal, has provided any regulation or even guidance with respect to insurance that supports brownfield cleanups. The most important type of insurance in this arena — known as cost cap — reduces risks of cost overruns for a cleanup that is known to be required for redevelopment to take place.

Although cost cap insurance did not exist until the late 1990s, by the early 2000s it had become a critical tool in redeveloping many of the nation's largest and most significant cleanups. However, the lack of regulatory leadership resulted in policies that so frequently lacked suitable loss control and other terms that, by 2011 and for almost a decade, the entire industry (American International Group Inc., Zurich Insurance Group AG and others) stopped offering cost cap.

Over the past decade, a small handful of cleanups were done with cost cap alternatives accomplished through captive insurers and escrows.[5] On a very limited and case-by-case basis, the EPA approved the use of those nontraditional alternatives, applying lessons learned from the pre-2011 era and resulting in more than 17,000 jobs created at just one site (a former Air Force base) and the EPA's first award for federal facility reuse.[6]

One insurer, Markel Corp., stepped back into the field in 2020, offering cost cap under the same model that the EPA had approved during the nearly 10-year hiatus.[7]

The EPA should work proactively now with that insurer and others to develop guidance or even regulations for the industry as a whole to follow. With an EPA push toward insurance that is regulated and otherwise reliable, more urban areas will be cleaned up, more jobs and tax revenue streams created, and vehicle miles traveled will be reduced.

Wetlands Protection

In addition to their many other benefits (e.g., flood control and migratory flyways), wetlands are carbon sinks, the enhancement of which is included in the Earth Day stated goals.

The Army Corps of Engineers in 2008 issued regulations for a program to trade credits designed to protect and expand wetlands in the context of road construction and other development. The regulations require credit sales to be accompanied by insurance or one of several other identified types of financial assurance to ensure that wetlands underlying credits remain intact.

Although a 2016 Corps white paper[8] recognized that insurance is best among the identified options, the Corps has issued no meaningful guidance even for its own personnel as to the specific terms of the options to ensure that they are in fact protective and delivered at a fair price.

As a result, Corps districts have approved policies that lack any coverage for first-year loss, legal fees or other costs mandated by the Corps' own regulations. The approval problems stem not only from the fact that the federal government generally does not regulate insurance but also because, except in very narrow circumstances, the federal government is prohibited from even buying insurance for its own actions.

Again, with states having abandoned the environmental field and given the delays inherent in expecting a multistate solution, the Corps should develop in-house expertise and create clear and compliant policy requirements, so developers, insurers and regulators (delegated states as well as Corps districts) have a clear understanding of what is needed.

Such involvement would not only improve the quality of the financial assurance but also reduce its cost, resulting in more wetlands and, in turn, more carbon sequestration.

Electric Vehicles

President Joe Biden's Executive Order No. 14008, Infrastructure Plan and Earth Day pledge all include an increase in electric and other zero-emission vehicles as a goal but omit any discussion of a critical transportation cost — insurance — as a tool to advance that goal.

Although states do regulate auto insurance including for zero-emission vehicles, state-regulated premiums still fail to reflect the advantages of zero-emission vehicles' lower center of gravity, disproportionately high use of driver assistance technologies and other safety advantages.[9]

Under today's state-led system, many insurers will not even offer to insure zero-emission vehicles or offer it only at premiums that are higher than for other vehicles. Although — unlike with brownfields and wetlands — state regulators do set language requirements for auto policies, failures as to rate structures (i.e., premiums) for zero-emission vehicles show federal involvement is needed for timely reform.

Premiums reflecting zero-emission vehicles' lower risks could over the life of a zero-emission vehicle reduce its cost by as much as the $7,500 tax credit the administration proposes but with virtually no public expense.

Forest Protection

Similar to wetlands, forests sequester carbon and forest conservation is enhanced through the trading of related credits. The California-based Climate Action Reserve has served as the U.S. epicenter of forest-related carbon credits, and in its Forest Project Protocol has for over a decade expressly anticipated an insurance product to be developed to insure the credits.[10]

In the absence of insurance, the Climate Action Reserve created what it calls a buffer pool — basically a set-aside of roughly 20% of a particular project's credits into a pool drawing from multiple projects — but the pool does not do what a well-regulated, market-based product could.

It does not, for example, incentivize long-term management of the credits or the lands underlying the credits to maximize the reserves (e.g., through biochar and other carbon-sequestering steps).

AIG briefly considered offering a policy but ultimately withdrew. Significant hurdles deterring any traditional insurer from offering coverage include: (1) that the protections must last 100 years (far beyond virtually any private company's planning horizon); and (2) the difficulty in determining the cost of replacing a credit lost even just a few years into the 100-year span.

A captive-based insurance product was conceived of roughly a decade ago but it, too, came to a halt when, in the absence of regulatory leadership, the market for forest-related carbon credits collapsed.

With federal leadership, insurance to meet this need would enable project owners to sell a greater percentage of their credits, resulting in greater return. That return should, in turn, increase the amount of forest protected, advancing another of the administration's identified goals.

Federal Leadership Is Needed

Despite McCarren-Ferguson's deference to states, specific areas show that the federal government can regulate insurance where necessary to advance federal goals. These areas include 1957-present subsidies for liability insurance to support nuclear power under the Price Anderson Act; 2002-present subsidies for terrorism coverage provided under the Terrorism Risk Insurance Act; and 2010-present health insurance protections provided under the Affordable Care Act.

In addition, on Jan. 26, Biden issued a memorandum reinstating the federal interpretation that a 2013 regulation, Title 24 of the Code of Federal Regulations, Section 100.500, does in fact hold homeowner insurers to the Fair Housing Act's discriminatory effects standard.[11]

As to climate-related insurance in particular, U.S. Treasury Secretary Janet Yellen has pledged a Treasury Department team to focus on climate change,[12] and Sen. Dianne Feinstein, D-Calif., has urged the department's recently created Federal Insurance Office to "recommend ways to modernize the U.S. system of climate risk regulation in insurance."[13]

History shows the critical role the federal government has played in developing and supporting insurance for targeted, critical needs in our nation.

To successfully meet the Biden administration's climate-related goals, we need to move beyond discussions of insurance that merely responds to climate impacts and shift to a new sustainable insurance framework that incentivizes and facilitates activities that proactively reduce carbon impact. Only through focused and robust federal leadership can this happen; and never before has it been so within reach.

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[1] Executive Order 14008 (Jan. 27, 2021) 86 Fed. Reg. 7619 (published Feb. 1 but dated Jan. 27). https://www.federalregister.gov/documents/2021/02/01/2021-02177/tackling-the-climate-crisis-at-home-and-abroad.

[2] White House Fact Sheet (March 31, 2021). https://www.whitehouse.gov/briefing-room/statements-releases/2021/03/31/fact-sheet-the-american-jobs-plan/.

[3] White House Fact Sheet (Apr. 22, 2021). https://www.whitehouse.gov/briefing-room/statements-releases/2021/04/22/fact-sheet-president-biden-sets-2030-greenhouse-gas-pollution-reduction-target-aimed-at-creating-good-paying-union-jobs-and-securing-u-s-leadership-on-clean-energy-technologies/.

[4] EPA Brownfields Program website: https://www.epa.gov/brownfields/brownfields-program-environmental-and-economic-benefits.

[5] M. Hill, Insured Fixed-Price Cleanups: Still Possible Even After Commercial Insurers' 2011 Exit from the Cost Cap Market, 70 Chem. Waste Litig. Rprt. 955 (Oct. 2015).

[6] U.S. Air Force Civil Engineer Center website https://www.afcec.af.mil/News/Article-Display/Article/1653015/epa-honors-afcec-team-at-former-mcclellan-air-force-base-with-national-site-reu/.

[7] M. Hill, Cost Cap Is Back: And Better Than Before, Int'l. Risk Mgt. Inst. (Aug. 2020). https://www.irmi.com/articles/expert-commentary/cost-cap-is-back.

[8] U.S. Army Corps of Engineers, Implementing Financial Assurance for Mitigation Project Success (March 2016). https://www.iwr.usace.army.mil/Portals/70/docs/iwrreports/Financial_Assurance.pdf.

[9] E.g., Tesla Vehicle Safety Rept. Q1 2021 (accident rate less than 1/8 that of U.S. fleet as a whole). https://www.tesla.com/VehicleSafetyReport).

[10] Climate Action Reserve, Forest Project Protocol v. 5.0, 64 (Oct. 16, 2019). https://www.climateactionreserve.org/wp-content/uploads/2021/04/Forest_Protocol_V5.0_Package_040921.pdf.

[11] White House Memorandum (Jan. 26, 2021): https://www.whitehouse.gov/briefing-room/presidential-actions/2021/01/26/memorandum-on-redressing-our-nations-and-the-federal-governments-history-of-discriminatory-housing-practices-and-policies/.

[12] See, e.g., Treasury Department News Release (Apr. 6, 2021) https://home.treasury.gov/news/press-releases/jy0104.

[13] Cite: Office of Senator Diane Feinstein, Press Release (Jan. 28, 2021) https://www.feinstein.senate.gov/public/index.cfm/press-releases?ID=F494CF21-B927-404B-876A-CF80D3231985.
