



# Rising to the challenge: climate risk in the UK banking sector

**An assessment of the state of play and how to enhance approaches**

**Climate Risk and Banks Survey 2020**  
October 2020





## Contents

Foreword/Executive Summary	1
Results at a glance	4
Where are banks on their climate risk journey?	5
Board engagement and governance	8
Scenario analysis – a new frontier for banks	13
Risk management – towards a strategic approach?	18
Disclosures	26
Regulatory landscape – a global framework for a global problem?	33

# Foreword



**Jon Williams**

Partner,  
Sustainability &  
Climate Change,  
PwC UK &  
Member of FSB  
Task Force on  
Climate-related  
Financial  
Disclosures

Despite the COVID-19 pandemic, firms and regulators are keen that the climate risk agenda continues to progress. The Bank of England has continued to emphasise that climate risk is a strategic priority and the Prudential Regulation Authority's (PRA) 2020-21 Business Plan<sup>1</sup> clearly sets out that climate change brings financial risks that need to be managed now. There is a clear regulatory expectation that firms should continue to make progress on executing the plans they submitted in response to the PRA's Supervisory Statement on managing climate risk (SS3/19)<sup>2</sup>. The PRA's 'Dear CEO' letter<sup>3</sup> in July 2020 has also confirmed a deadline of the end of 2021 for fully embedding the regulator's expectations on climate risk.

Nonetheless, it's clear that recent events have had an unavoidable impact on climate risk programmes. While there is a shift towards a broader focus on ESG issues in the market, which has been accelerated by COVID-19, the PRA still wants firms to focus on identifying and managing climate risks as per the prescribed responsibility for a Senior Management Function (SMF) holder. We therefore believe it's timely to consider the progress that banks and building societies are making with respect to their climate risk programmes, as well as identifying any common challenges across the industry.

We surveyed PRA-regulated banks and building societies to understand the state of play across the sector with regards to implementing the PRA's expectations in relation to SS3/19. This report sets out the results of this exercise and our observations on common challenges and potential ways forward. We hope this will benefit readers by providing insights about the implementation of the climate risk plans and banks' wider strategic efforts to embed climate risk management across the industry.

From our survey, it's clear that respondents are looking ahead to develop a strategic approach to climate risk and establish a mature risk management framework – but first they need to build the foundations, and time is running out. The impending deadline of the end of 2021 for fully embedding firms' climate risk programmes means time is of the essence, and so we have also set out key next steps and guidance that firms should consider to progress their approaches in the short-term.

In recent years, we've seen firms make great strides in identifying and managing climate-related risks. There is still much to do, but by working together with the regulators and their customers, banks and building societies can continue to make progress, and ultimately advance the overall goal of an orderly transition to a net zero future.

<sup>1</sup> PRA, 2020, Prudential Regulation Authority Business Plan 2020/21,

<https://www.bankofengland.co.uk/prudential-regulation/publication/2020/pru-business-plan-2020-21>

<sup>2</sup> PRA, 2019, Enhancing banks' and insurers' approaches to managing the financial risks from climate change, <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2019/ss319>

<sup>3</sup> PRA, 2020, Letter from Sam Woods 'Managing climate-related financial risk – thematic feedback from the PRA's review of firms' SS3/19 plans and clarifications of expectations', <https://www.bankofengland.co.uk/prudential-regulation/letter/2020/managing-the-financial-risks-from-climate-change>



# Executive summary

**Few banks or building societies would dispute the fact that climate change has steadily crept up the risk register in recent years.**

**An increasing awareness of the material financial impacts of climate-related risks, as well as growing societal and regulatory pressures, is forcing banks to act. In the UK context, this regulatory pressure was given additional momentum by the PRA's Dear CEO letter, published in July 2020. The PRA noted that significant near-term improvements are required if firms are to establish robust climate risk management frameworks by the now formalised deadline of end-2021.**

17

PRA-regulated banks<sup>1</sup>  
surveyed

We surveyed 17 PRA-regulated banks and building societies of varying sizes to understand how they were progressing against the regulator's expectations on climate change. Almost all respondents stated they were on track to embed their climate risk programmes by the end of 2021.

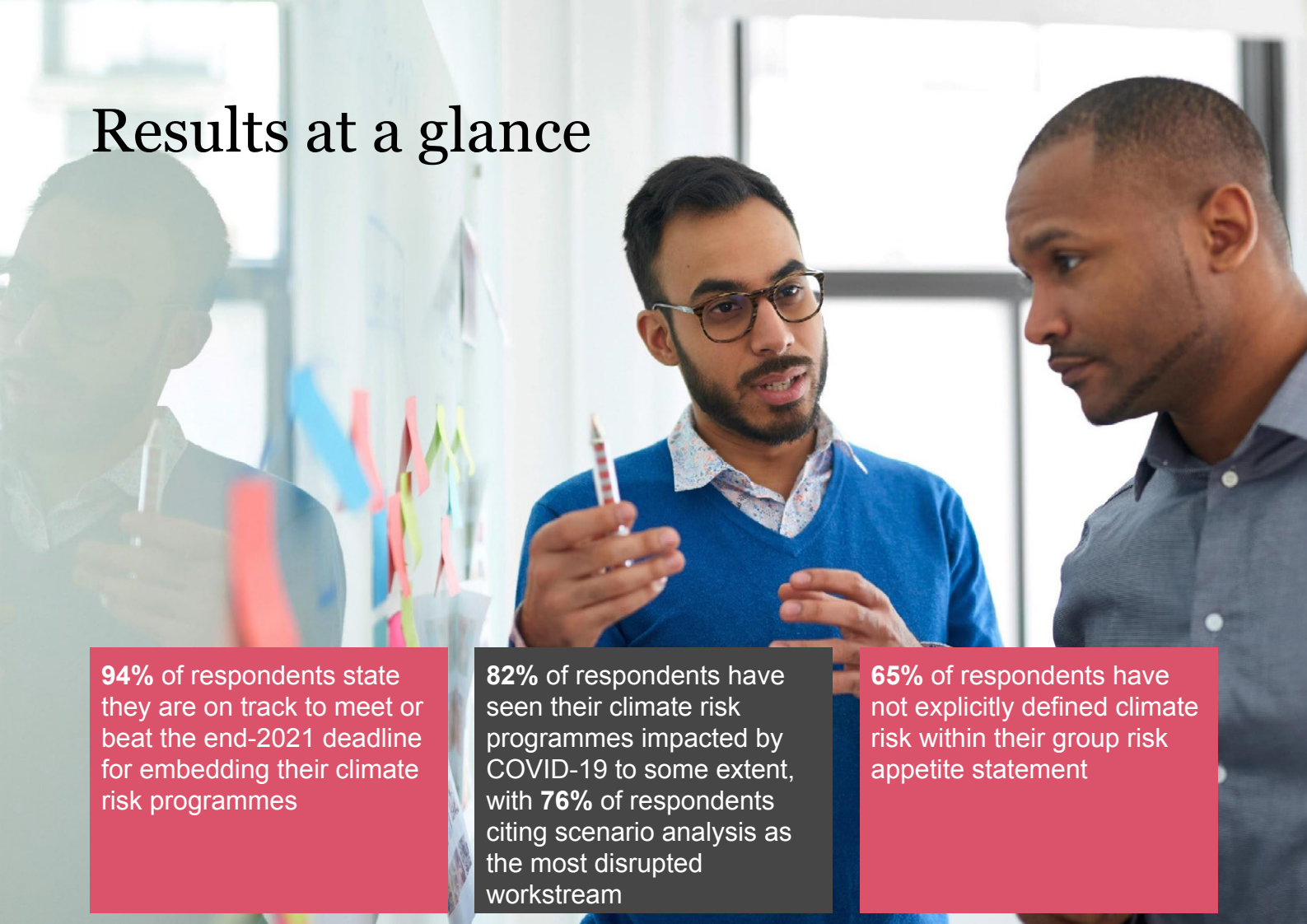
However, our findings indicate that many respondents are struggling to build the foundations of a robust risk management framework. All respondents indicated that gathering accurate, decision-useful data to inform their risk management activities was a critical challenge, and many have encountered difficulties in selecting and calculating the right metrics to monitor risk. In addition, nearly half of the firms surveyed are yet to translate initial analysis of their exposures into assessment of the risks and opportunities created by climate change. These challenges have made it difficult to meet requirements in more complex areas of risk management, notably scenario analysis, which only half of the respondents to our survey have managed to undertake.

Considering these issues against the backdrop of COVID-19, which has disrupted critical climate risk workstreams for a number of respondents, highlights the scale of the challenge firms face in 'fully embedding' a robust climate risk management programme by the end of 2021. Moreover, our study suggests there does not appear to be a noticeable correlation between maturity of programmes and the size and level of resources available to firms. Respondents of various sizes and resources were united by common difficulties in establishing the 'building blocks' of their programmes on which a more sophisticated framework can be developed.

Firms should be working to evidence their approach on a 'best efforts' basis, even if such an approach feels imperfect at times. Leveraging recent regulatory guidance; engaging directly with clients and counterparties to gather data; setting the tone from the top and defining climate risk explicitly within corporate strategy; these are the activities that banks need to be considering in the immediate future if they have not done so already. While progress is being made, and banks clearly understand where the barriers to implementation arise, more work needs to be done to get the building blocks right – and time is running out.

<sup>1</sup>Please note that in this survey, banks, building societies, and PRA designated investment firms are collectively referred to as 'banks'.

# Results at a glance



**94%** of respondents state they are on track to meet or beat the end-2021 deadline for embedding their climate risk programmes

**82%** of respondents have seen their climate risk programmes impacted by COVID-19 to some extent, with **76%** of respondents citing scenario analysis as the most disrupted workflow

**65%** of respondents have not explicitly defined climate risk within their group risk appetite statement

**71%** of respondents state that climate risk is embedded in the firm's long-term corporate strategy... but only **29%** have set a science-based target or Net Zero strategy

**94%** of respondents have used initial climate change analysis to explore new business opportunities... but only **53%** have incorporated this analysis into risk assessments

**53%** of respondents have conducted scenario analysis... and **100%** of respondents cite lack of data as a key challenge to conducting the exercise

**70%** of respondents are in the process of defining metrics to quantify their exposure to climate risk... with a wide range of metrics under consideration and little consistency between firms

Over **two-thirds** of respondents anticipate that it will take at least a year to fully implement TCFD recommendations

**94%** of respondents agreed that TCFD-aligned disclosures should become mandatory

**One** respondent reported that they engaged directly with clients on climate-related issues, with **76%** of respondents relying primarily on publicly-available information

Nearly **three-quarters** of respondents believe the current regulatory framework for managing climate-related risks is inconsistent

**76%** of respondents would welcome the establishment of a global regulatory framework for managing climate risk

Where are banks on their  
climate risk journey?

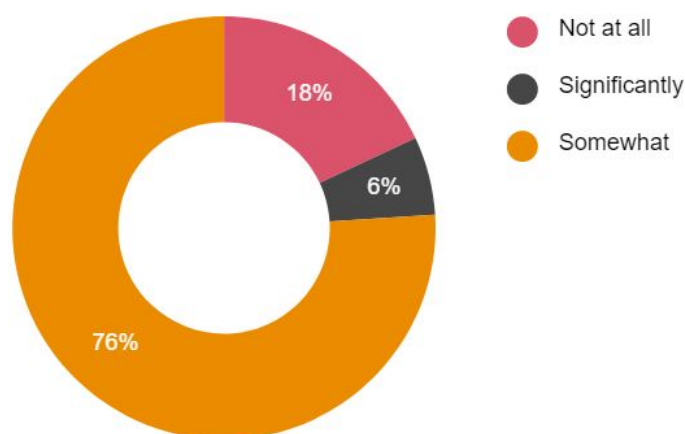
# Where are banks in their climate risk journey?

Nearly all banks surveyed report that they are on track to fully implement the regulator's expectations in line with the now formalised timeline of the end of 2021. A number of respondents have stated they will have embedded climate risk into their programmes ahead of this deadline.

Responses on the level of progress made against the regulator's expectations on climate risk management suggest that many banks are still in the initial stages of understanding and embedding their frameworks. This lends additional urgency to the need for firms to accelerate their programmes and allocate additional resources in order to ensure the deadline is met.

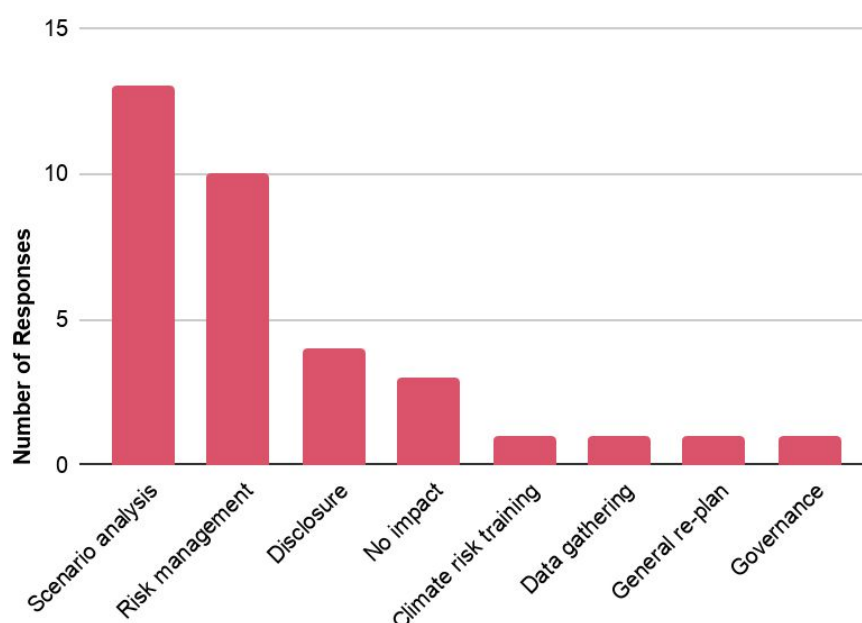
When combined with the fact that 82% of respondents have felt their climate risk programme impacted by COVID-19 to some extent, it seems many banks have a significant task on their hands to meet the challenge set by the regulator.

## To what extent has COVID-19 impacted your climate risk programme?



It may be that climate risk programmes in many of the banks' surveyed were already well established and underway. However, our findings show that the workstreams most impacted by COVID-19 (scenario analysis and risk management) are some of the most critical and time-consuming areas of focus for firms, and are specifically referred to as key gaps in the PRA's Dear CEO letter. This may highlight a potential need for greater clarity on what 'fully embedding' regulatory expectations on climate risk means in practice.

## Which of your climate risk workstreams have been most impacted by COVID-19?



## What does 'fully embedded' look like?

In its Dear CEO letter sent to firms in July 2020, the PRA sets out that firms should have fully embedded their approaches to managing climate-related risks by the end of 2021.

A 'fully embedded' climate risk management framework will vary between firms, and should be proportionate both to the level of exposure the firm has to climate-related financial risks and the complexity of its operations.

Ultimately, the process of fully embedding climate risk into an organisation will be iterative. The PRA recognises that full implementation across each key area outlined in SS3/19 by the end of 2021 is unlikely, and that the barriers to overcome are more considerable in some areas than others. Nevertheless, there are some key messages we can draw out from the supervisory statement that help provide a sense of how firms can satisfy regulatory expectations ahead of the deadline.



### Governance

Firms will need to be able to demonstrate they have made significant progress in establishing robust climate governance frameworks. All our respondents have allocated responsibility for climate-related risks allocated to a Senior Management Function (SMF), and the more advanced firms will have set out clear allocations of responsibility below the SMF(s) and across the three lines of defence as well. The more advanced firms will also have set out clear distinctions between elements of climate risk as a financial risk, a reputational risk and a corporate social responsibility issue, and provided training to the board in order to support oversight.



### Risk management

Firms should also have made significant progress in establishing frameworks to identify, measure, monitor, manage and report on their exposure to climate risks, acknowledging the need to review these frameworks on an ongoing basis in recognition of the evolving nature of the risk. Data limitations will continue to present a key challenge to embedding end-state risk frameworks, but firms should be comfortable that they are able to explain the steps they are taking to gather the necessary data to inform risk management activities, including carrying out quantitative analysis.



### Scenario analysis

Scenario analysis is clearly one of the most challenging areas for respondents and the sector as a whole to embed. Nevertheless, firms will need to evidence that they have made headway in developing a proportionate approach which is integrated into their broader risk assessments by the end of 2021.

Firms which have not yet undertaken this analysis will benefit from the recent guidance produced by the Climate Financial Risk Forum (CFRF)<sup>4</sup>, which sets out a staged approach to help firms get started.



### Disclosures

The PRA recognises that producing high quality, decision-useful disclosures will take time. Firms should adopt a phased approach, beginning with qualitative disclosures, with a view to having made progress in building out complementary quantitative disclosures by the end of 2021.

A number of regulatory initiatives are in-train to mandate TCFD-aligned disclosures over the course of 2021 and 2022, which should provide further impetus for firms to build out their capabilities to produce fully comprehensive outputs.

<sup>4</sup> CFRF, 2020, Climate Financial Risk Forum Guide 2020, <https://www.fca.org.uk/publication/corporate/climate-financial-risk-forum-guide-2020-summary.pdf>



# Board engagement and governance

# Engagement from the top – Governance

Much as for established financial and non-financial risks, board understanding and oversight of climate risk will be essential in embedding effective governance.

## Where are firms allocating responsibility for climate risk?

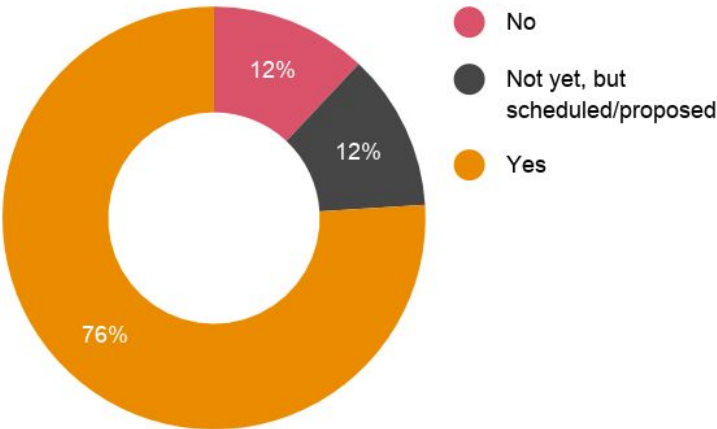
Most banks surveyed have designated responsibility for climate risk at an SMF level to the CRO, with 88% of our respondents also sitting in the Risk division of the bank. However, given the cross-cutting nature of climate risk, it is essential that firms also allocate and embed ownership of risk management more widely across the business. We have observed that some firms are already planning to transition accountability for climate risk management from the Risk department to the business once their change programmes conclude. Firms will need to ensure that roles and responsibilities for managing climate risk are defined across the three lines of defence, and clearly demonstrate where accountability for risk management resides across each line.

Our findings also indicate that some respondents may be thinking about the opportunities stemming from climate change when establishing their climate governance structures. Two respondents have assigned the SMF function for climate risk to the CEO, potentially indicating that climate change is starting to be seen by some as a central strategic consideration.

## Board training is being rolled out across the sector

The board's understanding and oversight of the firm's approach to management of climate risks is key to embedding effective governance. 76% of our respondents have conducted board-level training on climate risk, with just two respondents having not yet scheduled or proposed such training. This demonstrates our respondents' commitment to driving tone from the top. Nonetheless, board oversight and the ability to demonstrate an appreciation of the far-reaching breadth and magnitude of the risks and their relationship to financial risks is flagged as a key gap in the PRA's Dear CEO letter.

## Has board-level training been conducted to increase awareness and minimum requirements for climate risk?



# Driving strategic change

Firms are making progress in establishing appropriate governance and oversight over their climate-related risks, but it is critical that the board leads the way in shaping a strategic vision for firms' climate risk programmes

## Climate risk is central to strategy – but firms could be clearer on articulating the risks and opportunities

A total of 71% of respondents to our survey reported they are considering climate risk in the context of their wider corporate strategies. However, the PRA stated that firms need to be clearer in articulating their strategic responses to climate risk, and to continue to develop the necessary tools to help inform business decisions.

While firms are providing training to promote climate awareness at board level, and embedding climate considerations into board structures, there is still work to be done to better understand the risks and opportunities that climate change poses to business. As long-term stewards of the companies they oversee, boards have a critical role in ensuring this issue is addressed.

## How are firms embedding climate risk into strategy?

One clear way boards can demonstrate a more ambitious approach to the strategic management of climate-related risks is by setting science-based targets or committing to a Net Zero strategy. Over half (53%) of survey respondents have not yet done this, but would consider adopting such an approach in future.

Establishing such targets and strategies, while challenging, will help focus firms' minds on how to fully embed considerations of climate risks and opportunities across the organisation, as well as mitigate the risk that climate-related issues that may become material in the medium to long-term are overlooked. This will ultimately help to support firms' long-term resilience in the face of evolving climate scenarios.

# 71%

of respondents consider climate risk in their wider corporate strategies...

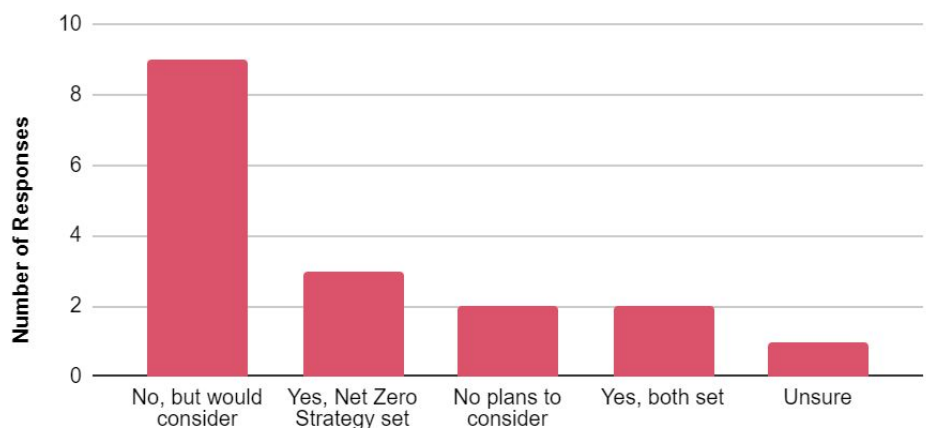
But only

# 29%

of respondents have currently set a science-based target or Net Zero strategy.

## Q28 – Net zero

### Have you set a science-based target or Net Zero strategy?



## What do firms need to do?

- Consider how best to align executive remuneration with sustainable value creation over time (e.g. through the introduction of climate-related targets and indicators to incentive schemes, where appropriate)
- Assess how to incorporate Net Zero/science-based commitments in disclosures, including the types of metrics and targets the firm is deploying



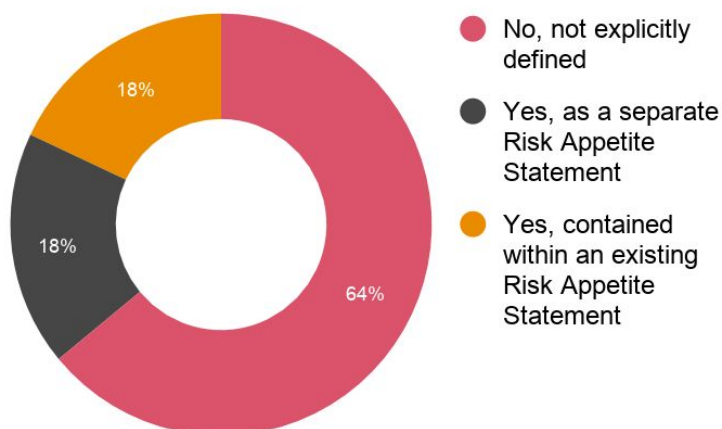
# Towards a strategic vision

While the nature and frequency of board engagement may vary, oversight should not stop at initial board training. Evolving risks and regulatory landscapes will require boards to be updated at appropriate regular intervals and go beyond just understanding the risks to driving a truly strategic response to climate risk.

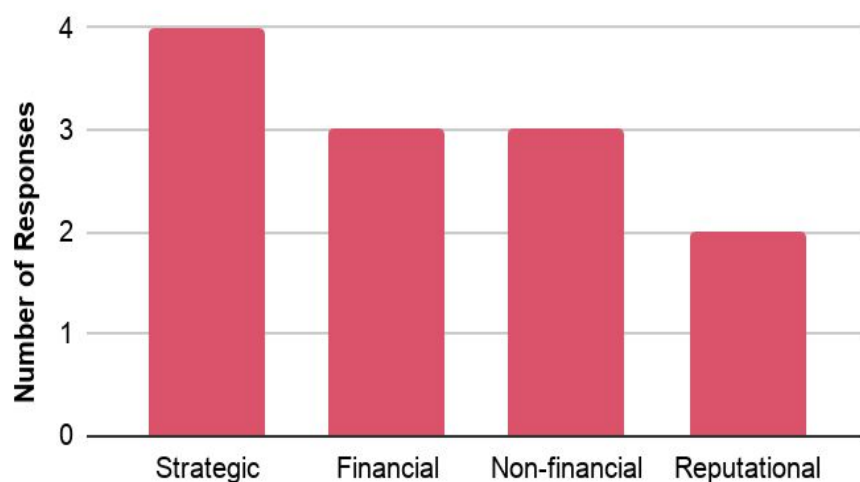
## Work still needs to be done to embed climate risk into risk appetites

By the end of 2021, the PRA expects firms to be able to manage and report on their exposure to climate risks against a well-defined risk appetite. However, just 36% of respondents have explicitly defined climate risk within the bank's group risk appetite statement so far. Those that have predominantly seem to be considering climate risk as both a strategic and financial risk type, indicating the clear need to have the correct level of board-level oversight on the risk.

### Has climate risk been defined within the bank's group risk appetite statement?

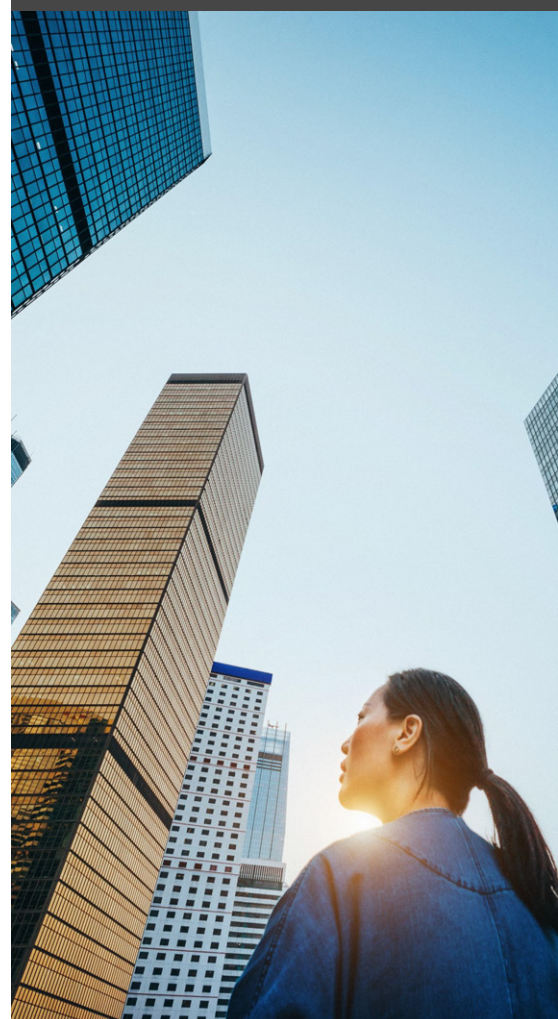


### If yes, which risk type is climate risk referenced within?



Climate management information should be communicated more consistently and actively discussed at board level.

**PRA Dear CEO letter**

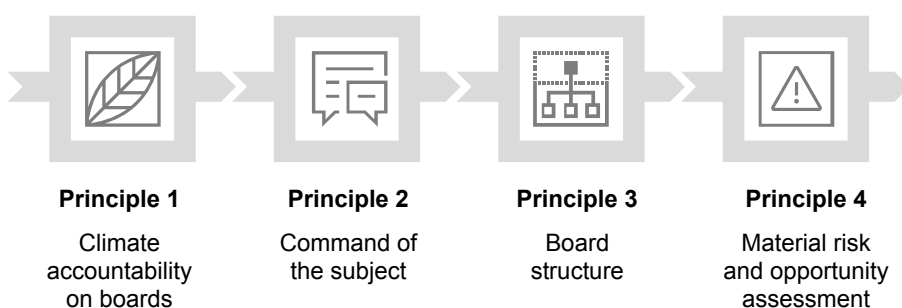


## Establishing effective climate governance – key principles

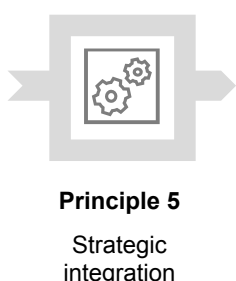
The World Economic Forum (WEF) has produced a report<sup>5</sup> in collaboration with PwC which sets out key principles to support the development of robust climate governance. The principles and guidance build on existing corporate governance frameworks, including the International Corporate Governance Network's (ICGN) Global Governance Principles<sup>6</sup>, as well as other climate risk and resilience guidelines, such as the TCFD recommendations<sup>7</sup>.

While the eight principles set out in the WEF report should not be considered a fixed sequence, or ordered on the basis of priority, they allow firms to develop an iterative approach to establishing robust climate governance, following a logical flow and building upon each other.

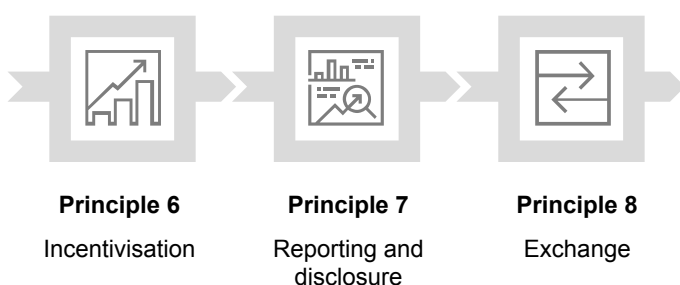
### Building the foundations (principles 1-4):



### Building a strategic approach to climate governance (principle 5):



### Establishing long-term vision (principles 6-8):



## What do firms need to do?

Firms should focus on making progress on updating risk appetite statements and developing management information and risk reporting metrics which can be provided to, reviewed and challenged by the board.

While tone from the top is important, firms should also ensure that climate risk governance is cascaded through all three lines of defence, and consider the need for and value in training and upskilling in climate risk firm-wide. The PRA notes that the more advanced firms have identified the skills required throughout the organisation to support climate risk programmes, and have established plans to close any resource gaps.

## Assurance moves up the agenda

Regulators are increasing the pressure on firms to report more information on sustainability and non-financial metrics, with a move towards mandatory assurance looking increasingly likely.

As of 2019, internal PwC analysis found that 58 FTSE 100 companies were obtaining standards-based external assurance on ESG matters. A further seven companies utilise other forms of assurance (e.g. use of internal audit).

## Survey findings

Outside of the three lines of defense, only 24% of our respondents intend to have their climate risk disclosures externally assured, while the vast majority (59%) are unsure. As regulatory expectations and assurance standards continue to evolve, firms should consider whether they would benefit from the additional comfort provided by external assurance of their climate-related non-financial metrics.

<sup>5</sup> WEF, 2019, How to Set Up Effective Climate Governance on Corporate Boards, [http://www3.weforum.org/docs/WEF\\_Creating\\_effective\\_climate\\_governance\\_on\\_corporate\\_boards.pdf](http://www3.weforum.org/docs/WEF_Creating_effective_climate_governance_on_corporate_boards.pdf)  
<sup>6</sup> ICGN, 2017, ICGN Global Governance Principles, <https://www.icgn.org/policy/global-governance-principles>  
<sup>7</sup> TCFD, 2017, Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures, <https://www.fsb-tcfd.org/publications/final-recommendations-report/>

# Scenario analysis – a new frontier for banks



# Scenario analysis – a new frontier for banks

Conducting scenario analysis and stress testing is a key challenge for banks.

## 47%

of respondents have yet to carry out the exercises and many cited stress testing as an area where greater clarity from regulators is needed.

## “

The development of a proportionate and integrated approach to scenario analysis by the end of 2021 will require many firms to increase their capabilities materially in the near-term.

**PRA Dear CEO letter**



The regulator expects approaches to scenario analysis to mature over time, but this should not be taken as a reason for inaction. The PRA has stated that scenario analysis capabilities are essential for all firms – irrespective of size, resources and product and business lines. Firms need to start acting now to build their capabilities, although our survey findings show this is easier said than done.

Scenario analysis and stress testing should be used by firms to inform the risk identification process. Conducting such exercises will allow firms to understand the short- and long-term financial risks arising from climate change that are likely to impact their business models.

### Firms lack clarity on how to approach scenario analysis

76% of respondents stated that COVID-19 has impacted their scenario analysis workstreams, and scenario analysis/stress testing featured prominently as an area in which respondents would appreciate further insights (including the data they are expected to source to perform these exercises). Our survey highlights that 65% of respondents would welcome further regulatory clarity on how to approach their stress testing programmes, and 58% of respondents agreed that they would benefit from further guidance on scenario analysis.

### Qualitative over quantitative?

For those firms that are undertaking scenario analysis, 44% have carried out qualitative analysis only, suggesting quantification of metrics to substantiate approaches is still in progress. Only 33% of respondents carrying out these exercises have undertaken both qualitative and quantitative analysis – and this is not just limited to the largest and most sophisticated firms. Hesitancy around incorporating quantitative data could well be the result of widespread concerns around data quality. But the regulator has noted that while qualitative scenario outcomes can be informative, they should be supplemented by quantitative analysis, even if there is uncertainty in the calculation of the results.

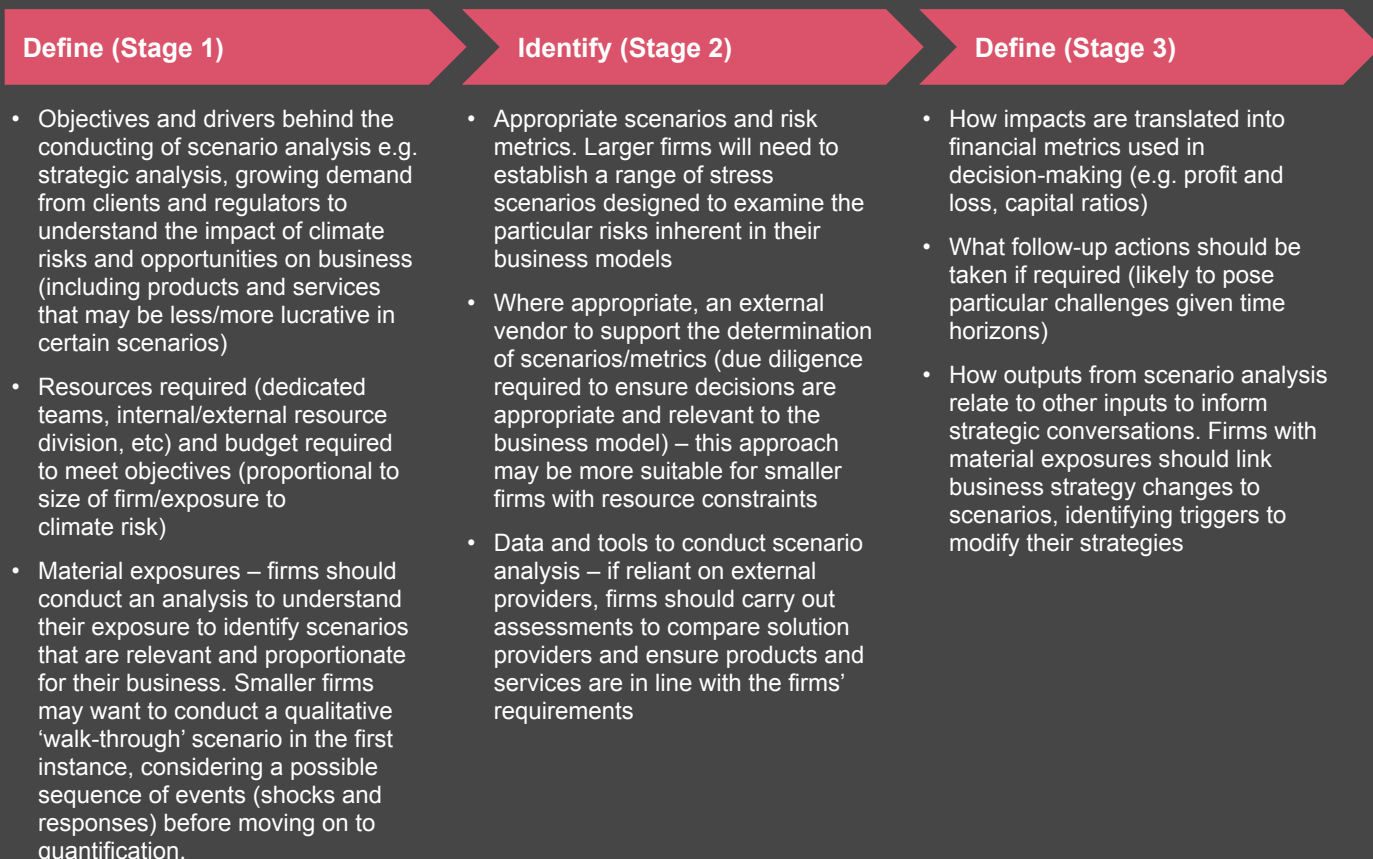
### Where next?

Our survey appears to indicate that firms of all sizes and structures are still in the early stages of embedding these capabilities into their climate risk management frameworks. The regulator has stated that many firms will need to increase their capabilities materially in the near-term to develop a proportionate and integrated approach to scenario analysis by the end of 2021. This will require investment by firms, both in terms of time and resources. As a starting point, firms should look to the CFRF's dedicated Scenario Analysis guidance chapter<sup>8</sup> to inform their approaches.

<sup>8</sup> CFRF, 2020, Climate Financial Risk Forum Guide 2020 Scenario Analysis Chapter, <https://www.fca.org.uk/publication/corporate/climate-financial-risk-forum-guide-2020-scenario-analysis-chapter.pdf>

## CFRF guidance on scenario analysis

The CFRF guidance accepts that making headway with scenario analysis can feel like an overwhelming task, given the considerable number of assumptions, data and decisions required to undertake these activities successfully. The Forum has published a practical three-stage approach to help firms quickly get to grips with the implementation of climate scenario analysis:



## Where do respondents sit in the CFRF’s 3-stage approach?

- All respondents to our survey appear to be at the initial ‘define’ stage of implementing scenario analysis, with varying levels of maturity evident within this stage. 53% of respondents have performed scenario analysis and/or stress testing. Of these firms, 78% of respondents have conducted climate scenario analysis at the physical and transition risk levels. The PRA has observed that analysis and strategies for mitigation of physical risks appear to be generally more developed than for transition risks, but our findings indicate that respondents are assessing both risks equally as part of their scenario analysis programmes.
- The more advanced firms are considering the granular impacts of climate risks and opportunities at business line and product level (33% and 11% of respondents conducting scenario analysis respectively).
- In order to advance to the second stage (identify), firms will need to continue gathering relevant data to help build their understanding of their material exposures, which will in turn support the development of suitable risk metrics. Firms should also select appropriate impact assessment tools that cover their exposures and take into consideration available resources and budget.
- The PRA has observed that the most advanced firms are using scenario analysis to inform their business, international model risk calibrations, and the integration of climate risk into their broader risk management framework. These activities could be seen as relating to the third stage (define) of the approach.



## Lessons learned – Bank of England 2019 stress test for insurers

The 2019 stress test for insurers<sup>9</sup> exposed significant gaps in capability and understanding of risks, particularly in relation to the industry's capacity to evaluate climate-related scenarios and the data and modelling used as inputs. The PRA also found that climate risk management was not yet sufficiently embedded within firms' overall risk management frameworks.

The PRA's feedback on the challenges encountered by insurers resonates with the findings in this banking survey. Respondents have expressed a desire to better understand how to develop their approaches to stress testing and scenario analysis. This includes the types and durations of stress tests required for different products, and the data firms are expected to source to carry them out.

As we have noted elsewhere, firms will need to address gaps in the data, tools, and expertise for assessing the impact of climate risks to effectively carry out scenario analysis. Direct engagement with clients and counterparties will be essential to gather critical data that is firm-specific and and/or not currently in the public domain.

### TCFD 2019 Status Report findings

The 2019 TCFD Status Report<sup>10</sup> found the majority of firms using scenario analysis to assess the resilience of their strategies do not disclose information on their findings. While this is consistent with the relatively nascent state of most firms' scenario analysis capabilities, this will be a key area for firms to address as their approaches mature.

## Looking ahead – 2021 Bank of England Biennial Exploratory Scenario on financial risks from climate change

The 2021 Biennial Exploratory Scenario (BES) will see the UK's largest banks, as well as the financial system more broadly, tested against different climate scenarios to understand their likely exposure to climate-related financial risks. The BES will draw upon lessons learnt from the climate scenarios in the 2019 Insurance Stress Test and help the Bank of England develop its approach to climate-focused scenario analysis. The climate scenarios are due to be finalised by the end of the year.

While the BES is intended to serve as a vehicle for banks to address data gaps, firms should already be well underway with their preparations, in particular in relation to the gathering of data on clients and counterparties' exposure to climate-related risk. This should help inform their approaches to scenario analysis more broadly and help them to meet supervisory expectations.

The Bank will be providing firms with additional guidance and material (such as reference scenarios) prior to the launch of the 2021 climate-focused BES.

<sup>9</sup> PRA, 2020, Insurance Stress Test 2019: Feedback for general and life insurers, <https://www.bankofengland.co.uk/prudential-regulation/letter/2020/insurance-stress-test-2019-feedback>  
<sup>10</sup> TCFD, 2019, TCFD: 2019 Status Report, <https://www.fsb-tcfd.org/publications/tcfd-2019-status-report/>  
PwC | Climate risk survey report



Firms are encountering considerable difficulties in procuring accurate data to conduct scenario analysis and stress testing. Until this is obtained and used to support the development of tangible metrics, firms will struggle to progress with their climate risk programmes.

Key challenges when conducting or planning scenario analysis:

100%

of respondents cited data approaches as a key challenge

71%

responded that counterparty data was a critical issue

53%

of survey participants found modelling to be a key challenge

### The data challenge

A number of questions firms need to consider as part of their scenario analysis are unlikely to be resolved easily in the current data environment, particularly for client/counterparty-specific matters that are not in the public domain.

Data continues to be at the forefront of firms' minds when it comes to barriers to progress



82%

of respondents to our survey agreed they would welcome further guidance in this area from the regulators.

But engagement with clients and counterparties is low



76%

of respondents are using publicly available information to obtain the data required to carry out climate risk assessments, with another **53%** using data sourced from ESG ratings agencies. While this should help inform data-gathering exercises, there is no substitute for client and counterparty engagement. Only one respondent stated they were engaging with clients directly to source relevant data to inform climate risk assessments. In line with TCFD recommendations, firms can support the development of consistent and comparable data and disclosures by engaging with companies on the specific types of information that are most decision-useful.

### What do firms need to do?

Firms should review publicly available climate scenarios and their relevance to the bank's nature, portfolio and strategy, focusing on:

- Are the right sectors and geographies covered?
- Does the bank agree with the assumptions made in the scenarios?

Firms should also weigh up the time benefits of sourcing external data versus opportunity benefits of reaching out to counterparties and clients directly. Engaging directly with counterparties and clients can help the bank understand and mitigate the risk, and also provide financing opportunities where counterparties or clients need capital to improve their resilience.

Engaging directly can also increase disclosures from counterparties/clients, in line with the expectations set out in SS3/19, that firms facilitate disclosure in the wider economy through their ownership of financial assets.

# Risk management – towards a strategic approach?

# Risk management – from risk to opportunity

## 94%

of respondents have undertaken initial analysis to understand the impact of climate risk on their business models, but this analysis has not yet cascaded into risk assessments.

By the end of 2021, the regulator expects firms to be able to demonstrate how they have embedded climate risk management within their frameworks to identify, measure, monitor, manage and report on their exposure. The ultimate objective for firms should be the establishment of a risk management framework for climate risks like those established to monitor and mitigate financial risk, while also accounting for climate-risk specific nuances where necessary.

### Firms are starting to think about the business opportunities created by climate change...

The overwhelming majority of respondents to our survey have undertaken initial analysis to understand the impact of climate change on their business lines, products and portfolios. A total of 71% of respondents are considering how climate change could create opportunities to develop new products or services, with strategic considerations and new opportunities to engage with clients on climate-related issues also high on the agenda.

### But analysis has not yet translated into risk assessments on a widespread basis.

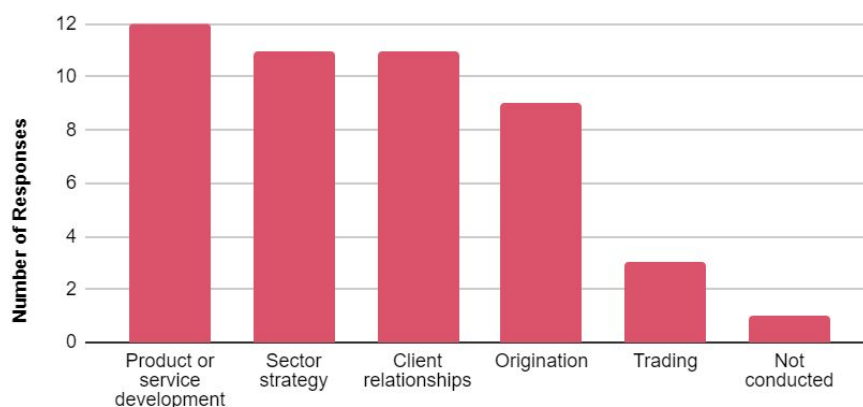
Risk management workstreams appear to have been impacted by COVID-19 for the majority of respondents (59%), and in most cases, the initial analysis has not yet been developed further to support the measurement and management of climate risks.

As a result, most respondents could be considered to be at a relatively nascent stage of their risk management programmes, which could raise questions about the extent to which climate risk can truly be considered to be ingrained into long-term strategies.

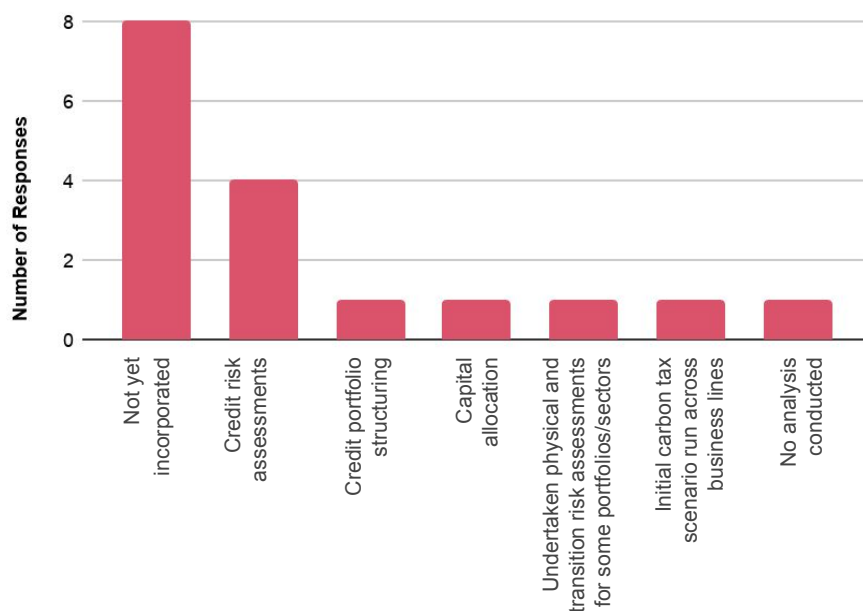
### What next?

The PRA is aware that firms' approaches to risk management will mature over time. But ahead of the 2021 deadline, the regulator will be looking to see the progress firms have made in incorporating climate risk into their existing risk management frameworks, including through the written risk management policy, management information, and board risk reports.

### Has initial analysis been conducted to understand the business opportunities created by climate change?



### Have the outputs of this analysis been incorporated into any of the following?





# Risk identification and measurement

SS3/19 breaks down the PRA's expectations around climate risk management into four broad areas:

- Risk identification and measurement;
- Risk monitoring;
- Risk management and mitigation; and
- Risk reporting and management information (which can be based on the climate metrics and targets established by the firm).

Our survey suggests most respondents are still at the risk identification and measurement stage of their risk management programmes.



## Firms are starting to incorporate climate risk into their risk management framework

The process of effectively integrating climate risk into existing risk management frameworks will need to start with the identification and measurement of firms' climate-related exposures. Most of the respondents to our survey appear to be at this stage.

### But many are struggling to quantify the impact of climate risk...

A total of 47% of respondents have started to incorporate their initial climate analysis into existing risk assessments, notably in relation to credit risk. But the assessments have, on the whole, yet to be translated into quantifiable metrics – the next critical stage in the risk management programme.

The PRA expects firms to be able to quantify their exposure to climate-related financial risks and develop risk metrics that can indicate potential financial loss. The development of metrics and their associated thresholds will allow firms to build out clear risk monitoring capabilities which can serve as an early warning system and prompt action where required.

The PRA notes there should be a clear flow of metrics from root analysis through to decisions and disclosure. On this basis, firms should be approaching the development of their risk programmes on an incremental basis. Only once the data is gathered to perform root analysis can effective metrics be developed, which will in turn support the decisions that will form the basis of a firm's disclosures.

### Especially for outsourced providers

In addition, while respondents appear to have been more comfortable identifying and assessing significant impacts of climate-related risks when it comes to their own operations, a smaller number of respondents have carried out the same assessments for their materially outsourced operations.

This issue has already been highlighted by the Bank of England in the context of the insurance sector<sup>11</sup>. It observed that firms did not have consistent visibility over the operational and financial resilience of some of their key outsourced service providers over the lockdown period.

# 21%

of respondents are incorporating initial analysis of climate risk impacts into their credit risk assessments.

## Credit risk assessments – best practice from CFRF<sup>12</sup>

- Agree baseline thresholds to trigger actions – e.g. sectors that should no longer be supported, when to exit a relationship, when to hedge and how long to hedge for. Agreements should be based on a combination judgmental/qualitative assessment with some external data points.
- Integration of climate impact upon all key credit metrics (P&L, cash flow, balance sheet metrics, etc.)
- Qualitative assessment of client's understanding of and communication on climate risk issues – banks should engage in strategic discussions to gauge the efficacy and verifiability of transition plans.
- Incorporation of physical and transition risks into BAU due diligence of clients to determine level of exposure (e.g. carbon intensity, adherence to climate scenarios).
- Understanding of climate risk concentrations and incorporation of climate scenarios into risk reporting.

<sup>11</sup> Bank of England, 2020, Speech: Life Beyond Solvency II: A view from the top of the regulator, <https://www.bankofengland.co.uk/-/media/boe/files/speech/2020/life-beyond-solvency-ii-a-view-from-the-top-of-the-regulator.pdf>

<sup>12</sup> CFRF, 2020, Climate Financial Risk Forum Guide 2020 Risk Management Chapter, <https://www.fca.org.uk/publication/corporate/climate-financial-risk-forum-guide-2020-risk-management-chapter.pdf>

# Integration of climate risk into ICAAP programmes

The PRA expects banks to assess the extent climate risk could adversely impact their financial soundness at least annually as part of the Internal Capital Adequacy Assessment Process (ICAAP). However, current assessments of climate risk within ICAAPs tend to be limited to a high-level qualitative risk articulation and an indication of how the process will be developed in future.

While such an approach may have satisfied regulatory expectations last year, the PRA will be scrutinising how these assessments have evolved over time, with greater emphasis on detailed, and ideally quantifiable analysis.

## What progress have firms made?

Our survey shows the majority of respondents are planning to include material climate exposures in their ICAAP process, but are unsure which pillar their assessments should fall under.

Of the 18% of respondents which have already included climate assessments within their ICAAPs, there is no clear consensus on the appropriate pillar for inclusion, with two respondents opting for Pillar 2a and one respondent including the assessments in Pillar 2b.

## ECB Report on ICAAP practices – Climate risk

A recent report<sup>13</sup> published by the ECB notes that the majority of banks have not yet established the necessary internal processes to facilitate the systematic identification and management of climate-related risks. As a result, only a small minority of banks are currently including these risks in their ICAAP assessments.

Where banks are beginning to consider climate risk as part of their ICAAP process, approaches to implementation are inconsistent. The ECB found the risk taxonomies used by banks are diverse, with most banks grouping climate-related risks together with credit or operational/reputational risk.

The majority of respondents to our survey who had explicitly defined climate risk within their risk appetite statements identified it as a strategic risk, with an even split between those identifying climate risk as a financial or non-financial risk. A smaller number of respondents determined climate risk to be a reputational risk.

## What do firms need to do?

Banks could reasonably cover climate risk under Pillar 2a, Pillar 2b, or both, depending on the nature of their exposures and their overall approach to risk management. Pillar 2a covers 1-in-1,000 1-year scenarios and Pillar 2b covers 1-in-25 5-year scenario. Both options should help to inform risk management processes as extreme climate scenarios become more severe and more frequent. While some firms may feel uncomfortable about the current lack of guidance around which pillar climate-related risk falls under, such an approach provides welcome flexibility for firms to tailor their approach in accordance with their specific risk profile.

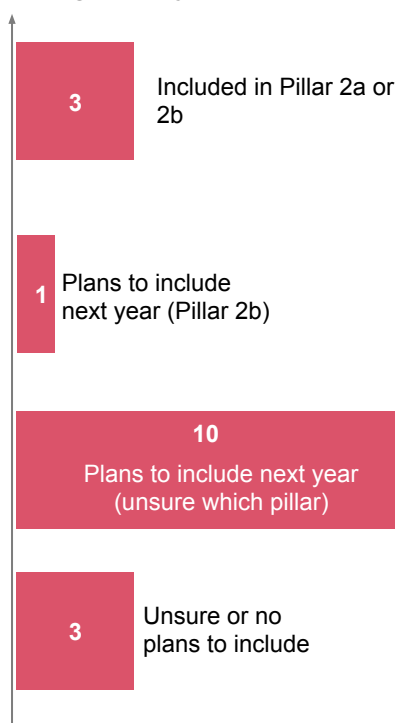
Critically, firms should not be taking a 'wait and see' approach to integrating climate-risk assessments into their ICAAPs. While additional regulatory guidance is due in 2021, firms need to get on the front foot now to avoid lagging behind regulatory expectations. This will require adopting a 'best efforts' approach to assessing climate risk, beginning with qualitative analysis before incorporating quantitative disclosures as data collection improves and regulatory guidance evolves.



# 59%

of respondents have plans to include climate-related risk in the ICAAP but are unsure which pillar to use for their climate exposures.

## Increasing maturity



<sup>13</sup> ECB, 2020, ECB report on banks' ICAAP practices, <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.reportbanksicaappractices202007~fc93bf05d9.en.pdf>

# How do you solve a problem like the metrics?

Over the period to end-2021, the type of climate metrics and targets that firms are using, as well as their comparability and the degree of integration into risk and governance frameworks, will be a key area of supervisory focus.

---

## Context

Establishing appropriate and robust metrics will be essential to measure the degree to which a firm is adhering to its climate risk appetite. Each identified risk is likely to have a number of quantitative and qualitative metrics associated with it, which will allow firms to monitor risk tolerances and the overall climate risk profile.

Guidance on the methodologies for developing metrics is emerging, but there remains a need for greater standardisation. As a result, firms are currently deploying a wide array of metrics to measure climate-related financial risk, which could over time reduce the scope for comparability and create an inconsistent and fragmented landscape.

---

## Findings from the 2019 TCFD Status Report

Respondents to the TCFD 2019 survey noted that increased standardisation of metrics would ease implementation challenges, while respondents that identified as users of metrics also agreed that increased standardisation would improve comparability across companies' climate-related financial disclosures.

---

## Firms are struggling to establish consistent approaches to developing metrics

Our survey highlights the extent the banking industry does not yet appear to have established consensus on the development of metrics. A quarter (24%) of respondents have not yet defined or considered any metrics. **Of the respondents that are considering or implementing metrics, there is minimal to no overlap in the metrics under consideration.**

---

## What stage are firms at in developing climate risk metrics?

6%

of respondents have defined metrics to monitor progress against overall business strategy and risk appetite in relation to climate risk

70%

of respondents are in the process of defining metrics

24%

of respondents have not yet begun to define or consider metrics to monitor climate risk



## Internal risk management metric guidance from the CFRF

The CFRF has published examples of the type of quantitative metrics firms can use to monitor climate risk as their programmes develop:

- **Bounding metrics** – single or small number of metrics that set limits (bounds) on the amount of climate risk that an institution is willing to take. The metric represents the key elements that drive the risk appetite (e.g. climate Value at Risk (VaR)).
- **Delivery** – forward-looking limits that ensure the risks are kept within the agreed thresholds. If climate risk is considered within existing risk types, then firms should establish clear links between climate-related delivery metrics and the relevant risk type (e.g. leverage trends/tolerance of specific industries).
- **Monitoring** – metrics that will alert management to a potential change which could mean that risk appetite may be breached (e.g. concentration metrics – mortgages and mortgage-backed securities at risk).
- **Wider metrics (e.g. reputational risk, ESG lens, etc)** – metrics which focus on alignment of the portfolio to strategic priorities or broader sustainability considerations (such as ESG factors), rather than measuring the financial exposure to climate risk (e.g. carbon footprint including supply chain).

## Which metrics are respondents considering/implementing?

Respondents are currently considering a wide range of metrics to monitor their exposures, with little consistency between firms. When compared against the categories established in the CFRF guidance, the majority of metrics identified by respondents could be considered to fall within the parameters of bounding metrics and monitoring metrics:

- **Bounding metrics (29%)** – exclusions and exits; carbon-related assets/CO2 emissions; adjusted counterparty ratings for transition risks; qualitative high/medium/low classifications for physical risk
- **Delivery (7%)** – exposure to carbon intensive industries
- **Monitoring (43%)** – proportion of counterparties/issuers/underwriting transactions with higher environmental risk sectors; portfolio level analysis; portfolio emissions financed; loan equivalent exposure factor; EPC distribution/flood risk on mortgage portfolio; concentration metrics
- **Wider strategic metrics (21%)** – temperature alignment; Net Zero commitment; delivery in reduction of financed emissions

## What do firms need to do?

Firms should consider the process of developing metrics as a 'chain', in line with the recent consultation on climate risk disclosures published by the Department for Work and Pensions (DWP)<sup>14</sup>. While the consultation is aimed at occupational pension schemes, banks may want to consider the following approach to inform their development of metrics:

- **Select** the characteristics they want to quantify (e.g. carbon intensity)
- **Obtain** data on those characteristics as far as they are able
- **Calculate** a metric to measure or communicate that characteristic using the available data (e.g. weighted average carbon intensity)

88%

of respondents report they explicitly consider climate-related issues when setting and monitoring limits

but only...

24%

are currently considering the type of bounding metrics that would measure adherence to these limits

<sup>14</sup> DWP, 2020. Taking action on climate risk: improving governance and reporting by occupational pension schemes - Chapter 3: Climate governance and TCFD. <https://www.gov.uk/government/consultations/taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes/chapter-3-climate-governance-and-tcfid#metrics-and-targets-proposals>



# Roadmap to maturity

Our survey reinforces the view that climate risk management programmes within the banking sector are still at an early stage of development. Given the challenges in addressing issues at the initial risk identification and management stages, this is understandable. But the need to build on these foundations, and to develop accompanying risk monitoring and management capabilities, is growing ever more pressing as firms approach the end-2021 deadline.

## **Risk identification – what do firms need to do?**

To quickly develop an understanding of their climate risk exposures, a sensible first step for many firms would be to perform a materiality assessment. This should initially focus on a small set of risks with scope and sophistication increasing over time. The assessment should be based on both quantitative and qualitative evidence, even if a lack of available data means that such evidence is unlikely to be granular at this point in time.

Firms should define climate risk within their appetite statements, either as a standalone risk category or within existing risk categories as a cross-cutting risk. This will help firms to identify appropriate metrics which can be tailored to their strategy and business model, with an associated set of thresholds that allow for effective risk monitoring.

Our survey indicates that 64% of respondents have yet to explicitly define climate risk within their existing group risk appetite statement or a separate statement, which may help to explain the lack of consistency we have seen in terms of metrics to be deployed.

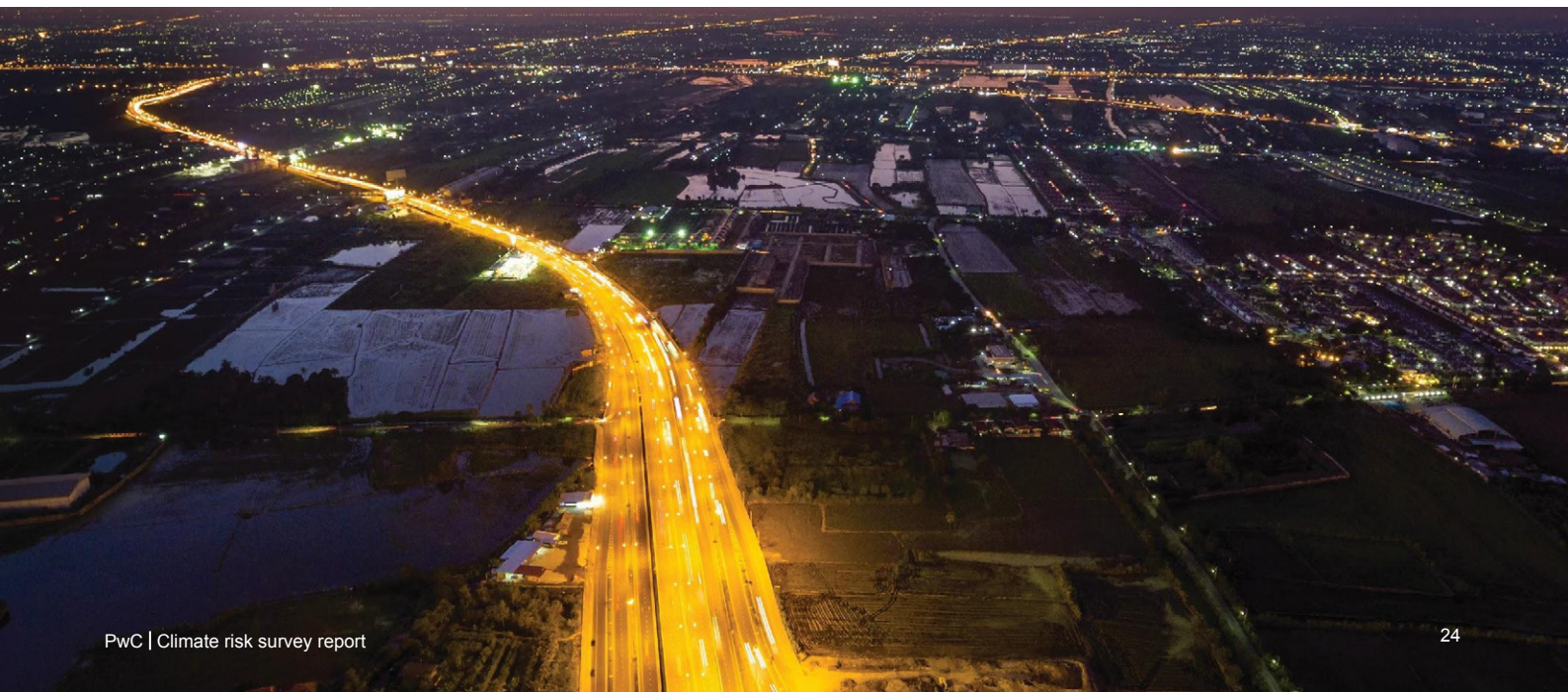
Data is clearly a challenge, particularly when seeking to establish quantitative approaches to measuring climate risk, and it can be a daunting process to develop valid and reliable metrics in a short space of time. But the important thing for firms to do is to start now, if

they haven't already done so, and adopt an iterative approach which can be refined over time.

Banks need to engage with their clients and counterparties to develop the data infrastructure required to measure risks. This could include gathering relevant data during client on-boarding and at annual reviews, which can facilitate the development of a proprietary management information framework.

Where data is not readily available, firms should ensure that identified risks are recognised through the use of reasonable proxies and assumptions. If firms are reliant on third-party data to inform their metrics, they are expected to demonstrate an understanding of the key assumptions and limitations in the information they receive, and to use the information appropriately in their risk management frameworks.

It is also important for firms to ensure they have considered the approach their outsourced service providers use to assess their own climate risk exposures, and any mitigating actions they have in place. If they haven't done so already, banks need to set out a clear and documented view of where they have third-party arrangements, with the view to collecting data at arrangement, service provider and portfolio level. This will help them identify significant impacts of climate change on these providers and the associated risks (e.g. physical risk factors on outsourced supply chains).





### **Risk monitoring – what do firms need to do?**

Once firms are comfortable they have implemented appropriate metrics to assess their climate-related risks, they should aim to develop tools that support decision-making and allow them to monitor progress against their climate-related strategic aims and risk appetite (which will be informed by monitoring and strategic metrics).

These tools should be appropriate for the speed of change that is necessary (e.g. early-warning indicators to engender prompt action where appropriate, or metrics to track a plan to pivot a firm's business model gradually over a number of years).

A sophisticated climate risk monitoring framework will be based on metrics which can help to monitor adherence to the firm's risk appetite, inform decision-making processes and serve as early warning indicators. Our survey responses indicate that firms are beginning to consider and implement metrics across the categories highlighted by CFRF, but there are still a number of challenges to address at the initial risk identification stage.

### **Risk management/mitigation – what do firms need to do?**

Once firms are able to assess and monitor the potential impacts of material climate-related risks, the PRA expects firms to show how they will mitigate these financial risks and to have a credible plan or policies in place for managing exposures (which could include actions to reduce concentrations of these risks).

Firms should build on their risk identification and monitoring capabilities by incorporating findings from scenario analysis, stress tests and ICAAP into their risk reporting frameworks. They should also continue to engage with clients and counterparties at a strategic level about potential current and future impacts of physical and transition risk factors. Over time, sustainability will need to be built into all client conversations and become a core consideration when assessing both risks and opportunities.

Over the longer-term, firms should start considering how metrics can incorporate the results from scenario analysis and impact assessment, as well as trend analysis, to build out a more sophisticated risk monitoring framework. Our survey highlights that 21% of the metrics under consideration could fall under this more strategic category – but it is important that firms get the foundations right by devoting sufficient resources to establishing metrics which can help set thresholds, monitor exposures and flag potential breaches of risk appetite before they move to this next stage.



# Disclosures and engagement

# Growing pressure on climate disclosures

All firms are expected to develop an approach to disclosing the potential impact of their material climate-related financial risks, although the PRA has observed that firms' appetite for making climate disclosures is limited by their current capabilities.

## A broad spectrum: embedding climate-related disclosures

The PRA has stated its belief that most of the largest UK firms have now begun the process of producing climate-related disclosures. Our survey results show that a sizeable proportion of respondents (53%) have already embedded climate risk into their financial reports, comprising a range of banks of varying sizes, regional presences and business/product lines. These findings indicate that firm size or resourcing capabilities should not be a core determinant of progress with regards to financial disclosures. All firms need to establish a proportionate approach to producing meaningful disclosures that can inform decision-making processes.

## But time is running out...

The majority of respondents (71%) anticipate a timeline of at least a year or more before they have fully implemented the TCFD recommendations. As some of our respondents have premium stock exchange listings, this could create difficulties when it comes to adhering to the FCA's 'comply or explain' requirements around TCFD for listed firms, which is due to commence for accounting periods beginning on or after 1 January 2021.

## What are the regulators' expectations?

It is clear that the PRA expects banks to continue to develop their capability to produce robust, decision-useful disclosures. For many firms, this will require a considerable amount of effort, with additional resource needing to be allocated to this area in order to bridge the gaps.

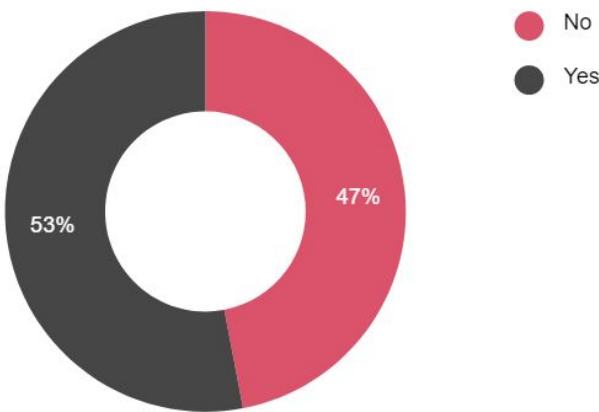
The regulator expects firms to engage with wider initiatives on climate-related financial disclosures, perhaps most notably the recommendations set out by the Taskforce on Climate-related Financial Disclosures (TCFD). The most advanced firms are already integrating TCFD format disclosures in their annual reports, with a smaller number now approaching fully comprehensive outputs.



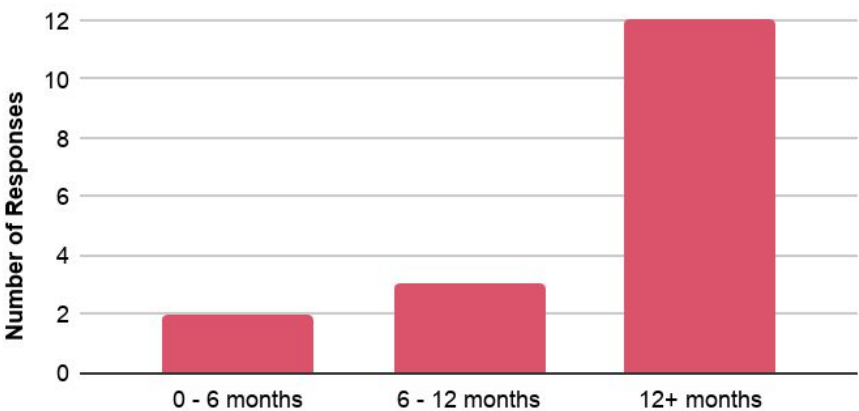
Capabilities will need to be materially improved to facilitate future disclosures.

PRA Dear CEO letter

## Is climate risk embedded into the bank's financial disclosures?



## How long do you expect it will take for your firm to fully implement the TCFD recommendations?





# Unlocking the disclosure puzzle – best practice approaches

The 2019 TCFD status report noted that while disclosures of climate-related financial information have increased since the Taskforce's inception in 2017, they remain insufficient for investor and client needs.

Some of our survey respondents noted the need for further clarity on how to develop appropriate metrics for disclosure that can meet regulatory expectations. As these expectations continue to evolve, firms should engage with the TCFD recommendations and the practical guidance on disclosures produced by the CFRF<sup>15</sup> to inform their approaches to disclosure and the establishment of suitable metrics and targets.

Developing decision-useful metrics for disclosures continues to pose a challenge for firms. Banks are struggling to overcome the limitations imposed by a lack of high quality data, resources, and inconsistent tools and methodologies. While there will be some overlap between the metrics used for risk management purposes and those used for disclosures, firms should remind themselves that the former are designed to inform the decision-making of internal stakeholders, while the latter are targeted at external stakeholders.

## TCFD – Fundamental principles for effective disclosure

In its 2017 report, the TCFD set out seven principles for effective climate disclosures:

- Disclosures should present relevant information
- Disclosures should be specific and complete
- Disclosures should be clear, balanced and understandable
- Disclosures should be consistent over time
- Disclosures should be comparable among organizations within a sector, industry, or portfolio
- Disclosures should be reliable, verifiable, and objective
- Disclosures should be provided on a timely basis

## Disclosure metric guidance from the CFRF

The CFRF's disclosures guidance sets out three categories which firms can consider when organising their approach to developing disclosure metrics. These metrics should be developed across a number of key risk categories, including transition risks and opportunities and physical risks:

- **Basic metrics:** widely used; methodologies are available today – e.g. proportion of portfolio with exposure to companies with fossil fuel revenues.
- **Stretch metrics:** some use; methodologies are at an early stage of development/acceptance in the market – e.g. proportion of clients (lending/securities underwriting) with explicit and credible climate change risk mitigation plans; credit risk exposure of portfolio in relation to key indicators of physical risk, according to the bank's prioritisation of risk, by geography/sector.
- **Advanced metrics** ('from the static to the strategic'): likely to be useful but methodologies not yet developed – e.g. quantitative, scenarios-based impairment metrics developed using a range of scenarios (such as carbon prices/transition pathways; forward-looking, location-specific models describing environmental hazard) including potential impact on revenues, costs and asset values.

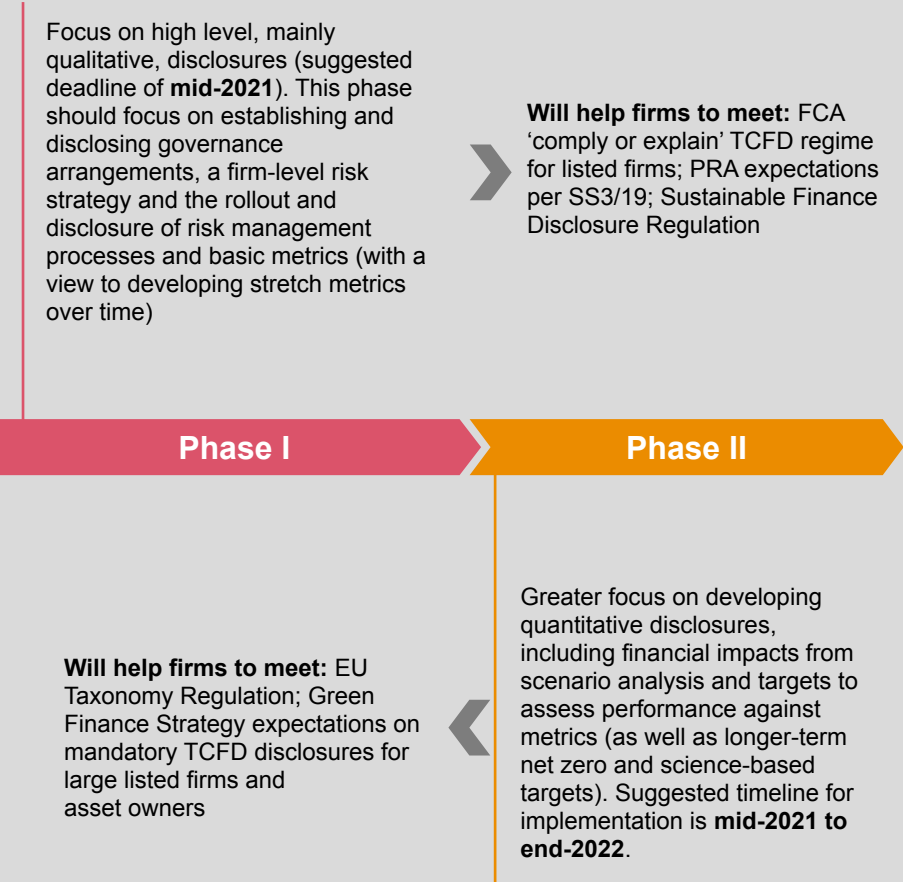
The PRA anticipates that international convergence on particular metrics, methodologies and targets will emerge over time. This should help to improve cross-firm comparability of metrics and improve decision-usefulness.

However, at this early stage in firms' climate risk journeys, the regulator is cautious of over-prescriptive approaches that could stifle analysis and risk international fragmentation.

<sup>15</sup> CFRF, 2020, Climate Financial Risk Forum Guide 2020 Disclosures Chapter, <https://www.fca.org.uk/publication/corporate/climate-financial-risk-forum-guide-2020-disclosures-chapter.pdf>

Suggested roadmaps for implementation

The CFRF guidance on disclosures recommends that banks set out a two-phase implementation plan to meet their various disclosure-related obligations:



# Are firms engaging on disclosure?

The establishment of an effective climate-risk management programme will depend on engagement with clients and counterparties. The regulator has stated that such engagement will be essential in order to develop the data infrastructure required to adequately measure the risks posed by climate change.

Our survey suggests that direct interaction with clients and counterparties is an area where most respondents are lagging. The PRA is clear that where firms do not have the necessary data to conduct climate risk assessments and produce disclosures, they are expected to engage with clients and counterparties, particularly where this information is considered material to a firm's own risks.

### Direct engagement with clients is uncommon

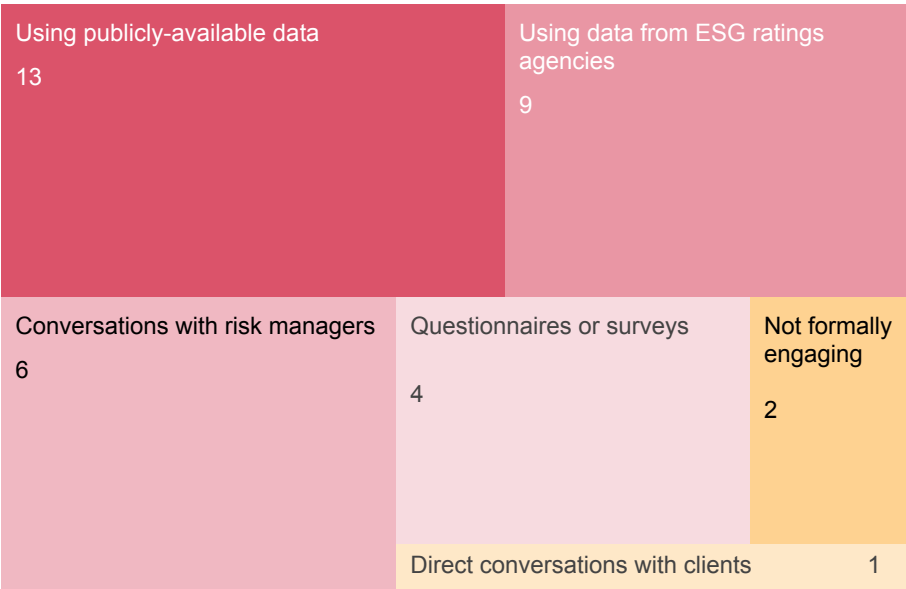
The more advanced firms have already started engaging with clients on climate-related issues, including strategic discussions of their approach to managing climate risk. However, the results of our survey indicate that many respondents are yet to reach this stage of maturity. Only one respondent reported that they were engaging with clients directly on climate risk issues, while the overwhelming majority (76%) relied primarily on public disclosures or data from ESG rating agencies (53%).

### What do firms need to do?

The use of publicly available information or collaboration with external data providers will be an important way of supplementing the data gathering process, but should not be prioritised over engagement. Firms need to address this critical issue and start collecting data at source to better inform risk assessment and management. In the absence of good quality and readily available data, alongside lagging public disclosures, engagement is likely to prove the most constructive near-term option available for firms that are struggling to gather decision-useful information.

For firms with a large percentage of their book in retail assets, such as mortgages and personal loans, engagement with clients can be more challenging, given the potential scale of these portfolios. In these cases, firms should look for alternative data sources, such as energy use, energy efficiency ratings and property locations to assess climate risks. Leveraging these alternative information sources could also help firms to develop innovative products that can enable customers to better manage the climate-related risks they face.

### How are you engaging with your clients to obtain the information you need to conduct climate risk assessment?



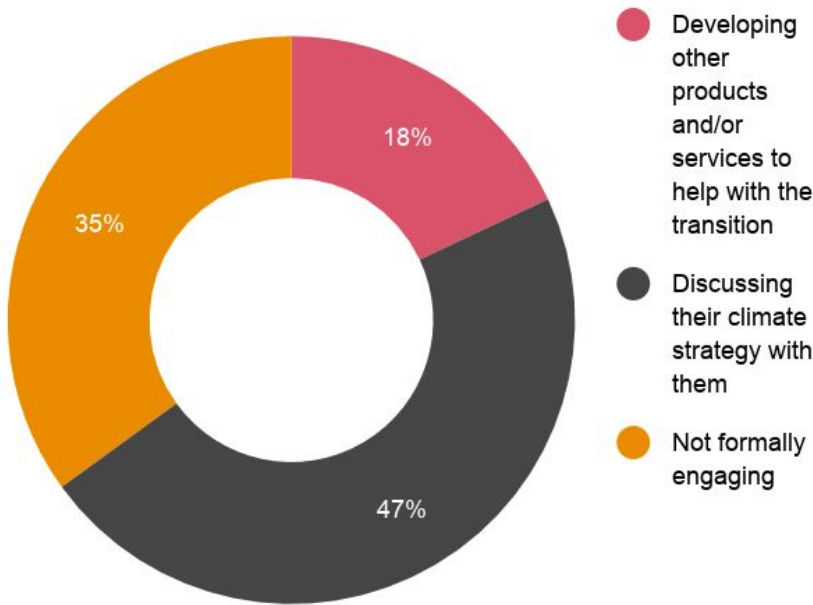
**Stewardship in the spotlight**

Banks should be considering how best to use their influence and relationships with clients and counterparties to drive progress on managing climate risk. Our survey shows that 47% of respondents state they are actively discussing climate strategies with clients. The more advanced firms (18% of respondents) are approaching engagement at a more granular product/service level. However, a considerable proportion (35%) of respondents, mainly smaller banks, are not formally engaging with clients on their transition plans at this stage.

**How can firms turn the dial up on climate conversations?**

Irrespective of size and available resources, firms should consider how they can use conversations with clients to push for action on climate transition, which should in turn help to mitigate the risks associated with their own exposures. Examples could include identifying clients that are highly exposed to physical and transition risks as a first step, with a view to engaging on how their business plans can evolve to become Paris-aligned (e.g. by committing to and disclosing science-based targets).

**How are you engaging with your clients to help them with the transition to a low carbon economy?**





# Towards a compulsory disclosure regime?

Regulators have stressed the importance of high quality disclosures in order to enable markets to operate effectively, manage risk and allocate capital. A number of initiatives are in-train to help support more widespread engagement and adoption of climate-related disclosures – with the potential for such disclosures to become compulsory over the next few years.

## 94%

of respondents believe that disclosures in line with the TCFD recommendations should be mandatory.

## Firms support moves to mandate climate disclosures

Firms need to address the growing possibility that climate-related disclosures will become mandated in more jurisdictions, and prepare accordingly. The overwhelming majority of respondents to our survey appear to support such a position, with 94% believing that disclosures in line with the TCFD recommendations should be made compulsory.

For financial firms, this has two aspects. Firstly, as users of disclosures, they will need to equip the first line of defence to engage with their clients and counterparties to make climate-related financial disclosures they can use to inform their decision-making. Secondly, as preparers of disclosures, they will also need to roll-up client and counterparty information at the portfolio and firm level, and engage their finance functions in making climate-related financial disclosures themselves.

## And regulatory pressure is increasing...

Beyond the FCA's proposed voluntary regime for listed firms<sup>16</sup>, which will take effect for accounting periods beginning on or after 1 January 2021, the UK Government's Green Finance Strategy<sup>17</sup> has set an expectation that all listed companies and large asset owners will be disclosing in line with TCFD recommendations by 2022. In addition, the PRA is working with the CFRF to examine the most effective way to approach disclosure, including exploring the appropriateness of making reporting mandatory. Additional ESG disclosure requirements will come into force for banks during 2021 and 2022.

## What do firms need to do?

Initially, firms will need to begin with simple, primarily qualitative, disclosures with a view to building more complex and sophisticated disclosures over time as understanding of climate-related risks improves. This will be an iterative process, with new inputs and processes developed and an increasing amount of quantitative information included to complement existing disclosures.

Firms should ensure their disclosures are consistently geared towards the needs of their audience, and clearly articulate how the firm is identifying, assessing and managing its climate-related risks. To ensure that disclosures are decision-useful for various users, they should focus on what the audience is likely to consider material, which may not always align with what the preparer themselves considers to be material.

Firms should think about disclosures in a holistic sense, and how they can help to address challenges encountered in other areas of their climate risk programmes by creating a positive 'feedback loop'. Disclosures will help to inform firms' identification, assessment and management of their own climate-related risks and those of clients and counterparties – which will refine the processes for gathering data and enhancing climate metrics to establish a more sophisticated risk management framework over time.

<sup>16</sup> FCA, 2020, Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations, <https://www.fca.org.uk/publication/consultation/cp20-3.pdf>

<sup>17</sup> HM Government, Green Finance Strategy: Transforming Finance for a Greener Future, <https://www.gov.uk/government/publications/green-finance-strategy>

# Regulatory landscape

# A global framework for a global problem?

While efforts are underway to establish a coordinated global regulatory framework, national and regional actions on climate risk are largely taking place independently

## 71%

of respondents to our survey agreed the current regulatory approach to managing climate risk is inconsistent, and a further 76% noted they would welcome the establishment of a global framework.

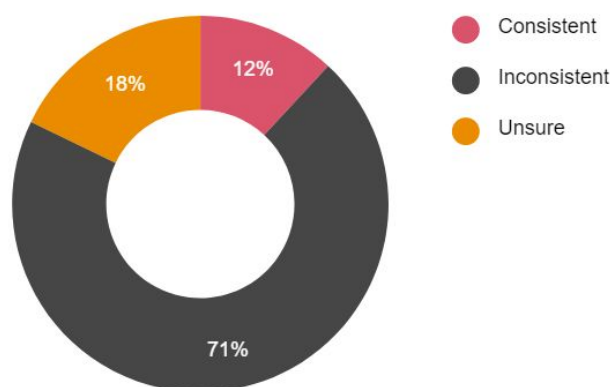
Without a consistent approach to policy and regulation, firms operating cross-border could end up having to navigate contradictory requirements, and the potential for regulatory arbitrage may also increase. A number of respondents stated it will be critical to ensure the current regulatory landscape does not give way to divergent approaches on how firms should manage their climate-related risks.

Although efforts by international organisations to set out a more coordinated approach to climate risk are likely to be appreciated by respondents, these initiatives will take time to come to fruition. A key challenge will be retrofitting a global approach in the context of numerous national and regional programmes which have already made considerable progress.

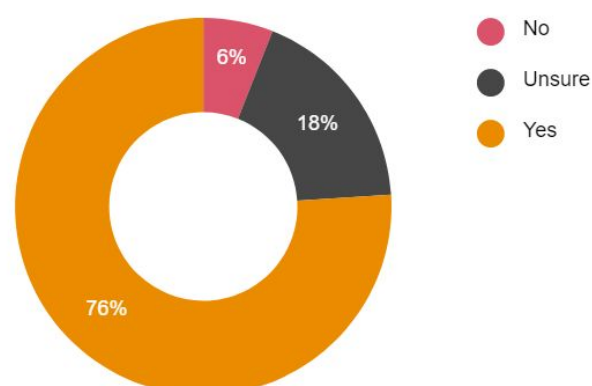
### Global initiatives

- The Network for Greening the Financial System (NGFS) has published reference scenarios<sup>18</sup> to be used by central banks and supervisors.
- IOSCO has established the Sustainable Finance Network to coordinate action by securities regulators and in April 2020 published a report<sup>19</sup>.
- The Basel Committee has established a Task Force on Climate-related Financial Risks, which published a stocktake report<sup>20</sup> in April 2020.

### Do you feel there is a globally consistent regulatory approach to managing climate risk?



### Would you welcome a global regulatory framework for managing climate risk? (e.g. developed at G20 level)



<sup>18</sup> NGFS, 2020, NGFS Climate Scenarios for central banks and supervisors,

[https://www.ngfs.net/sites/default/files/medias/documents/820184\\_ngfs\\_scenarios\\_final\\_version\\_v6.pdf](https://www.ngfs.net/sites/default/files/medias/documents/820184_ngfs_scenarios_final_version_v6.pdf)

<sup>19</sup> IOSCO, 2020, Sustainable Finance and the Role of Securities Regulators and IOSCO, <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD652.pdf>

<sup>20</sup> Basel Committee on Banking Supervision, 2020, Climate-related financial risks: a survey on current initiatives, <https://www.bis.org/bcb/publ/d502.pdf>

# Beyond climate change – a broader regulatory agenda emerges

As firms make progress with their climate risk programmes, they should be mindful of regulatory intentions to broaden the focus beyond climate change to other types of sustainability risks.

Firms need to consider how their approaches to embedding climate-related risks will be compatible with other forms of sustainability risk (notably ESG) which are also the subject of increasing regulatory scrutiny.

## **Firms are divided on whether approaches to managing climate risk should be broadened out...**

Our survey findings suggest that respondents are split on the question of whether the developing approach for managing climate risk in the UK should be broadened out to include ESG risks. Just over half (53%) of respondents agree with the approach, with one noting that the issues are clearly interlinked, which should necessitate a more integrated approach to risk management.

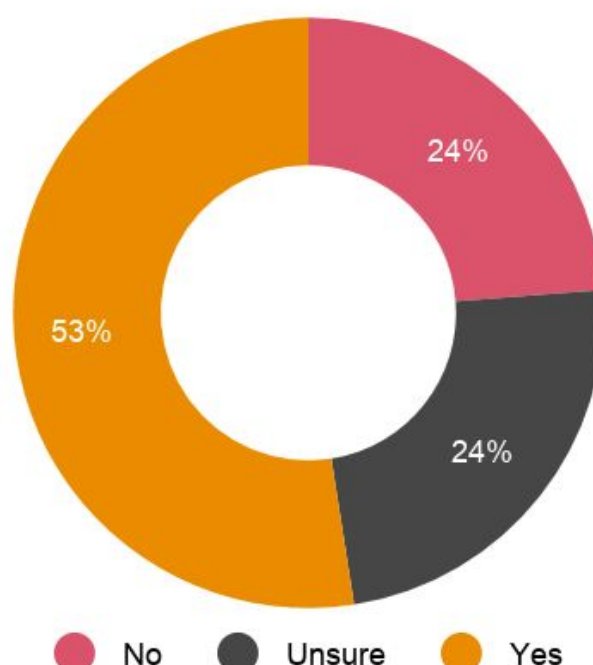
Others noted the inherent challenges in expanding the climate-centred risk management approach more widely before the existing climate risk-management frameworks are fully embedded. There are concerns that such a trajectory may dilute the focus on material environmental risks, alongside the resource and cost implications for managing a broader register of sustainability risks.

## **But such an approach seems inevitable**

Nevertheless, it should be noted that UK regulators are outliers in their focus on climate risk as opposed to thinking about environmental risks holistically, and it is unlikely they will maintain such a position for long.

For example, the Basel Committee's stocktake reports that one European supervisor has already proposed mandatory disclosure on ESG risks, which are due to come into effect in 2022 and become part of Pillar 3 requirements. Firms should continue to monitor regulatory developments closely and consider how their approach for existing climate risk programmes can be adapted to factor in a wider set of environmental, social and governance-related risks.

**Do you think the approach developing in the UK for managing climate risk should be extended to managing Environmental, Social and Governance (ESG) risk more broadly?**





# Looking ahead – what are the key questions banks need to ask themselves?



How do you intend to integrate climate risk more explicitly into your risk management frameworks? Has it been defined against your risk appetite, and allocated a specific risk type?



In order to evidence a strategic approach to climate risk management, will you set a science-based target or Net Zero strategy for your firm?



How will you evidence progress in enhancing your scenario analysis capabilities, including the establishment of appropriate processes for gathering data and complementing qualitative analysis with quantitative analysis?



How will you ensure your risk metrics are informed by reliable data and accurately reflect your exposures to climate risk, in order to facilitate robust risk monitoring and risk management?



How will you engage with clients and counterparties to obtain decision-useful data to inform your climate risk management framework?



How will you ensure that your governance structures facilitate oversight and management of the climate-related impacts on your business?



# Acknowledgements

**We would like to thank the following people and teams for their contribution to this report:**

## **Editorial**

**Jon Williams**, Partner, PwC UK

**Symon Dawson**, Partner, PwC UK

**Luke Nelson**, Senior Manager, PwC UK

**Nicole Linney**, Manager, PwC UK

**Leo Donnachie**, Senior Associate, PwC UK

## **Research and data analysis**

**Josh Fettes**, Associate, PwC UK

**We would also like to thank the following individuals for their insights:**

**Michael Snapes**, Director, PwC UK

**John East**, Senior Manager, PwC UK

**Declan McGinn**, Senior Manager, PwC UK

**Elise Angelino**, Senior Manager, PwC UK

# Contact us



**Jon Williams**

Partner

[jon.d.williams@pwc.com](mailto:jon.d.williams@pwc.com)

+44 7595 609666



**Symon Dawson**

Partner

[symon.k.dawson@pwc.com](mailto:symon.k.dawson@pwc.com)

+44 7483 422850

