

Managing the financial risks from climate change

PRA SS3/19 Banking Climate Survey

December 2021

Introduction

The [PRA SS3/19 supervisory statement](#), issued in 2019, set expectations regarding how firms should manage climate-related financial risks. The supervisory statement was followed in 2020 by a [PRA Dear CEO letter, setting out a deadline of the end of 2021 for PRA SS3/19 implementation](#).

Climate risks are to be considered across four areas: governance, risk management, scenario analysis, and disclosure. Across each pillar, there are several themes that should be reviewed when approaching compliance with SS3/19. However, the regulation does require a degree of interpretation from firms in determining what is deemed a proportionate response, considering the type of business and the size of the organisation.

In an effort to assess how banks are approaching their implementation of PRA SS3/19, BCS Consulting carried out a survey in October 2021 to understand banks' progress and key areas of implementation focus. This report considers the responses of a broad range of sector participants, including several of the large systemic banks in the UK market, mid-sized banks, and small-sized banks.



PRA SS3/19 expectations and survey results by pillar

Executive summary of the BCS survey results

Our survey demonstrates that there is widespread recognition of climate as a key risk factor, yet how this risk gets managed varies across organisations.

Governance	Scenario Analysis
<ul style="list-style-type: none"> 88% of banks participating report to the board on climate risk management Executive committee scope tends to cover climate primarily as a driver of financial and non-financial risk 75% of banks participating have made environmental commitments mostly covering <ul style="list-style-type: none"> Net Zero Financing and Operational emissions ESG product issuance targets Environmental Lending restrictions Scenario Analysis and TCFD reporting are the most commonly reported content to the board 	<ul style="list-style-type: none"> CBES and NGFS are the most used scenarios by banks Carbon tax has been highlighted as a key driver of transition risk, however few banks have considered physical risks in stress test modelling currently Most respondents have produced metric outputs on credit book impairments Stress testing has been used to inform awareness and business strategy, however in most cases this has been a pilot or qualitative assessment to date
Risk Management	Disclosure
<ul style="list-style-type: none"> 75% of banks have defined a qualitative risk appetite statement 75% of banks participating have implemented tools to support the identification and measurement of physical and transition risk primarily covering scenario analysis and transition risk assessments/questions for credit decisioning All banks participating have developed or are considering risk management metrics, particularly carbon assets, credit risk exposure to physical risk, and transition risk metrics 	<ul style="list-style-type: none"> 63% of banks participating have released a TCFD report and are planning to use this to meet SS3/19 disclosure requirements Banks that have not released a TCFD report are planning to use a Pillar III climate disclosure or are undetermined

Detailed analysis of PRA expectations and survey findings

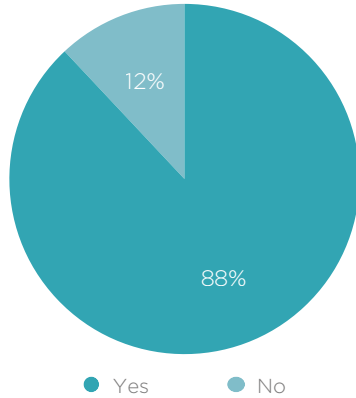
Governance

PRA expectations

Governance requirements aim to ensure that climate risk management issues are subject to appropriate governance and accountability. From the PRA's perspective, firms will need to demonstrate sufficient oversight at a board and executive level. Firms are also expected to assign senior management responsibilities for climate-related risks and to consider the impact of climate change on their business strategy.

BCS survey findings

Is the board receiving reporting on climate risk management?



Has an executive committee(s) been assigned or created to manage climate?

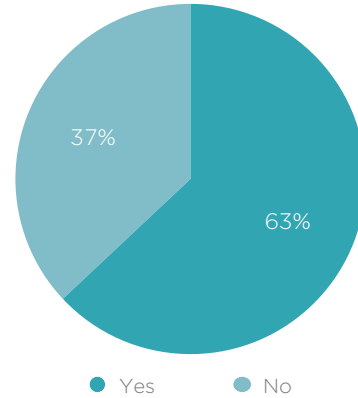


Figure 1: Responses provided to questions relating to the SS3/19 governance requirements. The graph on the left represents the ratio of respondents with board members receiving reporting on climate risk management and the graph on the right represents the breakdown of respondents with executive committee(s) assigned or created to manage climate risk.

What type of climate-related content is reported to the board?

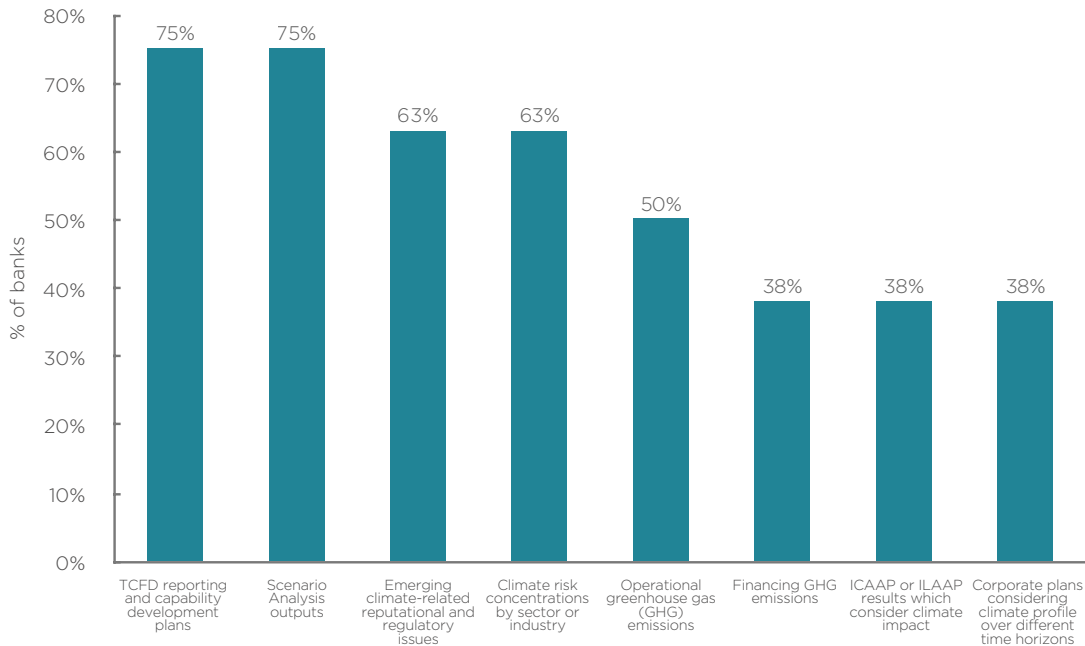


Figure 2: Bar chart showing the types of climate-related content reported to the board, ranked from most frequently reported to least frequently reported. The survey permitted respondents to select multiple options.

Our survey found that most banks’ boards (88%) are receiving reporting on climate risk management and have also received climate training. The results suggest that the integration of climate risk into capital and liquidity management is still in early stages of development, as is the development of financing emissions measurement to support Net Zero goals, with only 38% of banks reporting this type of content to the board. In contrast, stress testing and disclosure capabilities have been key areas of focus for banks, currently 75% of respondents report this content to the board.

How would you rate the current level of board oversight for climate-related risks and opportunities at your organisation?

(1 - no oversight, 5 - very comprehensive)

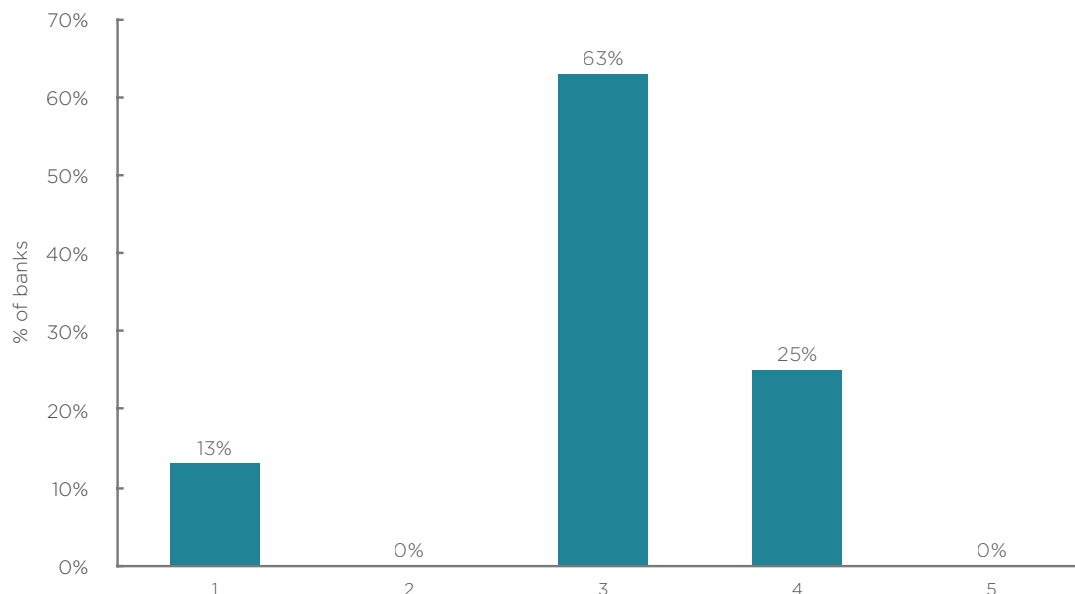


Figure 3: Bar chart to show how organisations rate the current level of board oversight for climate-related risks and opportunities, with 1 representing no oversight and 5 representing very comprehensive oversight.

Though the results evidence that the board is engaged, there are additional benefits to be realised from this engagement. When asked to rate the current level of board oversight for climate-related risks and opportunities between 1 (no oversight) and 5 (very comprehensive), the most popular answer was right in the middle, 3.

There are additional gaps identified in assigning and documenting climate accountabilities across the three lines of defence, as half of the respondents (50%) feel these have only been partially achieved. Additionally, only 63% of banks having either assigned responsibility for or created a specific non-board executive committee for managing climate. Where executive committee oversight exists, the survey results show most banks considering not only climate-related financial risks but also non-financial climate risks and climate-related business opportunities within their governance framework.

As per PRA SS3/19 requirements, all banks have allocated a senior management function for climate risk. In all cases this position has been held by the Chief Risk Officer. One respondent has additionally allocated this role to the Chief Executive Officer.

Which environmental strategic commitments have been made?

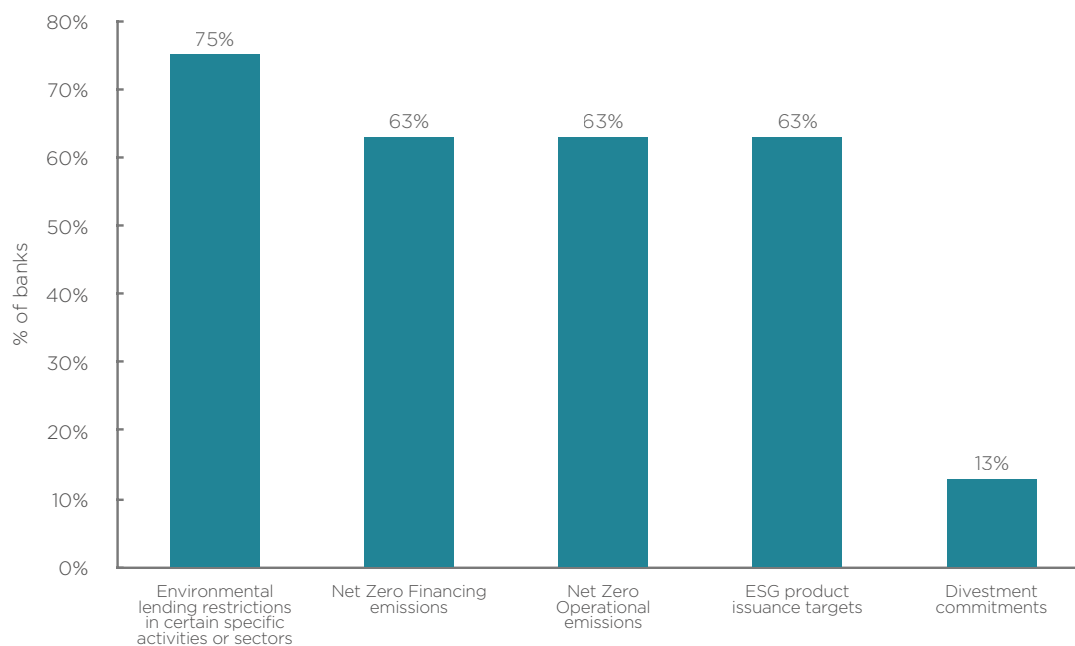


Figure 4: Bar chart showing environmental strategic commitments that have been made by organisations, ranked from most frequently reported to least frequently reported. The survey permitted respondents to select multiple options.

Encouragingly, the results also demonstrate that there is widespread recognition of climate as a key risk factor. Alongside recognising climate as a key risk to their operations, the majority (75%) of firms have made outward-facing environmental strategic commitments, ranging from environmental lending restrictions, Net Zero financing and operational emissions targets, as well as ESG product issuance targets. The recognition of climate as a strategic priority can also be reflected in firms' growth agenda.

86% of survey respondents are considering hiring additional resources to support climate risk management in the upcoming quarters. Indeed, amongst stress testing modelling, data capabilities and metrics development, many of these new hires are being brought in to assist not only to meet regulatory requirements but the increased strategic focus on Net Zero and the low carbon economy transition.

Risk Management

PRA expectations

These requirements are concerned with the firm's ability to recognise climate risk, articulating how it can drive losses across traditional risk types (e.g., market risk, credit risk) in different time horizons and developing measurement capabilities. Firms are expected to define a risk appetite statement for climate risk, update policies accordingly and conduct portfolio analysis to understand the firm's exposure to climate risk. Firms should also ensure that they've fulfilled the PRA's expectations to hold capital in the areas where material climate risks have been identified.

BCS survey findings

Which tools have been implemented to support identification and measurement of physical and transition risks to date in your organisation?

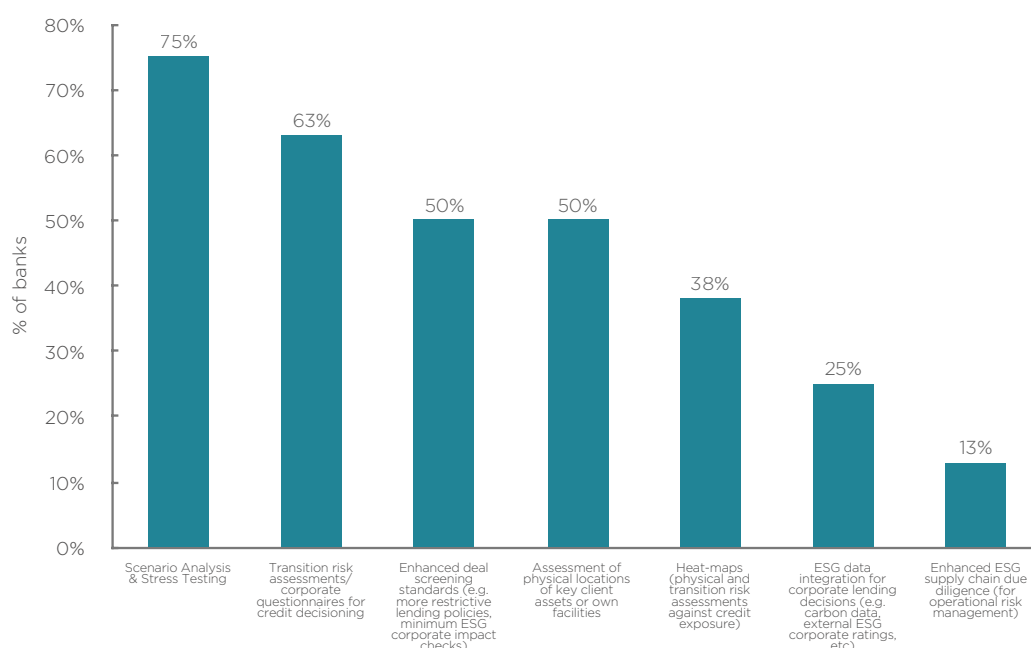


Figure 5: Bar chart showing the types of tools that have been implemented to support identification and measurement of physical and transition risks, ranked from most frequently reported to least frequently reported. The survey permitted respondents to select multiple options.

Aside from stress testing, several banks are progressing in the development of transition risk assessments to gain a better understanding of corporate client plans and their climate exposure (63% of respondents). The survey also evidences significant focus in reviewing deal screening standards and completing physical risk assessments for client assets and own facilities (50%).

Areas of future focus highlighted by firms, including enhanced ESG supply chain due diligence and assessment of physical locations of own facilities indicate a broadening of awareness from climate implications on credit risk management to operational risk management.

Which metrics have been implemented in your organisation for risk management?

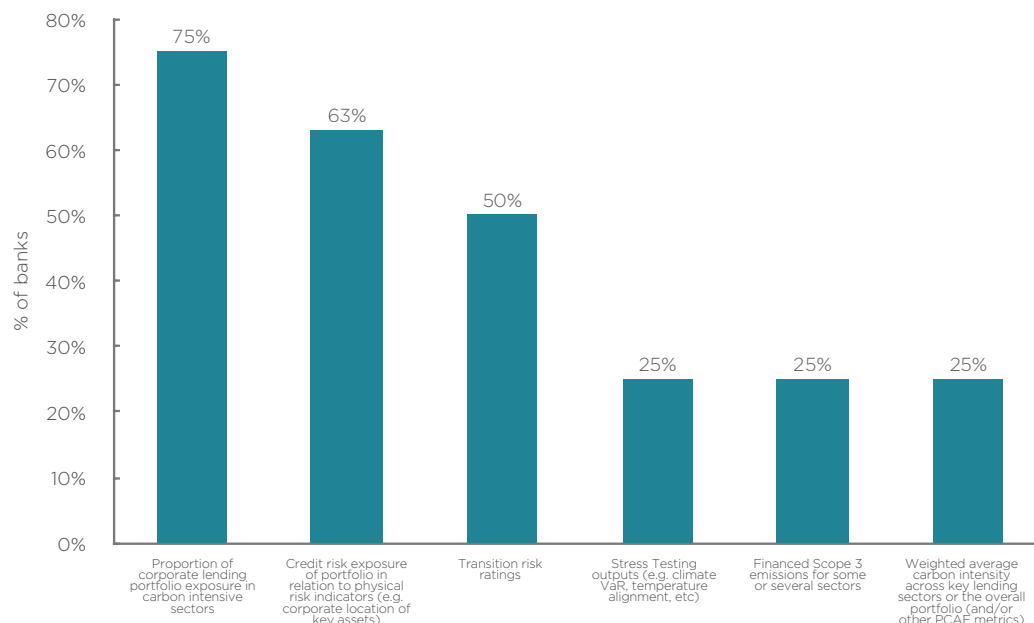


Figure 6: Bar chart showing the types of metrics that have been for risk management, ranked from most frequently reported to least frequently reported. The survey permitted respondents to select multiple options.

The progress in development of these risk assessments is further evidenced by the implementation of climate metrics such as the exposure of the portfolio to carbon-intensive sections and physical risk indicators. Firms are however, looking to further develop their monitoring capability of quantitative stress testing outputs such as climate VaR and temperature alignment, as well as financed scope 3 emissions and weighted average carbon-intensity across key lending sectors.

Furthermore, climate risk is being defined by most banks as a cross-cutting risk type (only 12% of banks defined climate as a standalone risk). The development of a climate risk appetite is still in early days of development with 75% of respondent banks acknowledging a qualitative risk appetite at this stage.

Scenario Analysis

PRA expectations

Scenario Analysis requirements vary depending on the business model of the firm, although the PRA emphasises that scenario analysis is a very important tool for smaller and larger firms alike to determine potential financial impacts and inform business strategy.

BCS survey findings

Which climate scenarios have you considered as the basis for your stress testing?

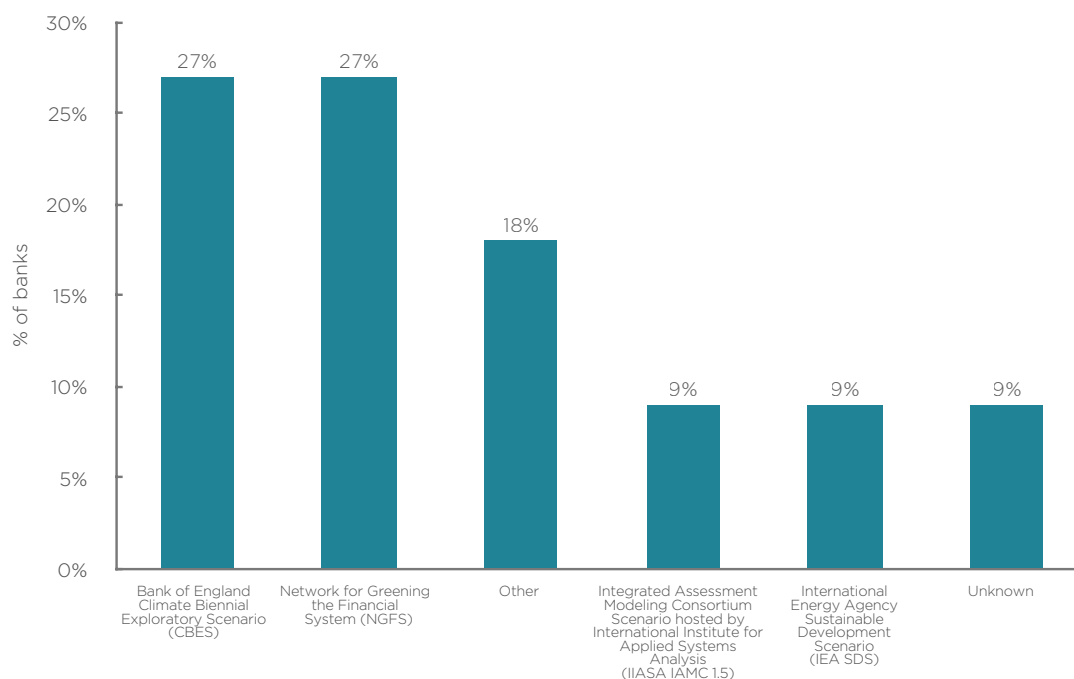


Figure 7: Bar chart showing climate scenarios considered as the basis for stress testing, ranked from most frequently reported to least frequently reported. The survey permitted respondents to select multiple options.

Many banks have developed internal methodologies to complete scenario testing whilst others have relied on third-party vendors, with carbon tax highlighted as the key driver of transition risk underpinning assessments across the majority of respondents.

In the few cases where banks have considered physical risks in stress testing, this has typically been measured by the impact on country-level GDP and the use of third-party tools to map natural hazard risks, as well as leveraging the Representative Concentration Pathways (RCP) scenarios published by the Intergovernmental Panel on Climate Change (IPCC). Key outputs of stress testing focus on credit impairments and credit rating impacts, with two firms further considering qualitative inclusion in internal capital adequacy assessments and only one respondent considering marked to market losses.

Most banks have used either CBES or NGFS scenarios to assess the resilience of the firm to climate change. Few banks have also considered Institute for Applied Systems Analysis IAMC 1.5, International Energy Agency Sustainable Development Scenario and Climate Change Committee Budget Scenarios, highlighting that meeting regulatory requirements has been the main driver for scenario testing capability.

Disclosure

PRA expectations

Firms are expected to develop an adequate approach to disclosure, reflective of the distinctive elements of the financial risks inherent in climate change.

The PRA recommends aligning disclosures to the Taskforce on Climate Related Financial Disclosures (TCFD) Recommendations and wider climate initiatives to promote comparability across the industry, support adequate pricing of climate risk and allocation of capital across the economy. For smaller firms, disclosing financial risks from climate change in their Pillar III disclosure is acceptable.

BCS survey findings

How is your organisation planning to meet PRA SS3/19 disclosure requirements?

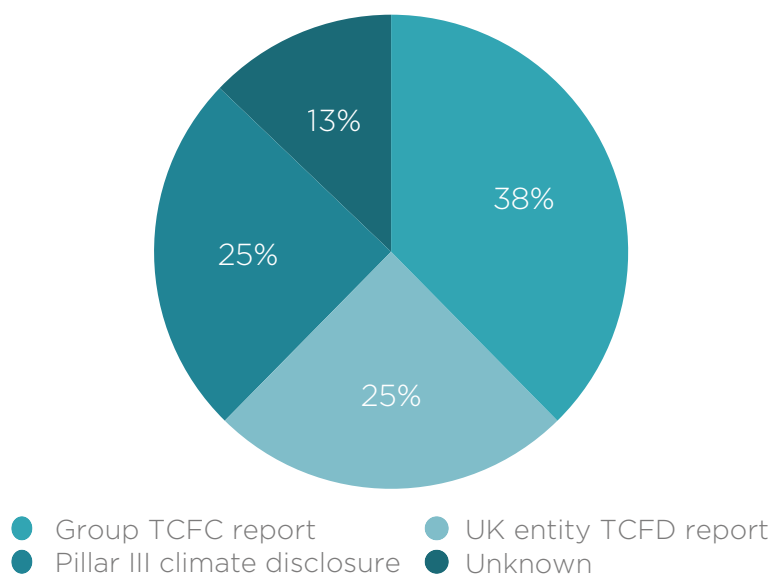


Figure 8: Responses provided to a question relating to PRA SS3/19 disclosure requirements, showing that the most favoured method of disclosure is via a Group TCFD report.

The majority of respondents (63%) have released a TCFD report and plan to meet their PRA SS3/19 disclosure requirements via either their Group or UK entity TCFD report. Banks that have not released a TCFD report to date are either planning to use Pillar III to complete a climate disclosure or have not yet determined how to meet PRA disclosure requirements.

Conclusion

The emergence of regulations such as PRA SS3/19 requirements have gone a long way towards operationalising what climate risk management should look like in the banking sector. Most firms in our survey, however, recognise that this will continue its growth trajectory into 2022.

In July 2020, the PRA highlighted with their [Dear CEO Letter](#), that there were important gaps that needed to be addressed ahead of the regulatory deadline for implementation of SS3/19:

1. Unclear strategic responses to climate-related financial risks and inconsistent board-level review of climate management information
2. Unclear understanding of the magnitude of climate risks and their relationship to financial risks
3. Immature definition of metrics and quantification of climate-related financial risks iv. Immature development and integration of climate risk management processes and lack of end-to-end understanding of climate-related financial risks
4. Significant gaps in capabilities, data and tools and a lack of integration of scenario analysis in broader risk assessments
5. Limited capabilities to make climate disclosures in line with the Taskforce on Climate-related Financial Disclosures (TCFD) framework

The results of this survey indicate that banks have made progress towards closing these gaps, particularly in terms of board engagement, disclosure capabilities and implementation of tools to support climate risk assessment, particularly from a credit risk perspective.

However, areas of development still include implementation of a risk appetite statement, embedding quantitative assessment of climate metrics into scenario analysis and integration the outputs of these assessments into strategic decisions.

Climate risk management will undoubtedly remain a key area of focus and cannot be ignored if firms want to strengthen their existing risk frameworks.

At BCS Consulting we understand the complexity that comes in developing climate risk management capabilities, and we have an extensive track record helping numerous clients embed climate risk into their operating models. If you would like to know more, please contact:

Hector Fontaine, Sustainable Finance Lead

Hector.Fontaine@bcsc consulting.com

Authors



Hector Fontaine
Managing Consultant, Sustainable Finance Lead

Hector is the Sustainable Finance Lead for BCS Consulting within the firm's Risk & Finance service line. Hector has deep expertise in risk, finance and sustainability, advising and supporting many of the world's largest financial institutions as well as smaller financial firms in these areas for many years. He is a frequent speaker in industry events and has authored numerous ESG publications. In 2018 Hector directed and co-authored the BCS Consulting ESG Banking Benchmark Report and in 2019 and 2020 Hector directed and co-authored the BCS Consulting TCFD Global Progress Report for the Banking Sector. Hector holds an APRM qualification by the Professional Risk Managers' International Association and a masters in Finance from London Business School.



Hannah Peter
Senior Consultant, Sustainable Finance

Hannah is a Senior Consultant within the Risk & Finance service line at BCS Consulting and specialises in Sustainable Finance. She holds a Diploma in Investment Compliance from the Chartered Institute of Securities and Investments and a Green Finance Certificate from the Chartered Banker Institute. In 2019 and 2020 she was a contributor to the BCS Consulting TCFD Global Progress Report for the Banking Sector. Having worked as both an industry professional and management consultant across Retail, Corporate and Investment Banking, Hannah has a breadth of experience across Financial Services with deep expertise in Reputational and ESG Risk.



Kata Vass
Consultant, Sustainable Finance

Kata is a Consultant within the Risk & Finance service line at BCS Consulting and specialises in Sustainable Finance. She holds a Certificate in the Prevention of Financial and Cyber Crime from the Chartered Institute of Securities and Investments. She has a breadth of experience helping firms embed and achieve strengthened non-financial risk management practices across the Insurance, Retail, Corporate and Investment Banking sector.

We are a leading UK provider of management consultancy to the financial services industry, specifically Retail and Corporate Banking, Capital Markets, Insurance and Asset and Wealth Management. Specialising in Risk, Regulatory and Finance change as well as in Operations and Technology transformation, we help to maximise our clients' potential in today's technology-driven financial landscape.

[bcsconsulting.com](https://www.bcsconsulting.com)



© Business Control Solutions plc 2021

This publication and its content is the copyright of Business Control Solutions plc and must not be stored, reproduced or disseminated in whole or in part except with the prior written consent of Business Control Solutions plc. Any derivatives of this publication shall be owned by Business Control Solutions plc. The publication's contents have been provided for information purposes only and every reasonable effort has been made to ensure the content's accuracy at the date of publication. Business Control Solutions plc assumes no responsibility or liability for any consequence resulting directly or indirectly for any action or inaction taken based on or made in reliance on the publication's contents.